

# **Seth Anandram Jaipuria College**

## **Subject – Company Law**

### **Topic - Formation of Company**

#### **Teacher – Pampa Jana**

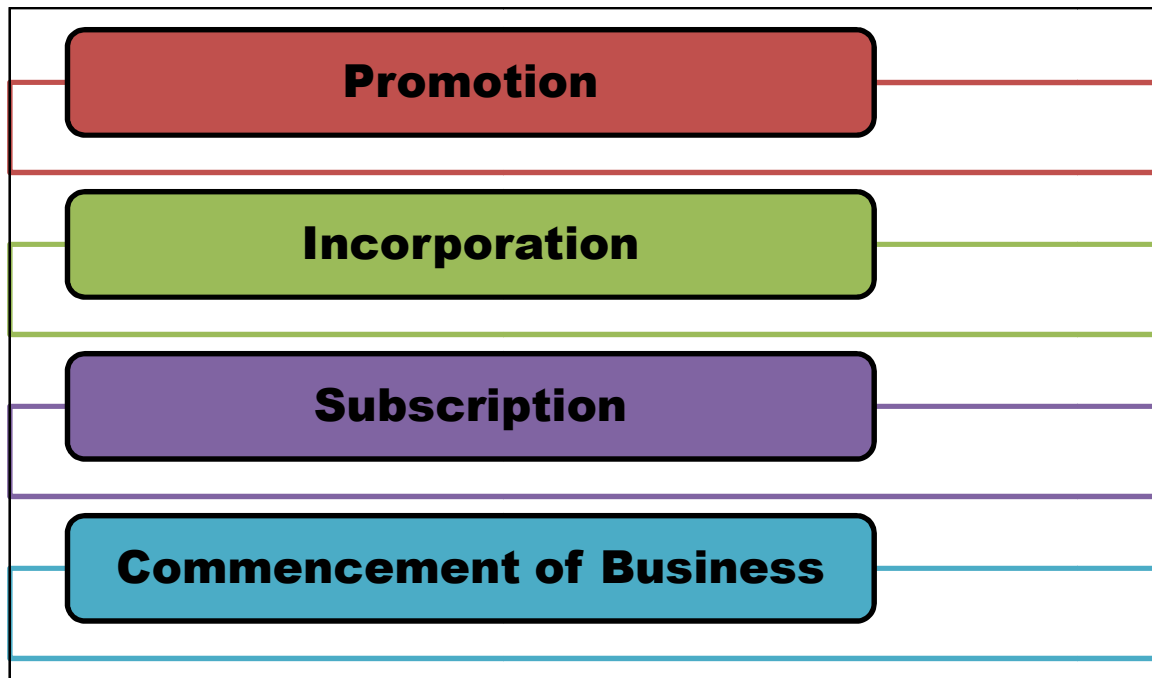
#### **Semester – B.Com 2<sup>nd</sup> (Day)**

A company comes into existence when a group of people come together with a view of forming an association to exploit the business opportunities by bringing together all the resources

A company can be formed or incorporated after following some essential condition required by law. As per section 3 of the companies Act 2013, A company may be formed for any lawful purpose by

1. 7 or more person, where the co. to be formed is a Public Co.
2. 2 or more person, where the co. to be formed is a Private Co.
3. 1 person, where the co. to be formed is a one person co.

#### **STEPS IN FORMATION OF A COMPANY.**



## **PROMOTION STAGE-**

Promotion is the first stage towards the formation of Co. It is a stage of conceiving an idea of forming a Co. to do business & working on that idea. The persons who are involved in the process of promotion is known as the promoters of the Co.

### **Promoters:-**

Person(s) who initiate the promotion of a company are known as Promoters. The person (s) who take steps for the registration of Co. are regarded as Promoters.

E.g. those associated with the preparation of a prospectus or in drawing up the memorandum Of Association of the Company & assisting in its registration are regarded as Promoters. It should be noted that person acting only in a Professional Capacity e.g. banker, accountant, etc. are not regarded as promoters. So whether a person is a promoter in any particular case depends on the fact, having regards to the person's action & his relationship with the co. which is formed.

As per section 2(69) of the Companies Act, 2013, A Promoter refers to a person:-

- a) Who has been named as such in a prospectus or is identified by the Co. in the Annual return referred to in section 92. or
- b) Who has control over the affairs of the Co. directly or indirectly whether as a shareholder, director, or otherwise or
- c) In accordance with whose advice, direction or instruction, The Board of Directors of the Co. is accustomed to Act.

### **Position of Promoter:-**

A Promoter is neither a Trustee nor an Agent of the Company but he has a fiduciary relationship with the Company. Fiduciary relation means a relation of trust & confidence. Therefore he is liable to disclose all the relevant facts & any secret profit made by him in relation with the formation of the Company. From the Fiduciary position of promoters the two important results are as follows:

- 1) A promoter cannot be allowed to make any secret profit. If it is found that in any particular transaction of the Co., he has obtained a secret profit for himself, he will be bound to refund the same to the co.
- 2) The promoter is not allowed to derive a profit from the sale of his own property to the Co. unless all material facts are disclosed.

### **Functions of promoter –**

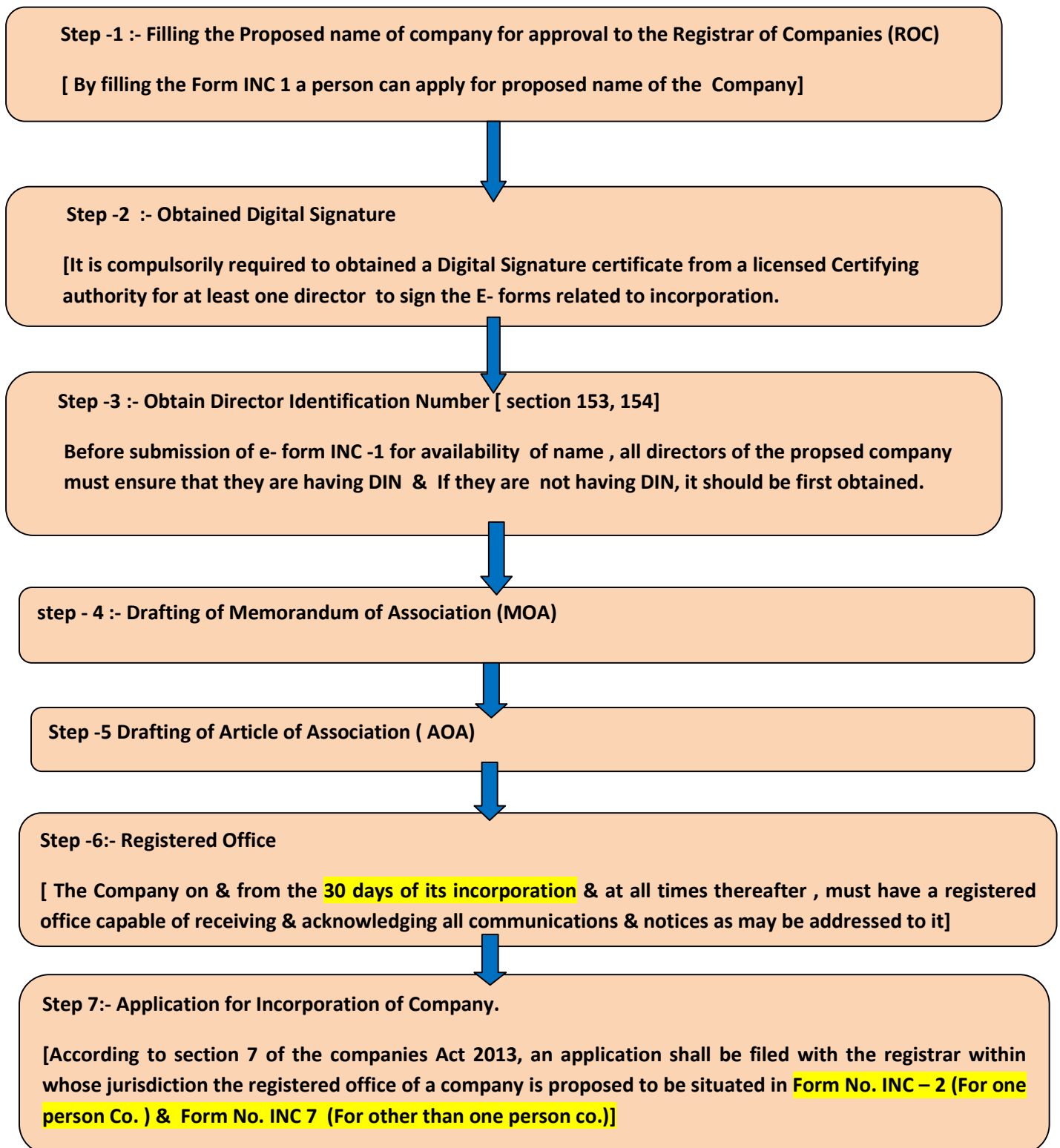
- 1) To conceive an idea & explore the possibilities of starting a business
- 2) To collect the requisite no. of person who will sign the memorandum & Articles of the company & also agree to act as the first directors of the Co.
- 3) To decide on the name of the Co., the location of its registered office, the appointment of banker, auditors, & legal advisor etc.

- 4) To get the Memorandum of Association & Article of Association of the proposed co., drafted, finalised & printed.
- 5) To pay for preliminary exp required for incorporation of the co.
- 6) To arrange for the preparation of prospectus.

## **INCORPORATION STAGE –**

Incorporation or Registration is the second stage in the formation of a company. A company is properly constituted only when it is duly registered under the Act & a Certificate of Incorporation has been obtained from the Registrar of Companies.

### **Steps for the Incorporation of Company**



## **Memorandum of Association [ Section 4]**

Memorandum of Association is a document which contains the fundamental rules regarding the constitution & activities of a co. It is the basic document which lays down how the co. is to be constituted & what are the types of work that it shall undertake. The purpose of the Memorandum is to enable the members of the Co. , its creditors & the public to know what its powers are & what is the range of its activities. It contains rules regarding capital structure, the liability of the members, the objects of the Co. & all other important matters relating to the company.

### **Contents of Memorandum of Association**

The Memorandum of Association of a Company shall contain the following clauses :-

1. **Name clause -** The name of the co will be ended with the word “Limited” in the case of a Public limited Company or the name of the co will be ended with the word “ Private Limited” in case of a Private Co. The name should not be considered undesirable & prohibited by the Central Govt.
2. **Situation Clause –** The state in which the registered office of the company is to be situated must be mentioned.
3. **Object Clause -** The object for which the company is proposed to be incorporated & any matter considered necessary in furtherance thereof.
4. **Liability Clause –** The Liability Clause of a Company states that the liability of its members is limited with the word unpaid, in case of a co. limited by shares. This means that the members can only be called upon to pay to the co. at any time the uncalled or unpaid amount on the shares held by them. The liability of the members is unlimited in case of Unlimited Company.
5. **Capital Clause –** The amount of share capital with which the company is to be registered & the division thereof into shares of a fixed amount & the number of shares which the subscribers to the memorandum agree to subscribe which shall not be less than one.  
The number of shares each subscriber to the memorandum intends to take , indicated opposite his name.
6. **Subscription Clause –** The memorandum has to be signed by each subscriber in presence of at least one witness. Each subscriber must written number of shares he shall take.

### **ALTERATION OF THE MEMORANDUM:-**

#### **a) Alteration of Name clause –**

- (i) **Change of name by special Resolutio**n- As per section 13(2) of the companies Act 2013, the name of the company can be changed by passing special Resolution at the general Meeting of the Company & getting the approval of the Central Government.

- (ii) **Change of name by Ordinary Resolution** - As per section 16(1) of the companies Act 2013, if through inadvertence or otherwise, a company on its 1<sup>st</sup> registration or on its registration by a new name, is registered by a name which in the opinion of the central Government is identical with or too nearly resembles the name by which an existing co. had been previously registered, it may direct the company to change its name within a period of 3 months from the issue of such direction.
- (iii) **New Certificate of Incorporation** – Where a co. changes its name or obtains a new name, it shall within a period of 15 days from the date of such change give notice of the change to the ROC along with the order of Central Govt. For this purpose the co. must apply in form no. INC 24 along with the requisite fees to the Registrar, who shall then issue a new certificate of Incorporation in form no. INC 25 consequent upon the change.

**b) Alteration in situation Clause-**

Change of situation or Registered office clause involve-

- **Change of Registered office from present Premises to another within the same city, Town or Village**

As per section 12(5)(a) of the companies Act 2013, by passing a special Resolution a Company can shift its Registered office from present Premises to another within the same city, Town or Village. The notice of such change shall be filed with the ROC within 15 days of such Change.

- **Change of Registered office from one city to another within the same state –**

For the purpose of changing the registered office from one city to another within the same state a Special Resolution is required to be taken.

- **Change of Registered office from one state to another state**

As per section 13 of the Companies Act 2013, a change of registered office from one state to another requires the approval of the members for alteration of the memorandum & also from the central Government. Form No. INC 23 has to be filled for this purpose. After getting the certificate of shifting the registered office from one state to another, this is filed in the prescribed form NO. INC 29 within 30 Days from the receipt of the certified copy.

- c) **Alteration in object Clause** –For change of object clause, a special Resolution has to be passed.
- d) **Alteration in Liability Clause** - A company limited by shares or guarantee cannot change its Memorandum, so as to impose any additional liability on the members or to compel them to buy additional shares of the company unless all the members agree in writing to such change either before or after the change .However, the limited liability of directors can be converted into unlimited liability, only by special Resolution provided articles authorises so. It must be intimated to registrar.

## **ARTICLE OF ASSOCIATION**

Article of Association is a document which prescribes the rules & bye – laws for the general management of the Company & for the attainment of its object as given in the memorandum. It defines the rights, duties, powers of the management of a company. An Article of Association is subsidiary to the memorandum of Association.

## **Contents of Article of Association –**

The Articles of Association contains provision related to the following:

1. Share Capital, right of shareholders, variation of rights & share certificate.
2. Lien of shares, Calls on shares, transfer of shares, forfeiture of shares.
3. Conversion of shares into stock, share warrants.
4. Alteration of capital
5. General Meeting & its procedure.
6. Voting rights of members.
7. Directors, appointment , qualification, remuneration & proceedings of the Board of Directors.
8. Capitalization of profits, Winding Up etc.

## **Alteration of Articles of Association**

A company may alter its Articles with a special resolution. Due importance & care should be given to ensure that the alteration of Articles of Association does not conflict with the provisions of the Memorandum of Association or the Companies Act. A copy of every special resolution altering the Articles must be filed with the Registrar within 30 days of its passing.

1. The Proposed alteration should not contravene the provision of the companies Act.
2. The Proposed alteration should not contravene the provision of the Memorandum Of Association.
3. The alteration should not propose anything that is illegal.
4. The alteration should be bonafide for the benefit of the Company.
5. The proposed alteration should in no way increase the liability of existing members.
6. Alteration can be made only by a special resolution.
7. Alteration can be done with retrospective effect.
8. The court does not have any power to order alteration of the Articles of Association

## **Difference between Memorandum of Association & Article of Association.**

Points of Difference	Memorandum of Association	Article of Association
1. Meaning	Memorandum of Association is the charter of the company. It contains those fundamental conditions upon which alone the company is granted incorporation.	Article of Association contain the rules & regulations for the internal management of the company.
2. Scope	Memorandum defines the objects & powers of the company. It fixes up the scope & the extent of activities of the company.	Articles form the bye-laws of the company.
3. Relation	Memorandum defines the relation between company & the outsiders	Articles regulate the relation between the company & its members.
4. Ratification	Things done by a company beyond the scope of the Memorandum are absolutely void & cannot be ratified.	Things done by a company beyond the Articles are simply irregular & not void & can easily be confirmed or subsequently ratified by the shareholders.
5. Alteration	Clauses of Memorandum cannot be easily altered. Prior permission of the central Government & tribunal is required.	Members have full control over the articles. They can alter the Articles by passing a special resolution provided other conditions are satisfied.

## **Doctrine of Constructive Notice**

The Doctrine of Constructive Notice is also popular as the doctrine of presumed notice. Presumed notice means every person dealing with the company is presumed to have read the conditions contained in the MOA & AOA.

Section 399 provides that the MOA & AOA when registered with the Registrar of companies “ become public documents” & then they can be inspected by any one by one by electronic means on payment of the prescribed fees. A company shall on payment of the prescribed fees send a copy of the following documents to a member within 7 days of the request being made by him.

1. The Memorandum of Association
2. The Article of Association
3. Every agreement & every resolution required to be filed with the registrar & referred to in sub section (1) of section 117, if & so far as they have not been embodied in the MOA & AOA. u/s

117(1) resolutions to be filed with ROC include special Resolution, resolutions agreed to by all the members, resolution to wind up the company voluntarily, etc.

Penalty: - Failure to supply the copy (ies) as above will make the company as well as every officer in default liable to a fine Rs. 1000 per day for each day of the default or Rs. 1, 00,000 whichever is less.

### **Doctrine of Indoor Management :-**

When the Article of Association of a company prescribe a particular procedure for doing a thing, the duty of carrying out the provisions lies on the persons in charge of the management of the company & outsiders are entitled to assume that the rules have been complied with. This is known as the "Doctrine of Indoor Management". It is an exception to the rule of constructive notice. As per the doctrine, a person dealing with a company is bound to read only the public documents.

### **Exception to the Doctrine of Indoor Management**

The Doctrine of indoor Management is however subject to certain exceptions. In other words, relief on the ground of "Indoor Management" cannot be claimed by an outsider dealing with the company in the few circumstances.

1. Where an outsider actually knows the internal irregularity, he cannot subsequently take shelter under the Indoor management.
2. Where an outsider is put suspicious as to the further enquiry into the Indoor Managements, he cannot subsequently plead the Indoor management rule for protection.
3. If a person relies upon a document that is forged.
4. A person who did not infact consults the AOA & MOA.

### **Certificate of Incorporation**

When the documents required for registration have been filed with the registrar & the necessary fees paid, the registrar will, if he is satisfied enter the name of the company on the Register of companies maintained by him & then will issue a certificate of Incorporation under his signature as token of registration of the company on the date noted on it. These certificates serve the same purpose in the case of a company which a birth certificate does in the case of a natural person.

On registration the company comes into existence as a legal person distinct from members who constitute it from the earliest moment of the day of incorporation stated in the certificate of incorporation, with rights & liabilities similar to a natural person, competent to enter into contract. The registrar shall issue a certificate of incorporation [Form No. INC 11 ] normally within 7 days of receipt of documents.

## **SUBSCRIPTION STAGE**

This is the third stage of Formation of a company & in this stage , the promoters of the company will decide the capital structure of their company & accordingly they can issue prospectus for raising money. But a private company is prohibited from inviting the public to invest in its shares & debentures. Therefore it obtains its necessary capital from friends & relatives through private placement. In the case of a Public Company, the promoters can either invite the public to subscribe to its shares & debentures or can arrange the capital privately.

## **Prospectus**

A prospectus is an invitation by a public company to the public to subscribe to its share capital. It is a significant tool, which helps the company to disclose its identity in the stock exchange. Interested investors may obtain it either directly from the company or through the company banker.

According to section 2(70) of the companies Act 2013, Prospectus means “ any document described or issued as a prospectus & includes a red herring prospectus referred to in section 32 or self prospectus referred to in section 31 or any notice, circular, advertisement or other document inviting offers from the public or inviting offers from the public for the subscription or purchase of any securities of a body corporate.”

It means that any document inviting offers or deposits of public subscription for shares or debentures is called prospectus. A document is considered as prospectus if it satisfies the following conditions:

1. It invites subscription or deposits of shares or debentures.
2. It is only for the Public.

As per section 23 of the companies Act 2013, the initial public offer of a public company is done through prospectus.

## **Contents of Prospectus [section 26]**

1. Names & Addresses of the registered office of the Company along with company secretary, chief Financial officer, auditor, Legal advisor, banker & underwriter.
2. Dates of the opening & closing of public issues, & the date of issue of allotment letter & refund.
3. A statement made by the Board of Directors with separate bank accounts where money has been transferred.
4. Details about the underwriters.
5. Consent of the Directors, Auditors, & banker regarding the issue.
6. Time schedule of allotment & issue of securities.
7. Objective of Public issue.
8. Capital Structure of the Company.
9. Minimum subscription, amount of premium, number of shares issued etc.
10. Report made by the auditor.

## **Types of Prospectus:-**

Prospectus is of various types & These are :-

1. Red Herring Prospectus
2. Shelf Prospectus
3. Deemed Prospectus
4. Abridged Prospectus

### **Red Herring Prospectus**

As per section 32 of the companies Act 2013, if a company proposing to make an offer of securities for acquiring fund, it may issue a Red Herring Prospectus, prior to the issue of a prospectus. Red herring prospectus means a prospectus which does not include complete particulars of the quantum or the price of the securities included therein. Such company shall file it with the registrar at least 3 days prior to the opening of the subscription list & the offer.

### **Shelf Prospectus**

As per section 31 of the companies Act 2013, 'shelf Prospectus' means a prospectus in respect of which the securities or class of securities included therein are issued for subscription in one or more issues over a certain period without the issue of s further prospectus.

### **Deemed Prospectus**

As per section 25 of the companies Act 2013, where a company allots or agrees to allot any securities of the company with a view to all or any of those securities being offered for sale to the public.

### **Abridged Prospectus**

As per section 33 of the companies Act 2013, no form of application for the purchase of any securities of a company shall be issued unless such form is accompanied by an abridged prospectus.