

D.N.R.COLLEGE, (AUTONOMOUS): BHIMAVARAM
DEPARTMENT OF MANAGEMENT STUDIES



CORPORATE LEGAL FRAMEWORK
III SEMESTER

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CP - 303, CORPORATE LEGAL FRAMEWORK MBA III SEMESTER eNOTES

UNIT-V:The Companies Act, 2013: Nature and Registration—Kinds of Companies—Memorandum of Association—Article of Association—Kinds of Shares—Powers and duties of Directors—windingup.

Introduction:

A **company**, is a legal entity made up of an association of people, be they natural, legal, or a mixture of both, for carrying on a commercial or industrial enterprise. Company members share a common purpose and unite in order to focus their various talents and organize their collectively available skills or resources to achieve specific, declared goals. Companies take various forms such as:

RIGHTS OF DIRECTORS

Rights can be categorized into individual and collective rights. Individual rights are such as right to inspect books of accounts {Section 209(4)}, Right to receive notices of board meetings (Section 285), right to participate in proceedings and cast vote in favour or against resolutions (Section 300), right to receive circular resolutions proposed to be passed. (Section 289), right to inspect minutes of board meetings.

Right to refuse to transfer shares: According to Section 111 of the Act, directors of private companies and deemed public companies are entitled to refuse registration of transfer of shares to a person whom they do not approve.

Right to elect a Chairman: Regulation 76(1) of Table-A provides that the directors are entitled to elect a chairman for the board meetings.

Right to appoint a Managing director: The Board has the right to appoint the managing director/ manager (as defined in the Act) of the company.

Right to recommend dividend: The Board is entitled to decide whether dividend is to be paid or not. Shareholders cannot compel the directors to pay dividend. However, they can reduce the rate of recommended dividend. Payment of dividend is the prerogative of the board.

DUTIES OF DIRECTORS

Directors as individuals have a duty to attend board meetings and contribute to the deliberations of the board and ultimately to the decision making leading to formulation of policies. Directors are under obligation to disclose their interest whether directly or indirectly in contracts or arrangements with the company (Section 299). They are also duty bound to disclose their directorships in other companies within 20 days of appointment or relinquishment of his office in other companies (Section 305). As per Section 308, directors are also required to disclose their shareholding in the company.

The following are some of those duties exercised collectively:

Approval of annual accounts and authentication of annual accounts

Directors report to shareholders highlighting performance of the company, transfers to reserves, investment of surplus funds, borrowings.

Issuance of Notice and Holding of Board meetings and shareholders meetings Passing of resolutions at board meetings or by circulation.

Directors are paid remuneration for their efforts in formulating policies and for devoting their valuable time for the company. Directors remuneration consists of sitting fees as per provisions in Articles of association, and Commission as a fixed percentage of net profits or as a fixed monthly sum as decided by the shareholders in the general meeting. As per the provisions in the new companies bill, 2009 independent directors cannot receive any remuneration other than sitting fees, expenses for attending board meetings and commission linked to profit.

KINDS OF SHARES

1. Ordinary shares

These carry no special rights or restrictions. They rank after preference shares as regards dividends and return of capital but carry voting rights (usually one vote per share) not normally given to holders of preference shares (unless their preferential dividend is in arrears).

Some companies create more than one class of ordinary shares – **E.g.** “A Ordinary Shares”, “B Ordinary shares” etc. This gives flexibility for different dividends to be paid to different shareholders or, for example, for pre-emption rights to apply to some shares but not others.

2. Deferred ordinary shares

A company can issue shares which will not pay a dividend until all other classes of shares have received a minimum dividend. Thereafter they will usually fully participate. On winding up they will only receive something once every other entitlement has been met.

3. Non-voting ordinary shares

Voting rights on ordinary shares may be restricted in some way – e.g. they only carry voting rights if certain conditions are met. Alternatively, they may carry no voting rights at all. They may also preclude the shareholder even attending a General Meeting. In all other respects they will have the same rights as ordinary shares.

4. Redeemable shares

The terms of redeemable shares give the company the option to buy them back in the future; occasionally, the shareholder may (also) have the option to sell them back to the company, although that's much less common.

The option may arise at or after a specific date, between two dates or be effective at any time the shares are in issue. The redemption price is usually the same as the issue price, but can be set differently. A company can only redeem shares out of profits or the proceeds of a new share issue, which may restrict its ability to redeem shares even if the directors would like to exercise the option.

If a company chooses to have redeemable shares, it must also have non-redeemable shares in issue. At no point can all of its share capital be made up of redeemable shares.

5. Preference shares

These shares are called preference or preferred since they have a right to receive a fixed amount of dividend every year. This is received ahead of ordinary shareholders. The amount of the dividend is usually expressed as a percentage of the nominal value. The full entitlement will be paid every year unless the distributable reserves are insufficient to pay all or even some of it. On a winding up, the holders of preference shares are usually entitled to any arrears of dividends and their capital ahead of ordinary shareholders. Preference shares are usually non-voting (or only have a vote only when their dividend is in arrears).

6. Cumulative preference shares

If the dividend is missed or not paid in full then the shortfall will be made good when the company next has sufficient distributable reserves. It follows that ordinary shareholders will not receive any dividends until all the arrears on cumulative preference shares have been paid.

By default, preference shares are cumulative but many companies also issue non-cumulative preference shares.

7. Redeemable preference shares

Redeemable preference shares combine the features of preference shares and redeemable shares. The shareholder therefore benefits from the preferential right to dividends (which may be cumulative or non-cumulative) while the company retains the ability to redeem the shares on pre-agreed terms in the future.

MEMORANDAM OF ASSOCIATION:

The **Memorandum of Association** of company, often simply called the **Memorandum** (and then often capitalised as an abbreviation for the official name, which is a proper noun and usually includes other words) is one of the most important documents and must be drafted with care. It has to be filed with the Registrar of Companies during the process of incorporation of a Company. It contains the fundamental conditions upon which the company

is allowed to operate. Its purpose is to enable shareholders, creditors, and those who deal with the company to know what is its permitted range of enterprise.

A **Memorandum of Association (MOA)** is a legal document prepared in the formation and registration process of a limited liability company to define its relationship with shareholders. The **MOA** is accessible to the public and describes the company's name, physical address of registered office, names of shareholders and the distribution of shares. The **MOA** and the Articles of Association serve as the constitution of the company. The **MOA** is not applied in the U.S. but is a legal requirement for limited liability companies in European countries including the United Kingdom, France and Netherlands, as well as some Commonwealth nations.

Name Clause

The name clause requires you to state the legal and recognized name of the company. you are allowed to register a company name only if it does not bear any similarities with the name of an existing company. your company name must end with the word "limited" because the preparation of a **MOA** is a legal requirement for limited liability companies only.

Registered Office Clause

The registered office clause requires you to show the physical location of the registered office of the company. you are required to keep all the company registers in this office in addition to using the office in handling all the outgoing and incoming communication correspondence. you must establish a registered office prior to commencing business activities.

Objective Clause

The objective clause requires you to summarize the main objectives for establishing the company with reference to the requirements for shareholding and use of financial resources. you also need to state ancillary objectives; that is, those objectives that are required to facilitate the achievement of the main objectives. the objectives should be free of any provisions or declarations that contravene laws or public good.

Liability Clause

The liability clause requires you to state the extent to which shareholders of the company are liable to the debt obligations of the company in the event of the company dissolving. you should show that shareholders are liable only their shareholding and/or to their commitment to contribute to the dissolution costs upon liquidation of a company limited by guarantee.

Capital Clause

The capital clause requires you to state the company's authorized share capital, the different categories of shares and the nominal value (the minimum value per share) of the shares. you are also required to list the company's assets under this clause.

Association Clause

The association clause confirms that shareholders bound by the moa are willingly associating and forming a company. you require seven members to sign an **MOA** for a public company and not less than two people for a moa of a private company. you must conduct the signing in the presence of witness who must also append his signature.

ARTICLES OF ASSOCIATION (AOA)

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

The article is binding not only to the existing members, but also to the future members who may join in the future. The heirs of members, successors and legal representatives are also bound by whatever is contained in the Article. The Articles bind the company and its members as soon as they sign the document. It is a contract between the company and its members. Members have certain rights and duties towards the company and the company have certain obligations towards its members. At the same time the company also expects some duties and obligations which the member has to fulfil for the smooth functioning of the company.

The Objectives and the purpose of the Company are determined in advance by the shareholders and the **Memorandum of Association(MOA)**, if separate, which denotes the name of the Company, its Head- Office, street address, and (founding) Directors and the main purposes of the Company – for public access. It cannot be changed except at an **AGM** or **Extraordinary General Meeting (EGM)** and statutory allowance. The **MOA** is filed with a Registrar of Companies who is an appointee of the Ministry of Corporate Affairs. For their assurance, the shareholders are permitted to elect an Auditor at each AGM. There can be Internal Auditors (employees) as well as an External Auditor.

NATURE OF COMPANIES

1.VoluntaryAssociation:

A company is a voluntary association of two or more persons. A single person cannot constitute a company. At least two persons must join hands to form a private company. While a minimum of seven persons are required to form a public company. The maximum membership of a private company is restricted to fifty, whereas, no upper limit has been laid down for public companies.

2.Incorporation:

A company comes into existence the day it is incorporated/registered. In other words, a company cannot come into being unless it is incorporated and recognised by law. This feature distinguishes a company from partnership which is also a voluntary association of persons but in whose case registration is optional.

3.ArtificialPerson:

In the eyes of law there are two types of persons viz:

Natural persons i.e. human beingsand

Artificial persons such as companies, firms, institutionsetc.

Legally, a company has got a personality of its own. Like human beings it can buy, own or sell its property. It can sue others for the enforcement of its rights and likewise be sued by others.

4. Separate Entity:

The law recognizes the independent status of the company. A company has got an identity of its own which is quite different from its members. This implies that a company cannot be held liable for the actions of its members and vice versa. The distinct entity of a company from its members was upheld in the famous **Salomon Vs. Salomon & Co case**.

5. Perpetual Existence:

A company enjoys a continuous existence. Retirement, death, insolvency and insanity of its members do not affect the continuity of the company. The shares of the company may change millions of hands, but the life of the company remains unaffected. In an accident all the members of a company died but the company continued its operations.

6. Common Seal:

A company being an artificial person cannot sign for itself. A seal with the name of the company embossed on it acts as a substitute for the company's signatures. The company gives its assent to any contract or document by the common seal. A document which does not bear the common seal of the company is not binding on it.

7. Transferability of Shares:

The capital of the company is contributed by its members. It is divided into shares of predetermined value. The members of a public company are free to transfer their shares to anyone else without any restriction. The private companies, however, do impose some restrictions on the transfer of shares by their members.

8. Limited Liability:

The liability of the members of a company is invariably limited to the extent of the face value of shares held by them. This means that if the assets of a company fall short of its liabilities, the members cannot be asked to contribute anything more than the unpaid amount on the shares held by them. Unlike the partnership firms, the private property of the members cannot be utilized to satisfy the claims of company's creditors.

9. Diffused Ownership:

The ownership of a company is scattered over a large number of persons. According to the provisions of the Companies Act, a private company can have a maximum of fifty members. While, no upper limit is put on the maximum number of members in public companies.

10. Separation of Ownership from Management:

Though shareholders of a company are its owners, yet every shareholder, unlike a partner, does not have a right to take an active part in the day to day management of the company. A company is managed by the elected representatives of its members. The elected representatives are individually known as directors and collectively as 'Board of Directors'.

Model Questions from UNIT -V

I. Short Notes

1. Company
2. Deferred Ordinary Shares
3. Name Clause
4. Limited Liability

II. Essays

1. Briefly explain about Powers and Duties of Directors.
2. Explain in detail about Memorandum of Association.
3. Distinguish between Memorandum and Articles of Association.
4. What do you mean by Articles of Association? Explain the registration of AOA.
5. Discuss the various kinds of Shares.