REVIEW QUESTIONS

1. Explain the meaning and importance of prospectus. What constitutes the public issue of the prospectus?
2. Explain the legal provisions relating to the issue and registration of a prospectus?
3. Discuss the civil and criminal liabilities of directors for misstatement in a prospectus.
4. What are the remedies open to an allottee of shares who had applied for them on the faith of a false and misleading prospectus and what are the defences available to the directors of the company who have issued such a prospectus?
5. Write short notes on :

   (a) Statement in lieu of prospectus; (b) Underwriting commission; (c) Minimum Subscription; (d) Deemed Prospectus; (e) Shelf Prospectus; (f) Information Memorandum; (g) Abridged Prospectus.

PRACTICAL PROBLEMS

1. A company issued a prospectus containing mis-statement on which action could be taken against the company. Raman purchased shares in the market relying on the prospectus and filed a suit against the company for mis-statements. Will Raman succeed?

   [*Hint* : No. Raman will not succeed because he is not an original allottee of shares who had relied on the prospectus. [Peek Vs. Gurney-(1873)L.R.6 H.L. 377].

2. A prospectus stated that A and B. two leading business of repute. have agreed to become the Directors of the company. In fact, both A and B had liked the idea of starting such a company and also expressed their willingness to help the company but had not agreed to be its Directors. Subsequently A and B clarified their position by way of an advertisement in a newspaper. Can a subscriber rescind the contract of purchase of shares in the company after the issue of the clarification?

   (*Hint* : Yes. A subscriber can rescind the contract of purchase of shares after the clarification issued by A and B in a newspaper.

3. The prospectus of a company stated that an application had been made to the Chennai Stock Exchange for enlisting its shares. On the faith of the prospectus. A purchased 20 shares in the company. Thereafter, Chennai Stock Exchange refused to enlist the shares of the company. Has 'A' got any remedy against the company?

   (*Hint* : Yes. 'A' can return the shares issued to him and recover his money from the company. [Section 73(1) of the Companies Act,1956.)]

4. In a prospectus issued by the Managing Director of a Company it was mentioned that the company had paid a dividend every year during 1981 to 1987 (years of depression), thus implying that the company has sustained loss during the relevant period and had paid the dividends only out of reserves accumulated in the past. Can this observation be constructed as a mis-statement so as to render the Managing Director criminally liable, and if so, on what ground? If not, why not?

   (*Hint* : Yes. The Managing Director is criminally liable. As a material fact, that the dividend has been paid out of past accumulated profits, has been hidden by the Managing Director. [*Rex Vs. Kylsant-(1932) 1 K.B. 442.)*]

❖ ❖ ❖

CHAPTER - 25

SHARES AND DEBENTURES

CHAPTER OUTLINE

MEMBERS AND SHAREHOLDERS

RIGHTS, DUTIES ETC. OF A MEMBER

SHARES AND SHARE CAPITAL

APPLICATION AND ALLOTMENT OF SHARES

SHARE AND STOCK CERTIFICATE

SHARE WARRANT

TRANSFER AND TRANSMISSION OF SHARES

- **LIEN ON SHARES**
- **FORFEITURE AND SURRENDER OF SHARES**
- **SWEAT EQUITY/RIGHT SHARES**
- **BONUS SHARES**
- **BUY BACK OF SHARES**

DEBENTURES

- **CHARACTERISTICS AND KINDS**
- **REMEDY FOR DEBENTURE HOLDERS**
- **CHANGES AND MORTGAGES**

DEBENTURE TRUST DEED

(i) *To take up shares, when they are allotted* in due time and in compliance with provisions of the Act, unless the refusal to accept the shares has been sent on the ground of non-compliance with the provisions of the Act as regards the issue of the prospectus or as regards allotment.

(ii) *To pay for the shares allotted* to him when the allotment is made and when calls have been made validly and in conformity with the provisions of the articles.

(iii) *To abide by the doing of the majority of members* unless the majority acts vindictively, oppressively, malfide or fraudulently.

(iv) *To contribute to the assets* of the company in the case of winding up when the shares held are partly paid-up.

(v) Members are *severally liable for debts of the company contracted*, where its business is carried on beyond the expiry of six months from the date at which its membership is reduced below the legal minimum (i.e., seven members in the case of a public company and two members in the case of a private company). However, such members are not liable for debts contracted before the expiry of six months. No liability will accrue to those members who are not cognizant of the fact that the business of the company is being carried on with members fewer than the legal minimum (Section 45).

SHARE CAPITAL

The word '*Capital*' used in connection with a company has a different meanings. It may mean the *nominal, issued, called-up, paid-up*, or *reserve share capital* of the company. Section 86 provides that the share capital of a company limited by shares shall be of two kinds only; namely (a) Preference Share Capital; (b) Equity Share Capital. It is that part of paid-up share capital which carries a preferential rights as to the payment of dividend at a fixed rate and also a preferential right to the repayment of the paid up capital. It means all the share capital which is not preference share capital.

Alteration of Capital : Under Section 94, a company limited by shares may in general meeting, if so authorised by its articles, alter the conditions of its memorandum relating to share capital in order to : (a) increase its share capital by issuing new shares; (b) consolidate and divide all or any of its share capital into shares of larger amount than its existing shares; (c) 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-divide its shares into shares of smaller amount than is fixed by the memorandum, provided the paid-up amount will remain at the same proportion of its share capital; (e) by cancelling shares which have not been taken up and diminishing the amount of its share capital by the amount of the shares so cancelled. The powers conferred by Section 94 shall be exercised by passing an ordinary resolution of the company in a general meeting and shall not require to be confirmed by the Court.

Reduction of Capital : A company may wish to reduce its capital for a number of reasons; namely : 1. The capital of the company may be more than enough for its needs, and so, it may return the surplus capital to the shareholders. 2. The paid-up capital of the company is sufficient and it may refrain from calling up the unpaid portion of share money. 3. Some of the capital may in fact have been lost or diminished e.g., Rs. 100 shares may represent assets worth Rs. 50. The company may wish to write off the lost capital. Reduction of share capital under item (3) affects the rights of different classes of shareholders as well as the interest of the members of the public who may be induced to take shares in the company.

The question of reducing the capital is a domestic affair to be decided by the majority, but this power must be exercised in a fair and equitable manner. Reduction of capital may be effected in several ways which maybe classified under two heads :

1. **Reduction without the Consent of the Court :** There are a number of cases where a company may reduce its capital without the sanction of the court: (a) Where *redeemable*

preference shares are redeemed in accordance with the provisions of Section 80. (b) Where any shares are *forfeited* for non-payment of calls. (c) Where there is a *surrender* of shares or a gift is made to the company of its own shares. (d) Where *unissued shares are cancelled* and (e) where '*buy back scheme*' of shares is in operation. In all these cases, the procedure laid down under Section 100 of the Companies Act is not required to be followed.

2. **Reduction with the Consent of the NCLT :** Section 100 gives a company limited by shares or a company limited by guarantee and having a share capital the power to reduce its share capital in any way. The Act has not prescribed the manner in which the reduction is to be carried out, nor has it prohibited any methods of effecting that object. A company, if so *authorised by its articles*, may, by *special resolution*, reduce its share capital subject to the *confirmation of the court* in any one of the following ways (a) Extinguish or reduce the liability on any of its shares in respect of share capital not paid-up. (b) Cancel any paid-up share capital which is lost or is unrepresented by the unavailable assets. (c) Pay-off any paid-up share capital which is in excess of the requirements of the company.

After having passed the special resolution for reducing the share capital, sanction of the court shall be obtained by the company. The object of requiring this sanction is two fold : (1) To protect persons dealing with the company so that the fund available for satisfying their claim shall not be diminished except by ordinary business risks. (2) To ensure that the reduction is equitable as between the shareholders of the company.

Where the NCLT is satisfied that the interests of the creditors have been secured, it may confirm the reduction on such terms and conditions as it may think fit. The NCLT may, at the time of confirmation, *direct the company to add to its name the words "and reduced"* for a specified period and these words will be deemed to be part of the company's name for such specified time. The court may also make an order requiring the *company to publish the reasons for such reduction for the information of the public.* (Section 102).

The company shall *deliver to the Registrar a certified copy of the NCLT order and a minute approved by the NCLT showing* the following details for registration : (a) the amount of the share capital; (b) the number of shares into which it is to be divided; (c) the amount of each share; and (d) the amount, if any, at the date of registration deemed to be paid-up on each share.

The Registrar will, thereupon register the order and the minute. On such registration, the resolution for reducing the share capital takes effect. *Notice of the registration shall be published* in such manner as may be directed by the Court.

Reduction of Capital and Diminution of Capital: (Section 94(1) (c) and Section 100}. Reduction of capital involves writing off past losses against capital cancellation of the uncalled capital or repayment of surplus capital. It may involve reduction of issued capital, subscribed or paid-up share capital. Diminution of capital does not constitute a reduction of capital within the meaning of the Companies Act.

Distinction between Reduction of capital and Diminution of capital

1. *Nature :* Reduction may involve reduction *inter alia* of issued capital, whereas diminution may be in respect of authorised capital but not of issued capital.

2. *Resolution :* If the articles authorise, diminution can be effected by an ordinary resolution, while reduction can be effected only by special resolution.
3. *Confirmation by Court :* Diminution needs no confirmation by the Court, but reduction needs such confirmation.
4. *And Reduced :* Where a company is ordered to add to its name the words '*And Reduced*' these words shall until the expiry of the period specified in the order, be deemed to be part of the company's name; but such a provision does not exist in the case of diminution of share capital.
5. *Time Limit :* In the case of diminution, notice is to be given to the registrar within 30 days from the date of cancellation where upon the registrar shall record the notice and make the necessary alternation in the Memorandum of Association and Articles of Association. In case of reduction of capital, however, more detailed procedure has been prescribed, though there is no such time limit as aforesaid.

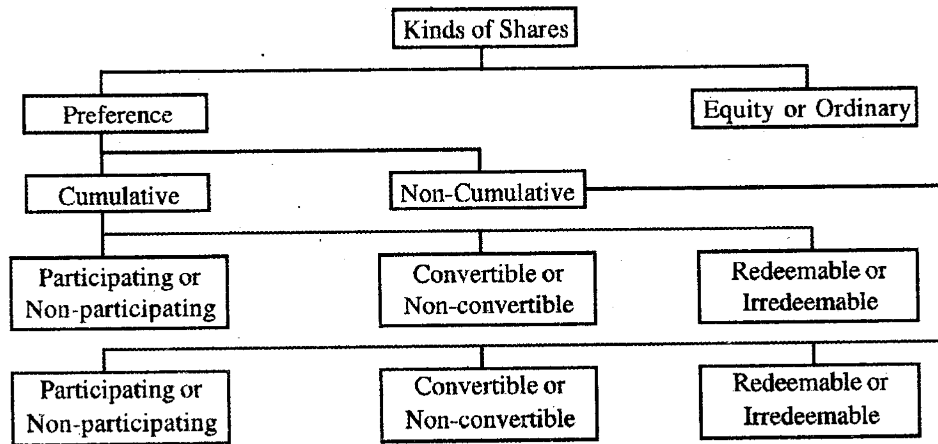
SHARES

A share is the interest of a shareholder in a definite portion of the capital. It expresses a proprietary relationship between the company and the shareholder. A share is a personal estate capable of being transferred in the manner laid down in the articles of association. *A certificate of shares issued by a company under its common seal specifies the shares held by any member. The share certificate is the prima facie evidence of the title of the member to such shares.* [Section 84(i)}. The share certificate is not a negotiable instrument. According to Section 86 of the Companies Act, a company can issue only two types of shares - (a) Preference shares and (b) Equity shares.

Preference Shares : A preference share must satisfy the following two conditions : (i) It shall carry a preferential right as to the payment of dividend at a fixed rate; and (ii) In the event of winding up, there must be a preferential right to the repayment of the paid up capital. These are two dominant characteristics of preference shares. A preference share may or may not carry such other rights as-(a) a preferential right to any arrears of dividend; (b) a right to share in surplus profits by way of additional dividend; (c) a right to be paid a fixed premium specified in the memorandum, and (d) a right to share in surplus assets in the event of a winding up, after all kinds of capital have been repaid.

Issue of preference shares : No company limited by shares shall, after the commencement of the Companies (Amendment) Act, 1996, issue any preference share which is irredeemable or is redeemable after the expiry of a period of 20 years from the date of its issue.

Equity Shares : All shares which are not preference shares are equity shares. Equity shareholders have the residual rights of the company. They may get higher dividend than preference shareholders if the company in prosperous or get nothing if the business of the company flops. In the winding up, the equity shares are entitled to the entire surplus assets remaining after the payment of the liabilities and the capital of the company, unless the articles confer right on the preference shares a right to participate in the distribution of surplus assets.



Stock : *Stock is the aggregate of fully paid up shares legally consolidated. The aggregate can be split up into fractions of any amount without regard to the original nominal amount of shares.* When shares are fully paid up they may be converted into stock. The issue of partly paid up stock is invalid. The use of the term 'stock' merely denotes that a company has recognised the fact of the complete payment of the shares and that the time has come when these shares may be assigned in fragments, which, for obvious reasons, could not be permitted before.

A company limited by shares, may, if so *authorised by its articles*, convert all or some of the fully paid-up shares into stock or re-convert its stock into fully paid up shares of any denomination. The company shall *give notice to the Registrar* of such conversion within 30 days of tis doing so. When shares are converted into stock, the Register of members must show the amount of stock held by each member. Further, the annual return must state the amount of stock held by each member. Stock certificates, similar to share certificates must be issued.

Stock is transferable like share. The Board may, however, fix the minimum amount of stock transferable. The holders of the stock have according to the amount of stock held by them the same rights, privilege and advantages as regards dividends, voting at the meetings of the company and other matters as if they held the shares from which the stocks arose. But no such privilege or advantage (except participation in the dividends and profits of the company and in the assets on winding up) shall be conferred by an amount of stock which would not, if existing in shares, have conferred that privilege or advantage.

APPLICATION AND ALLOTMENT OF SHARES

A prospectus issued by a company inviting the public to subscribe to the shares of a company is a mere invitation. An application for shares is an offer by a prospective shareholder to take shares. *When an application is accepted it is an 'allotment'. Allotment creates a binding contract between the parties.*

Shares to be dealt in on Stock Exchange : [Section 73] : Where a prospectus states that application has been or will be made for permission for shares to be dealt in on one or more recognised stock exchanges, such prospectus shall state the names of the stock exchanges. Any allotment made on an application under the prospectus shall be void - (i) if permission has not been applied for before the tenth day of the issue of the prospectus; or (ii) if permission is refused

before the expiry of 10 weeks from the closing date of the subscription list. Such permission has to be granted by each of the stock exchanges in which application for permission has been made. A company can appeal both against the decision of the stock exchange refusing permission and its failure to dispose of the application for permission within 10 weeks from the date of the closing of the subscription list. Such allotment shall not be void until the disposal of the appeal. [Section 73(1)].

If a prospectus states that application has been or will be made for permission to deal in the shares on a recognised stock exchange, *the money received from applicants must be paid in a separate bank account maintained with a scheduled bank.* On failure to apply for permission or where permission has not been granted, the company has to *return all moneys received from the applicants within 8 days after the company becomes liable to pay.* If the application money is not repaid within 8 days, the directors are jointly and severally liable to repay the money with interest not less than 4% and not exceeding 15% per cent per annum from the expiry of the 8th day. A director will not be liable if he proves that the default was not due to any misconduct or negligence on his part [Section 72(2)]. For failure to return the money within the time, the company and every officer who is in default shall be liable upto a fine to Rs. 5,000. [Section 73(5)].

Retention of over-subscription : In case the issue is over-subscribed then shares etc. are allotted as per the scheme of allotment framed in consultation with the Stock Exchange(s) and passed by a Board Resolution.

As per the guidelines of SEBI, a company raising equity capital, (not being bonus shares) may retain over-subscribed equity to the extent of 15% of the amount sanctioned.

Essential of Valid Allotment

For an allotment to be called valid, some provisions of the Contract Act as well as Companies Act are to be complied with.

*A. **Provisions of Contract Act*** **say that allotment must be made** by proper authority, within reasonable time, communicated, absolute and unconditional. The Companies Act does not prescribe any restrictions regarding the allotment of shares in case of private companies. But in case of the public company:

(i) *When no public offer is made:* As per Section 70, Company has to file a Statement in Lieu of Prospectus with the Registrar at least three days before the first allotment.

(ii) *When public offer is made :* In case of first allotment following statutory restrictions must be complied with:

1. A copy of the prospectus must be duly filed with the Registrar for registration (Section 60).

2. The *minimum subscription* amount as disclosed in the prospectus must be received within 120 days of the issue of prospectus (Section 69).

3. The company must receive at least 5 per cent cash of nominal value of shares as application money (Section 69 (3)}.

4. Application money must be deposited in a scheduled bank and it can not be withdrawn till the company secures the '*Certificate to Commence Business*' or until the entire amount payable

on applications for shares in respect of minimum subscription has been received by the company (Section 69(4).\

5. The company shall not proceed to allot shares until the beginning of the fifth day from the date of issue of prospectus or such a later date as may be specified in the prospectus.

6. Before the issue, the company must make an application to one or more recognised stock exchange for permission for the shares so offered to be dealt with in the stock exchange.

A *minor, lunatic*, being incompetent to enter into a contract, cannot be allotted shares of a company (*Mohri Bibi. vs. Dharamadas Chose (1930).* If directors, in ignorance of the fact of minority, allot shares to a minor, and enter his name on the register of members, the company can repudiate the allotment and remove his name on the register of members, when the fact of applicant's minority comes to its knowledge. The minor can also repudiate the allotment at any time during his minority. In either case, the company must repay to minor all money received from his in respect of the allotted shares, and whether or not the minor should restore to the company the benefits he might have derived from the shares would be for the court to decide in view of the facts and circumstances of each case.

Irregular allotment : An allotment made by a company before the minimum subscription is received or the filing of the statement in lieu of the prospectus is *voidable at the option of the applicant. Such an option must be exercised within two months of the statutory meeting* and where the company is not required to hold a statutory meeting or where the allotment is made after the statutory meeting, within two months after the date of allotment and not later. The allotment may be avoided although the company is being wound up. A member entitled to avoid an irregular allotment of shares will lose his right if, after becoming aware of the irregularity he exercises any rights of a member. Such an allotment though irregular, is nonetheless an allotment and the applicant may retain the shares notwithstanding the irregularities to allotment. Where the directors knowingly contravene the provisions as to allotment, they are liable to compensate the company and the allottee for any loss or damage suffered thereby. Proceeding against the directors must be commenced within two years of allotment.

Calls on shares : When shares are issued, the full amount of each share is not generally payable at once. A part is payable on application, a part on allotment and the remainder by instalments when called for. A call may be defined as a *demand by the company on its shareholders to pay whole or part of the balance remaining unpaid on each share.* It is, thus, an intimation to the shareholder to discharge his obligation by paying the whole or part of the amount which remains unpaid on the shares. All money payable by any member to the company under the memorandum or articles is a debt due from him to the company. But he is not bound to pay unless a call has been made.

A call can be made by the directors during its lifetime and by the liquidator during its winding up.

Conditions of a valid call : The conditions of a valid call are as follows:

1. Resolution of the Board,
2. For the benefit of the company,
3. On uniform basis,
4. Amount, place and time of payment are clearly specified,
5. In accordance with Articles of Association

Power to refuse registration of shares in the name of the transferee is covered under Section 111 of the Companies Act. It permits the Company to empower itself through its articles to refuse to register the transfer, or the transmission by operation of law, of the right to any shares or interest of a member in, or debentures of the company. Under this section, the company may empower the Board of Directors to refuse registration of a transfer even without assigning any reason besides providing for certain specific ground. Section 22A if the Securities Contracts (Regulation) Act, 1956 provides that notwithstanding anything contained in its articles or in Section 82 or Section 111 of the Companies Act, 1956, a company whose securities are listed on a recognised stock exchange, may refuse to register the transfer of any of its securities in the name of the transferee on any one or more of the following grounds, namely:

1. That the *instrument of transfer is not proper or has not been duly stamped and executed* or that the certificate relating to the security has not been delivered to the company or that any other requirement under the law relating to registration of such transfer has not been complied with.
2. That the transfer of security is *in contravention of any law.*
3. That the transfer of security is *likely to result in such change in the composition of Board of Directors* as would be *prejudicial to the interests of the company or to the public interest.*
4. That the *transfer of the security is prohibited by any order of any court*, tribunal or other authority under any law for the time being in force.

Effect of a company's refusal to transfer : If the company refuses to register the transfer of shares for no fault or on default of the transferee, the transferor shall be treated as trustee for the transferee and would be bound to act in accordance with the directions of the transferee and for his benefit in respect of the shares unless the transferee has rescinded the contract. Until the transferee's name is placed on the register of members, the position is as follows:

1. The transferor continues to be the legal owner of the shares.
2. The transferee cannot exercise the rights of a shareholder vis-a-vis the company *(Commissioner of I. Tax Vs. M. Ramaswamy).*
3. The transferee has an equitable claim to the shares.
4. If calls are made, the transferor must pay them, but he can recover the amount from the transferee *(Hardoon Vs. Belilios).*
5. The transferor must vote as the transferee directs him, since the voting rights attached to the shares have passed to the transferee. *(Musselwhite Vs. Musselwhite & Sons).*

The company, after refusal to transfer the shares, whether in pursuance of any power under its articles or otherwise, is required to send notice of refusal to the transferee and the transferor within two months from the date of receipt of request for the registration. The remedy against such refusal of the company is available under Section 111 of the Companies Act to the aggrieved parties to appeal to CLB.

Steps that investors can take in the case of delay or refusal of registration of transfers

(i) The buyer or the seller can make an *appeal to the National Company Law Tribunal* against any refusal of the company to register the transfer. But the appeal has to be

made *within two months* of the receipt of the notice by the company, or where no notice has been sent by the company for refusal of registration of transfer, *within four months* from the date on which the Transfer Form was delivered to the company. The appeal to the NCLT has to be preferred in a Form prescribed by the NCLT Bench Rules.

(ii) For listed companies, if the shares are fully paid-up the investor can also avail of the remedy under Section 22A of the Securities Contracts (Regulation) Act by *writing to the Stock Exchanges and the Stock Exchange Division*, Ministry of Finance, Deptt. of Economic Affairs, New Delhi.

(iii) Under Section 62 of the Companies Act, the shareholder is authorised *to file criminal proceeding against the company and its officer in default.*

Powers of the National Company Law Tribunal

(i) The company and every officer in default of the company are liable to be punished with fine which may extend to Rs. 500 per day in case of non-compliance with Section 113.

The NCLT has the powers under Section 111 of the Companies Act to -

(a) direct the company to register the transfers;

(b) direct :ectification of the register;

(c) pass interim orders including orders as to injunction or stay;

Certification of Transfer : Some times, a shareholder who is a holder of a large number of shares, desires to sell only a part of them. In such a case he hands over to the company the original share certificates for the whole amount thereof as he desires to sell. The company then stamps the transfer, (which is for desired lesser amount), with the original amount of the transferrer's holding. This is called "*certification of transfer*" and the transfer is called "*certified transfer*" e.g., 500 shares have been lodged in the company's office, the sale desired being 100 shares thereout. The Company, there prepares two new share certificates, one for 400 shares which is handed over to the transfer or and one for 100 shares which is handed over to the transferee, the original share certificate for 500 shares being kept by the Company with itself for cancellation.

Section 112 of the Act makes the following provisions with regard to the subject: (i) the certificate of transfer by a company only amounts to a representation by the Company to persons acting on the faith thereof, that documents have been produced before the Company which on their face show a prima facie title to those shares (or debentures) in the transferred (ii) It is not a representation that the transferee has any title to the shares (or debentures) in question, (iii) If such certificate is made by the Company negligently, the company shall be liable to the person acting on the faith thee of as if it and been made fraudulently. (vi) "Certification" shall be deemed to be made by the Company if (a) the person issuing the certificated instrument is authorised by the Company in that behalf and (b) if the certification is "signed" by an officer or servant of the Company authorised in that behalf.

Transmission of shares : The transmission of shares means transfer of title in shares by '*operation of law*'. In other words, the transmission of shares signifies involuntary assignment of shares because in this case the property in shares passes '*not by the act of the parties*', but by '*operation of law*'. For instance : (i) on the *insolvency* of a shareholder, property in shares passes

to Official Receiver who shall become entitled to the shares owned by the insolvent; (ii) on the *death* of a shareholder, the property in shares passes to his legal representatives who shall become entitled to shares owned by the deceased; (iii) on the *lunacy* of a shareholder, the property in shares passes to the administrator appointed by the court.

Distinction between Transfer and Transmission of Shares

Sl. No.	*Basis of Difference*	*Transfer of Shares*	*Transmission of Share*
1. r	Operation of the e	Transfer of shares is the voluntarily act s u	Transmission of shares is the l t of operation of law.
2.	Base	Transfer is the method of transferring property	Transmission takes place only on the death, insolvency and lunacy of the owner of the shares.
3.	Consideration	There is adequate consideration in the case of transfer of shares	In the case of transmission of shares question of consideration does not arise.
4.	Lodgement	In the case of transfer of shares, lodgement of instrument of transfer is necessary.	In case of transmission of shares, lodgement of 'proof of title' is necessary.
5.	Stamp	In case of transfer of shares, stamp is necessary	In case of transmission of shares, there is no need of stamp

Forged Transfer : A forged transfer is a nullity . It does not give the transferee concerned any title to the shares. If the company acts on a forged transfer and removes the name of the real owner from the register of Members then the company is bound to restore the name of the real owner on the register as the holder of the shares and to pay him any dividends which he ought to have received [*Barton Vs.North Straffordshire Railway Co. People Insurance Co.Ltd Vs.Wook & Co.Ltd., (1961)*].

Thus, if by forgery, A obtains a certificate of transfer of shares from a company and transfers the shares to a purchaser does not get a good title to the shares so transferred. But the company shall be liable to compensate the purchaser in so far as the company had issued a certificate issued by the company could validly and reasonably assume that the person named in the certificate as the owner of shares was really the owner of the shares represented by the certificate [*Balkis Consolidated Co. Vs. Tamkinson (1982) A.C. 1961*]. If as a result of the forged transfer, the name of the true owner of shares is taken off the Register of members he can *compel the company to restore his name to the register. He can also claim any dividend which may not have been paid to him during the intervening period (Barton Vs.North Staffordhire Supra}*.

Lien on Shares : A lien is the *right to retain possession of a thing until a claim is satisfied.* In the case of a company, lien on a share means that a member would not be permitted to transfer

his shares unless he pays his debt to the company. The articles generally provide that the company shall have a first and paramount lien on the shares of each member for the debts and liabilities to the company. The right of lien is not inherent but must be clearly provided for in the articles. The articles may give the right of lien over shares either for unpaid calls or for any other debt due by the member to the company. The company may have lien on fully paid-up shares. The lien also extends to the dividends payable on the shares.

Surrender of Shares : The Companies Act does not provide for surrender of shares. Shares are said to be surrendered when they are voluntarily given up. The articles of a company may authorise the directors to accept surrender of shares. Surrender of shares is valid where it is done to relieve the company from going through the formality of forfeiture of shares and the shareholder is willing to surrender the shares. A surrender and a forfeiture have practically the same effect, the only difference being that the former is done with the assent of the shareholder while the latter is done at the instance of the company.

Forfeiture of Shares : A company has not inherent power to forfeit shares. *The power to forfeit shares must be contained in the articles. Where as the shareholder fails to pay the amount due on any call, the directors may, if so authorised by the articles, forfeit his shares.* Shares can only be forfeited for non-payment of calls. An attempt to forfeit shares for any other reasons is illegal. Thus, where the shares are declared forfeited for the purpose of relieving a friend from liability, the forfeiture may be set aside.

Conditions to be satisfied before a company may forfeit shares : A company may forfeit the shares of a shareholder if the following conditions are satisfied.

1. **In accordance with Articles:** A forfeiture must be authorised by the Articles of the Company. It must be strictly in accordance with the grounds specified in the Articles, Any irregularity in the procedure or any departure from the rules laid down invalidate the forfeiture. Forfeiture is in the nature of penal proceedings. It is valid only if the provisions of Articles are strictly complied with (*Karachi Oil Products Ltd. Vs. K.S.Narender Singhiji).*
2. **Bonafide:** Forfeiture must be bonafide and in the interest of the company. The right to forfeit shares, like the powers to make calls, is in the nature of a trust and must be exercised for the benefit of the company. For instance, if the shares are forfeited for the purpose of relieving a friend from liability, the forfeiture may be set aside (*Re Mirza Ahmed Nizami*).
3. **Valid Call :** When forfeiture is for non-payment of call, the call must have been properly made i.e. by passing a proper resolution confirming to the provisions of articles on a uniform basis and bonafide in the interest of the company.
4. **Notice prior to forfeiture :** A proper notice must be served requiring a defaulting member to pay outstanding amount of call. The notice must give at least 14 days time from the date of its service for payment of the amount due and must inform the member that in the even of non payment his share amount will be forfeited. Any defect in the notice, even though slight, invalidates it and is fatal to the forfeiture.
5. **Resolution of the Board:** If the defaulting shareholder does not pay the amount within the specified time as required by the notice, the directors must pass a resolution forfeiting the shares. If this resolution is not passed, the forfeiture as well, e.g., when it states

that in the event of default, the shares shall be deemed to have been forfeited, no further resolution is necessary.

Legal Effects of Valid Forfeiture

1. The defaulting share holder ceases to be a member of the company and his name is removed from the register of members.
2. He loses his claim to the paid-up amount on his shares.
3. He remains a contributory as a past member if liquidation commences within one year of forfeiture.
4. If the articles provide so, he will remain liable for unpaid calls as an ordinary debtor for a period of 3 years from forfeiture.
5. Forfeited shares become property of the company which may re-issue them or otherwise dispose off.
6. The title of the purchaser of re-issued forfeited shares is not affected by any irregularity in the forfeiture.

Difference between Forfeiture and Surrender of shares

Both forfeiture and surrender of shares result in termination of membership of a person However, the two differ from each other in the following respects.

1. *Initiative* : In case of forfeiture, initiative is taken by the company whereas in surrender of shares it is the member who takes the initiative.
2. *Reason*: Shares can be forfeited for non-payment of call only, but surrender of shares may be accepted for other reasons also, for example, for exchange of new shares.
3. *Object* : The object of forfeiture of shares is to penalise a member for non-payment of call whereas the object of surrender of shares for the member is different. The member surrenders his shares either because he cannot make payments of calls due on it or because he wants to get it exchanged into new shares of the same nominal value.
4. *Legal Technicalities*: In case of forfeiture of share, the rules and regulations are to be followed exactly and carefully as a slight irregularity will invalidate the forfeiture made. However, it is not so in case of surrender of shares. In certain cases, the sanction of court is necessary.

Issue of Sweat Equity Shares (Sec. 79A)

Notwithstanding anything contained in Section 79, a company may issue sweat equity shares of a class of shares already issued if the following conditions are fulfilled, namely :

(a) the issue of sweat equity shares is authorised by a special resolution passed by the company in the general meeting;

(b) the resolution specifies the number of shares, current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;

(c) not less than one year has at the date of the issue elapsed since the date on which the company was entitled to commence business;

(d) The sweat equity shares of a company whose equity shares are listed on a recognised stock exchange are issued in accordance with the regulations made by the Securities and Exchange Board of India in this behalf [Sec. 79A(1)]. However, in the case of a company whose equity shares are not listed, the same must be issued in accordance with the guidelines as may be prescribed.

Explanation I : For the purposes of this sub-section, the expression "*a company*" means a company incorporated, formed and registered under this Act and includes its subsidiary company incorporated in a country outside India.

Explanation II : For the purposes of this sub-section, the expression "*sweat equity shares*" means equity shares issued by the company to 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.

All the limitations, restrictions and provisions relating to equity shares shall be applicable to such sweat equity shares issued under sub-section (1) [Sec. 79A(2)].

Right Shares

A company can at any time by passing an *ordinary resolution* increase its capital by issuing new shares. If the directors could offer new shares to any person at their discretion, they would add to their own majority. According to Section 81, such shares must be offered to the existing equity shareholders of the company in proportion, as nearly as the circumstances admit, of the shares held by them. The restriction applies only when it is proposed to increase the subscribed capital of the company by allotment of further shares after the expiry of two years from the formation of the company or after the expiry of one year from first allotment of shares, whichever is earlier. Such shares are called '*right shares*' and the right to receive them as the '*pre-emptive right*'. The offer is made by giving each member a notice of shares offered to him. The notice must fix the time for payment which should not be less than fifteen days and should inform the shareholders that they have the right to renounce all or any of the shares offered to him in favour of their nominees. The shares which are not taken by the share holders and which are left over after making proportional distribution may be allotted by the directors in such manner as they think most beneficial to the company. Subject to this restriction, the directors are at liberty to decide at what particular time the capital should be increased. Thus, in *Nanalal Zavar Vs. Bombay Life Assurance Co.*, the Supreme Court approved a scheme for the increase of capital and its allotments to the existing shareholders even when the scheme was designed to prevent the domination of the company by a person who had purchased a majority of its shares in the open market. The directors had acted honestly in the interest of the company.

The new shares can however, be offered to outsiders to the exclusion of the existing shareholders in the following cases:

(1) If the company has by passing a *special resolution* resolved to allot the new shares in a different manner than that provided in Section 81(2).

(2) If an ordinary resolution to that effect has been passed and the Central Govt. is satisfied that the proposal to offer the shares to outsiders is most beneficial to the company.

The directors must not increase capital and allot it to themselves or their nominees solely for the purpose of maintaining themselves in power.

Members of private companies do not have a right of pre-emption unless articles so provide. Again, there is no right of pre-emption in case of convertible debentures and when Central Govt. converts its loan to a company into shares of the company.

The provision of Section 81 do not apply : (a) to a private company; or (b) to the increase of the subscribed capital of a public company caused by the exercise of an option attached to debentures issued or loans raised by the Company-(i) to convert such debentures or loans into shares in the company; or (ii) to subscribe for shares in the company provided that the terms of issue of such debentures or loans, include a term providing for such option and such term (a) either has been approved by the Central Government before the issue of debentures or the raising of the loans, or is in conformity with any rules, made by that Government in this behalf an d(b) in case of debentures or loans other then debentures issued to, or loans obtained from, the Government or any institution specified by the Central Government in this behalf has been approved by a special resolution passed by the company in general meeting before the issue of the debentures or the raising of the loans.

Bonus Shares

A company may, if the articles so provide, capitalise profits by issuing fully paid-up shares to the members thereby transferring the sums capitalised from the Profit and Loss Account or Reserve Account to the Share Capital [Section 205(3)]. Such shares are known as *bonus shares* and are issued to the existing members of the company free of charge.

Difference between Bonus Shares and Right Shares

Sl. No.	*Basis of Difference*	*Bonus Shares*	*Right Shares*
1.	Meaning	By Bonus shares we mean the shares which are issued to the existing shareholders from the profits and reserves of the company without taking no extra payment.	The shares which are meant for the existing shareholders are known as right shares.
2.	Objective	The issue of bonus shares implies the payment of dividend in the form of 'shares' instead of 'cash'	The object of the issue of right shares is to increase the subscribed capital of the company
3.	Consideration	Bonus shares are issued to the existing share holders without taking any extra payment	In case of issue of right shares, payment is made entirely by shareholders subscribing fresh capital
4.	Provision	Bonus shares are issued under the provision of Sec. 78, 80 and 205.	Right shares are issued under the provisions of Sec. 81.

The issue of bonus shares is regulated not only, by the Companies Act, 1956 but also by the guidelines issued by SEBI in this regard.

SEBI Guidelines, 2000 for issue of BONUS SHARES (w.e.f. 2000)

(a) The bonus issue shall only be made out of free reserves built out of the genuine profits or share premium collected in cash only.

(b) Reserves created by revaluation of fixed assets are not to be capitalised.

(c) The declaration of bonus issue, in lieu of dividend, is not made.

(d) The bonus issue is not made unless the party-paid shares, if any, existing, are made fully paid-up.

(e) The company (i) has not defaulted in payment of interest or principal in respect of fixed deposits and interest on existing debentures or principal on redemption thereof, and (ii) has sufficient reason to believe that it has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity, bonus,etc.

(f) A company which announces its bonus after the approval of the Board of Directors must implement the proposal within a period of 6 months from the date of such approval and shall not have the option of changing the decision.

(g) There should be a provision in the Articles of Association of the company for capitalisation of reserves, etc. and, if not, the company shall pass a special resolution at its general body meeting making provisions in the Articles of Association for capitalisation.

(h) Consequent to the issue of bonus shares, if the subscribed and paid-up capital exceed the authorised share capital, resolution shall be passed by the company at its general body meeting for increasing the authorised capital.

(i) No company shall, pending conversion of FCSs/PCDs, issue any shares by way of bonus unless similar benefit is extended to the holders of such FCDs/ PCDs through reservation of shares in proportion to the convertible part of FCDs/PCDs.

(j) The shares so reserved may be issued at the time of conversion (s) of such debentures on the same terms on which the bonus issues were made.

SEBI guidelines regarding RIGHT ISSUES

Applicability : These guidelines apply to the rights issues made by existing listed companies (i.e. companies whose equity capital is listed). Therefore, a company whose debentures/bonds are listed but not the equity (i.e. shares) will not be governed by these guidelines.

These guidelines are not applicable where the size of the issue is upto Rs. 50 lakhs.

Withdrawal of a rights issue : Rights issue cannot be withdrawn after the announcement of their record date. If done, then no security of the company shall be eligible for listing upto 12 months.

Underwriting : The underwriting of rights issued shall be optional.

Appointment of Registrars : Appointment of Registrars to Issue shall be compulsory.

Appointment of Merchant Banker : Appointment of Category-I Merchant Banker holding a valid certificate of registration issued by SEBI shall be compulsory.

Partly paid shares : Partly paid shares, if any, must either be made fully paid or forfeited.

Letter of Offer : Letter of offer shall contain disclosures specified by SEBI as per Form 2A. The Lead Merchant Banker shall :

(i) ensure compliance of the requirements of SEBI guidelines with respect to the offer document relating to rights issues.

(ii) file with SEBI a copy of the offer document at least 21 days before filing of the same with the Regional Stock Exchange.

Agreement with Depository : The company shall enter into an agreement with the depository for dematerialisation :

(i) of securities already issued;

(ii) proposed to be issued;

(iii) the subscribers/shareholders must be given an option of holding the shares in a dematerialised mode or by way or by way of share certificates.

Closure of Rights Issue : The right issue must be kept open for a minimum period of 30 days. It cannot remain open for more than 60 days.

Minimum Subscription : SEBI requires the following clauses in respect of minimum subscription to be stated in the letter of offer.

"If the company does not receive the minimum subscription of 90% of the issue, the entire subscription will be refunded to the applicants within 42 days from the date of closure of the issue. If there is delay in the refund of the application money by more than 8 days after the company becomes liable to pay the amount, i.e., forty two days after closure of the issue, the company will pay interest for the delayed period, @ 15% per annum as prescribed in sub-section (2) and (2A) of Section 73 of the Companies Act, 1956".

In case of composite issue, the Lead Merchant Banker shall ensure that the requirement of minimum subscription is satisfied both jointly and severally i.e., independently for both rights and public issues.

No Reservations in rights issues : SEBI guidelines prohibit any preferential allotment in favour of the issuing companies' permanent employees and financial institutions. If a company desires to make any preferential allotment to the employees or any identified persons it may do so independent of rights issue by complying with the guidelines in that regard.

Promoter's Contribution and lock-in-period : The requirement of promoter's contribution shall not be applicable in case of rights issues.

Rights of FCD/PCD Holders : No company shall, pending conversion of FCDs/PCDs, issue any shares by way of rights unless similar benefit is extended to the holders of such FCDs or PCDs. The benefits shall be extended by making a reservation of shares in proportion to the convertible part of FCDs/PCDs. The shares so reserved may be issued at the time of conversion of such debentures on the same terms on which the rights issue was made.

Restriction on further Capital Issues : No company shall make any further issue of capital in any manner whether by way of issue or otherwise, during the period commencing from the submission of offer document to SEBI on behalf of the company for right issues, till the securities referred to in the said offer document have been listed or application moneys refunded on account of non-listing or under subscription, etc.

Oversubscription not to be retained : Oversubscription shall not be retained under any circumstances.

Issue to be made fully paid up : The issue shall have to be made fully paid up within 12 months except where the issue size exceeds Rs. 500 crore.

Additional Facility for applying : The Lead Merchant Banker shall ensure that an advertisement giving the date of completion of despatch of letters of offer, is released in at least one English National Daily with wide circulation, one Hindi National Paper and a Regional language daily circulated at the place where registered office of the issuer company is situated. The advertisement must be published at least 7 days before the date of opening of the issue.

The advertisement must contain the following details.

(a) The centres other than registered office of the company where the shareholders or the persons entitled to rights may obtain duplicate copies of composite application forms in case they do not receive the original application form within a reasonable time even after opening of the right issue.

(b) Where the shareholders have neither received the original composite application forms nor are they in a position to obtain the duplicate forms, they may make applications to subscribe to the rights on a plain paper.

(c) The advertisement shall also contain a format to enable the shareholders to make the application on a plain paper containing necessary particulars like name, address, ratio of right issue, issue price, number of shares held, ledger folio numbers, number of shares entitled and applied for, additional shares if any, amount to be paid along with application, particulars of cheque, etc. to be drawn in favour of the Company Account Rights issues.

(d) The advertisement shall further mention that application can be directly sent by the shareholder through Registered Post together with the application money's to the company's designated official at the address given in the advertisement.

(e) The advertisement may also invite attention of the shareholders to the fact that the shareholders making the applications otherwise than on the standard form shall not be entitled to renounce their rights and shall not utilise the standard form for any purpose including renunciation even if it is received subsequently.

(f) If the shareholder makes an application on plain paper and also in standard form, he may face the risk of rejection of both the applications.

Compliance Report : The Post-Issue Lead Merchant Bank shall file :

(a) *3-Day Post-Issue Monitoring Report* : The report shall be filed on the 3rd day from the date of closure of the subscription of the issue.

(b) *50 Day Post-Issue Monitoring Report* : The report shall be filed on the 50th day from the date of closure of subscription of the issue.

Duty of transferor to transferee in respect of Rights Shares

There may be pending transfers at the time when a rights issue takes place. This raises the question whether the transferor of an unregistered transfer is under any obligation towards his transferee to apply for the rights shares for the benefit of the transferee. The Bombay High Court in *Dinge Venkataramana Reddy Vs. Padampat Singhania* AIR 1950 Bom. 76 held that it was the duty of the transferor to apply for the new shares and to hold them in trust for the transferee. But, the Supreme Court in. *R. Mathalone Vs. Bombay Life Assurance Co. Ltd.* AIR 1953 SC 385

The buy back may be from:

(a) from the existing security holders on a proportionate basis; or

(b) from the open market; or

(c) from the odd lots, that is to say, where the lot of securities of a public company whose shares are listed on a recognised stock exchange is smaller than such marketable lot, as may be specified by the stock exchange; or

(d) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

(6) Declaration of Solvency: Where a company has passed special resolution under clause (b) of sub-section(2) to buy back its own shares or other securities under this section, it shall, before making such buy back, file with the Registrar and the Securities and Exchange Board of India a declaration of solvency in the form as may be prescribed and verified by an affidavit to the effect that the Board has made a full inquiry into the affairs of the company as a result of which that have formed an opinion that is capable of meeting its liabilities and will not b rendered insolvency within period of one year of the date of declaration adopted by the Board, and signed by at least two directors of the company, one of whom shall be the managing director, if any:

Provided that no declaration of solvency shall be filed with the Securities and Exchange Board of India by a company whose shares are not listed on any recognized stock exchange.

(7) Extinguishment of Securities: Where a company buys back its own securities, it shall extinguish and physically destroy the securities so bought back within seven days of the last date of completion of buy back.

(8) Cooling Period: Where a company completes a buy back of its shares or other specified securities under this section, it shall not make further issue of same kind of shares (including allotment of further shares under clause (a) of sub-section (1) of section 81) or other specified securities within a period of twenty-four months except by way of 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.

(9) Register of buy-back: Where a company buys-back its securities under this section, it shall maintain a register of the securities so bought, the consideration paid for the securities bought-back, the date of cancellation of securities, the date of existing and physically destroying of securities and such other particulars as amy be prescribed.

(10) Filling of Buy-back Return: A company shall, after completion of the buy-back under this section, file with the Registrar and the Securities and Exchange Board of India by a company whose shares are not listed on any recognised stock exchange.

(11) Penalty for Default: If a company makes default in complying with provisions of this section or any rule made thereunder or any regulations made under clause (f) of sub-section(2), the company or any officer of the company who is in default shall be punishable with imprisonment for a term which may extend to two years, or with fine which may extend to fifty thousand rupees, or with both.

DIVIDEND

Dividend is the portion of the profits of company which is allocated to the shareholders in proportion to their shares and in accordance with their rights as shareholders. *A dividend can be declared by the shareholders at the annual general meeting, but no dividend shall exceed the amount recommended by the Board of Directors.* If the directors feel that a dividend should not be declared, the shareholders in general meeting cannot themselves declare it. Apart from these,

the articles may empower the directors to declare interim dividend.

The articles usually provide that the dividends shall be paid to the shareholders in proportion to the amounts paid on the shares held by them respectively. If not, dividends are paid on cash share in proportion to the nominal value of that share without reference to the amount paid upon it.

A company may declare and pay dividends out of current or previous years, profit or out of both or out of money provided by the Central or State Government for payment of the dividend in pursuance of a guarantee given by such Government. In the public interest the Central Government may allow a company to declare dividend out of profits of the current year without requiring the company to provide for depreciation. [Section 20(1)].

Interim dividend : The Articles of a company may empower the directors to declare interim dividend, i.e., *dividend in between its two annual general meetings*. The Board may from time to time pay to the members such interim dividend as appears to it to be *justified by the profits of the company* (Articles 86 of Table A). But before declaring an interim dividend, the directors must satisfy themselves that the financial position of the company warrants the payment of such dividend out of profits available for distribution.

Dividend Warrant : A dividend warrant is an instrument containing an order on a company's banker directing it to pay the stated amount to or to the order of the shareholder named therein who is entitled to claim dividend. *It is in two parts*-one part is a notice of the dividend to the shareholder as well as the *certificate of deduction of income-tax*, and the other part is the dividend warrant.

Sub-section (1A), (IB) and (IC) have been added to provide as under:

(i) The Board of Directors can declare interim dividend and the amount of dividend or interim dividend shall be deposited in a separate bank account within 5 days from the date of declaration.

(ii) The amount so deposited shall only be used for payment of interim dividend.

(iii) The provisions of Section 205, 205A, 205C, 206A and 207 dealing with declaration and payment of dividend, treatment unclaimed dividend, establishment of *Investor Education and Protection Fund*, etc. shall apply to interim dividend also.

Based on Section 2 (144) read with section 25 (IC), it can be concluded that since dividend include interim dividend, companies should provide depreciation as required by section 205 and comply with *Companies (Transfer of Profits to Reserve) Rules, 1975* before declaring interim dividend. The company has to provide estimated depreciation for the full year before declaration of interim dividend. If the company does not transfer any profit to Reserves, it has to be contended with declaring an interim dividend not exceeding 10% of the paid-up capital.

Hitherto, there were no provisions in the Act, pertaining to interim dividend. Clause (14A) of section 2 defines dividend as including any interim dividend. Section 205 (IB) provides that the amount of dividend including interim dividend so deposited shall be used for payment of interim dividend. The language used is some what not with clarity. It implies that even the amount deposited for payment of final dividend be used for payment of interim dividend.

Further section 205 has reduced the time from for payment of dividend from 42 days to 30 days from the date o f declaration.

petition for the winding up of the company by the court. If the company is already in the course of winding up, he may prove for the amount due to him. A secured debenture holder stands in a stronger position as compared to unsecured debenture holder.

CHARGES AND MORTGAGES ON THE ASSETS OF THE COMPANY

Where however the debenture is *secured* by a mortgage or a charge, the holder thereof who wishes to realise his security and recover the money due to him, may resort to all or any of the following remedies;

(i) He may sue on his behalf and on behalf of other debenture holders of the same class to obtain payment or *enforce his security by sale*;

(ii) He may *appoint a receiver* if the conditions of the issue of so permit;

(iii) He may *apply to the Court* foreclosure of the company's right to redeem the debentures. But, in such an action, all debenture holders of the company, in contradistinction to those of a class, as well as the company should be joined as parties;

(iv) He may, in the capacity of a creditor, *present an application for winding up* for the principal and interest thereon;

(v) He may *have the property sold by the trustee* if the debenture-trust-deed permits the sale;

Fixed Charges Vs. Floating Charges

The charge on the assets of a company, given by a debenture or a trust deed, may be either (i) specific or fixed charge? or (2) floating charge.

Difference between Fixed charge and Floating charge

	Fixed Charge	*Floating Charge*
1.	It is a legal charge	It is an equitable charge
2.	It is a charge on specific, ascertained existing and future assets	It is a charge on present and No specific assets.
3.	Company cannot deal with the assets except with the consent of the charge-holder	Company is free to use or deal with the assets the way it likes until the charge crystalizes i.e. becomes fixed.
4.	Registration of fixed charge on movable assets is not compulsory	Registration of all floating charge on all kinds of assets is compulsory by law
5.	Fixed charge has always priority over floating charge	Ambulatory and shifting in character.

Specific or Fixed charge : A *fixed or specific charge* is created in respect of a definite and ascertained property and this prevents the company from dealing with that property without the consent of the debenture-holders. In case of winding up of a company a debenture-holder secured by a specific charge is in the highest ranking class of creditors. Where there are a number of specific charges on the same property, their priority is determined by the general rules relating to priority of charges.

Floating charge : A *'floating charge'* is an equitable charge which does not fasten on any ascertained or definite property and as such the company can deal with any of its assets in the ordinary course of business. The consent of the debenture holders is not necessary for the company to deal with its assets. Whether a particular charge is a floating charge or not depends upon the construction of the words used in the document creating the charge. The nature of charge cannot be altered to become a floating charge merely because inspite of the charge, the business of the company continues to be carried on.

Registration of Charges : Where a company creates a charge over its property, Section 125 requires that *charge to be registered with the Registrar of Companies.* The particulars of every charge and mortgage created on a movable or immovable property must be filed by the company with the Registrar *within 30 days of their creation.* The Registrar may extend the time for filing of the particulars and instrument creating the charge by seven days provided the company had sufficient cause for not filing the particulars within the specified. *The charges which are required to be compulsorily registered are given below :*

1. A charge to secure any issue of debentures.
2. A charge on uncalled share capital.
3. A charge on any immovable property wherever situated or any interest therein.
4. A charge on any book debts of the company.
5. A charge not being a pledge on any movable property of the company.
6. A floating charge on the undertaking or any property of the company including stock in trade.
7. A charge on calls made but not paid.
8. A charge on a ship or any share in a ship.
9. A charge on goodwill, or a patent or licence under a patent, on a trade mark or copy right.

Particulars to be filled with the Registrar

(a) If the charge is in connection with the secured debentures, then (i) total amount secured by the debentures, (ii) the date of resolution authorising the issue of debentures and the date of the instrument by which the security is created; (iii) general description of the properly charged; (iv) name of the trustees for the debenture holders. If any commission has been paid to any person for subscribing to the debentures, the amount and the rate of commission so paid also to be indicated.

(b) In the case of any other charge : (i) the date of creation of charge, (ii) the amount secured, (iii) short particulars of the property charged; (iv) the person entitled to the charge.

Consequences of non-registration of registerable charge

(i) the charge will be *void as an against the Liquidator* (if the company) goes into liquidation) and against creditors, but against them only;

(ii) the charge is good against the company and the *amount becomes payable immediately*;

(iii) until liquidation of the company, the person seeking to enforce such a charge, has available to him all remedies of a mortgage against the company, though not against other creditors;

5. What is meant by allotment of shares? Discuss the rules relating to the allotment of shares. Point out the consequences of irregular allotment.
6. Discuss the restriction on the allotment of shares under the Companies Act. What is the effect of an irregular allotment?
7. How is the transfer of shares effected? Can the Board of Directors refuse to register a transfer of shares? What is the remedy open to a transferee in such a case?
8. What do you understand by the forfeiture of shares? If so, when and under what conditions?
9. Has the company power to issue shares at a discount? If so, when and under what conditions?
10. Can a company purchase its own shares? If so, under what circumstances?
11. Define debenture. Discuss the different kinds of debentures.
12. Discuss the remedies available to debenture-holders for the realisation of their security.
13. Enumerate the charges on properties of the company that require registration. Discuss the consequences of non-registration.
14. Write short notes on :

(a)	Share Warrant	(g)	Transmission of shares
(b)	Surrender of Shares	(h)	Preference shares
(c)	Floating Charge	(i)	Payment of interest out of capital
(d)	Interim dividend	(j)	Stock certificate
(e)	Lien on shares	(k)	Buyback Scheme of Shares
(f)	Calls on shares		

PRACTICAL PROBLEMS

1. A Public limited company issued two classes of shares, namely, Ordinary Shares and 14% Non-cumulative Preference Shares. It wishes to change its rights regarding the Preference Shares. There is no provision in the articles or memorandum regarding such variation. Advise the company.

   (*Hint:* The variation of the rights is allowed provided it is not prohibited by the terms of issue, at least. Section 106 of the Act)

2. If in the above Problem 15% of the holders of preference shares are opposed to the change in rights, then what should they do?

   (*Hint*: The dissenting shareholders are advised to apply to the Court under Section 107 of the Companies Act, 1956, to have the variation cancelled.)

3. A public company forfeited 100 shares, re-issued them and thereby earned a surplus of Rs. 2,500. The company did not file a Return of Allotment to the Register in respect of these shares. Has the company contravened any provision of the Company Act?

   (*Hint* : No. Company has to file a Return of Allotment at the time of first issue only. Moreover, the forfeited shares can be issued by the company at a premium without any further legal formalities. Section 75 (5) of the Companies Act, 1956.]

4. A company was incurring heavy losses over the past many years and its shares were partly paid-up. Rajesh, a member of the company, surrendered his 10 shares which the directors allowed, Is the surrender valid under the Act?

   (*Hint* : No. In fact, the surrender of shares is valid only in cases where their forfeiture is justified.)

5. The Secretary of a company issued a Share Certificate in favour of R which apparently complied with the company's Articles as it purported to be signed by two Directors and the Secretary and it had the company's

seal a fixed to it. Actually, the Secretary had forged the signature of the Directors and affixed the seal with out authority. Is the Certificate binding on the company?

(*Hint* : No. Issue of Share Certificate on which the Secretary of a company had forged the signatures of the Directors is a nullity in the eye of law and even the Court cannot compel for something which is void ab-initio.)

6. A and B each held half the issued capital of the company. The Articles provided "the directors may, at any time, in their absolute and uncontrolled discretion register any transfer of shares." A died and his executor applied to have his shares registered in his name. B, who is a Director, refuses under the above-mentioned provision of Articles. Can the Court come to the rescue of A's executor?

   (*Hint* : Yes. Court can come to the rescue of A's executor because under the Companies act, 1956. Directors cannot refuse to register transmission of shares as they have no right to interfere with the course of law.)

7. The shareholders, in a duly convened annual meeting of a company passed a resolution for payment of dividend at a rate higher than what was recommended by the Board of Directors Examine this from legal point of view.

   (*Hint* : The step of the shareholders is illegal)

8. X buys from Y 2000 shares of a company on the faith of share certificate issued by the company. X tenders to the company transfer from Y to himself duly executed together with Y's shares certificate. The company discovers that the certificate in the name of Y has been fraudulently obtained and refuses to register transfer. Is X entitled to get registration of the transfer?

   (*Hint* : No. X is not entitled to get shares registered in his name but he can claim damages from the company on the ground that he replied upon the share certificate issued by the company.)

9. P held shares in a company upon which dividends were declared from 1991 to 1999. These dividends were never claimed and paid. In 2000, a claim for all unpaid dividends was made. Advise P.

   (*Hint* : Under the Companies Act, 1956, a shareholder can recover the dividend within 6 years from the date of declaration of dividend. Thus, P can claim dividend from 1994 to 1999 and cannot claim for the years 1991 to 1993.)

◈ ◈ ◈

According to Section 2(13) of the Companies Act 1956, "*director*" includes any person occupying the position of director by whatever name called. Only an individual can be appointed a director [Section 253].

Number of directors : Every public company must have atleast 3 directors and every private company must have atleast 2 directors. Subject to the minimum number of directors a company should have, the articles of a company may prescribe the maximum and the minimum number of directors for its Board of directors. A company in a general meeting may by ordinary resolution increase or reduce the number of its directors within the limits fixed in that behalf by its articles (Section 258). A public company or a private company which is a subsidiary of a public company cannot increase the number of directors beyond the permissible maximum under its articles without the approval of the Central Government. However, no approval of the Central Government is required if such permissible maximum is twelve or less than twelve, and the increase in the number of its directors does not exceed twelve. (Section 259).

Appointment of directors : Directors may be appointed in the following ways:

1. By the articles as regards first directors (Section 254).
2. By the company in general meeting (Sections 255 to 263, 264).
3. By the directors (Sections 260, 262, 313).
4. By third parties (Section 255).
5. By the principle of proportional representation (Section 265).
6. By the Central Government (Section 408).

Legal position of directors : The directors are not servants of the company or members of its staff. They cannot be treated as the employees of the company. For certain matters under the Companies Act, the *directors are treated as Officers of the Company.* As such, they are liable to certain penalties if the provisions of the Act are not strictlv complied with. *Directors are Trustees* of (a) the company's money and property; and (b) the powers entrusted to them. They are trustees of a the company's money and property in the sense that they must account for all the company's money over which they exercise control and must refund to the company any of its money which they have improperly paid away. Directors are trustees of their powers and they must exercise their powers honestly and in good faith and in the interest of the company. Company being an artificial person, is governed by the human agency. *Directors control the affairs of the company as its Agents.* Acts of the directors for and on behalf of the company exclude directors from personal liability, provided they are within the scope of their authority.

The liabilities of directors follow mostly from their duties, they are also accountable to the company for damage suffered as a result of negligence in performance of their duties. They are also liable to the company when they commit a breach of trust reposed in them by the shareholders, and misuse or avail of misappropriate profits or assets of the company. If the directors fail in the performance of their statutory functions of accounts, etc., they render themselves liable to prosecution and penalties prescribed by the Statue.

The directors of a company are usually protected by an Indemnity Clause contained in the Articles of Association in order to provide recompensation and protection for bonafide acts of the directors in discharge of their functions as directors. Such indemnity, however, is not available where director has not acted in good faith and where he is charged with gross negligence, bad

faith and disregard of his duties in the conduct of his office as a director.

Penalties imposable on directors for the contravention or defaults are of two types : (a) those imposable on them directly as "*directors*" and (b) those imposable on them directly as "*officers who are in default*". Under each category, there is a long list of offences dealt with in different sections of the Companies Act with specific penalties prescribed thereunder.

Share qualification : The Act does not make it obligatory on any director to hold shares in the company. The articles of association generally requires that the qualification of a director shall be the holding of a specified number of shares known as qualification shares. The nominal value of these shares must not exceed Rs. 5,000 or the nominal value of one share where it exceeds Rs. 5,000.

A Person who can not be appointed as a Director (Disqualification of directors) : The circumstances in which a person can not be appointed as a director of a company are enumerated in Section 274. According to this section, a person cannot be appointed as a director of a company, if

(i) he has been found to be of *unsound mind* by a competent court and the finding is in force;

(ii) he is an *undischarged insolvent*;

(iii) he has *applied to be adjudicated as an insolvent* and his application is pending

(iv) he has been *convicted of an offence involving moral turpitude* and sentenced to imprisonment for not less than 6 months and a period of 5 years had not elapsed since the expiry of his sentence;

(v) he has *not paid any call in respect of shares of the company held by him* for a period of six months from the last day fixed for the payment.

(vi) he has been *disqualified by an order of the Court under* Section 203, of an offence in relation to promotion, formation or management of the company or fraud or misfeasance in relation to the company.

(vii) It may be noted that section 274 (1) (g) now provides that a person who is a director of a public company which has *defaulted in filing its annual accounts and returns* for a continuous period of 3 years from 1.4.1999 or has failed to *repay its deposits or interest on due date or redeem its debentures on due date* or pay dividend and such failure continues for one year or more, is disqualified from appointment as director of any company. Such disqualification will continue for a period of 5 years from such default.

Restriction or Ceiling on number of directorships : No person can be a director in *more than twenty companies*. The following companies shall be excluded in calculating the number of companies of which a person may be a director;

(a) a *private company* which is neither a subsidiary nor a holding company of a public company;

(b) an *unlimited company*;

(c) an *association not carrying on business for profit* or which profits the payment of a dividend;

(d) a company in which such person is only an *alternate director*.

for a meeting of the Board shall be one-third of its total strength (any fraction contained in that

one-third being rounded off as one) or two directors whichever is higher. When the meeting of the Board could not be held for want of quorum, then unless otherwise provided by the articles, the meeting shall automatically stand adjourned till the same day in the next week. (Section 288).

Powers of Board

As the company is an artificial person, it acts through its directors. The directors enjoy such powers as are given to them by the Act, Memorandum or Articles, Sections 291 to 293-A contain the powers of the Board and the restrictions thereon. The powers of directors are discussed under the following heads :

General Powers : Section 291 empowers the Board to exercise all such powers and do all such acts and things, as the company is authorised to exercise and do. But the Board cannot do any act which is to be done by the company in general meeting. In exercising any power, the Board will be subject to the provisions of this or any other Act, the Memorandum or the Articles.

Powers to be exercised by Board only at meeting : Under Section 292, the following powers can be exercised by the Board, only by resolutions passed at the Board meeting : (i) the power to make calls; (ii) the power to issue debentures; (iii) the power to borrow money otherwise than on debentures; (iv) the power to invest the funds of the company; (v) the power to make loans. Powers specified in points (iii), (iv) and (v) the above can be delegated by the Board, at a meeting by means of a resolution to a committee of directors, to the managing director, to the manager or to other principal officer of the company.

Duties of Directors

1. In discharging the duties of his position, a director must *exercise some degree of skill and diligence.*
2. A director must *act honestly* in the performance of his duties.
3. A director is not bound to give continuous *attention to the affairs of his company.*
4. Though all books of account and other *books and papers of the company are open to inspection by the director*, he is not bound to examine individual entries in the books.
5. The directors must *perform their duties personally.* The maxim "delegatus non-protest delegate" (a delegate cannot delegate further) applies to them like all agents. Hence, unless permitted by the articles specifically, *the directors must not delegate any of their powers to some other person.*
6. A director or his relative or any firm in which he or his relative has any interest or any private company of which he is a member or a director shall not *enter into any contract with the company for the sale, purchase or supply of goods, materials or services* or for underwriting the subscription of any shares or debentures.

Liabilities of directors : The liabilities of directors may be discussed under three heads; (a) Liability to outsiders, (b) Liability to company and (c) Criminal liability.

A. Liability to outsiders : The directors are not personally liable to outsiders if they act within the scope of powers vested in them. *The directors are personally liable to third parties of contract in the following cases :*

(a) They contract with outsiders in their *personal capacity.*