

## CHP. 4 DOCUMENTS RELATED TO FORMATION OF A JOINT STOCK COMPANY.

**Q.1 Select the correct answer from the option given below and rewrite the sentences.**

1) .....is a primary document of the company which contains the aims and objectives of the company.

a) **Memorandum of Association** b) Articles of Association c) Prospectus

2) ..... describes the relationship between company and outsiders.

a) **Memorandum of Association** b) Articles of Association c) Prospectus

3) The..... Clause describes the range of activities a company can undertake.

a) Name b) Capital c) **Object**

4) Any act done by the company beyond the powers of Memorandum is called as.....

a) Doctrine of Indoor management b) **Ultra Vires** c) Mis-statement

5) ..... acts are void or legally ineffective.

a) Object clause b) Main Object c) **Ultra Vires**

6) ..... clause contains the details of liability of the members.

a) Name b) **Liability** c) Object

7) ..... clause states the amount of Authorised capital with which the company is registered.

a) Liability b) Object c) **Capital**

8) ..... contains rules and regulations for internal management of the company

**A) Articles of Association** b) Prospectus c) Memorandum of Association

9) Articles establishes relationship between company and.....

a) **Members** b) Outsiders c) ROC

10) ..... is an invitation to the public to subscribe for the shares of the Company

a) Memorandum b) **Prospectus** c) Articles of Association

11) For making multiple issues of shares within a year, a company can prepare a..... Prospectus. '

a) Abridged b) **Shelf** c) Red Herring

12) ..... is an incomplete prospectus.

a) **Red Herring Prospectus** b) Shelf Prospectus c) Abridged Prospectus.

**Q.2 Match the pairs:**

Group A	Answer
Capital clause	<b>Detail of capital structure of a company</b>
Liability clause	<b>Extent of liability of member</b>
Acts beyond the power of memorandum	<b>Ultra vires</b>
Red herring prospectus	<b>Incomplete prospectus</b>
Shelf prospectus	<b>Used for multiple issues of shares</b>

**C. Write a word or a term or a phrase which can substitute each of the following statement,**

1) Primary document of a company which states aims and objectives of a company,

**Ans: Memorandum of association.**

2) Document which contains, Name Clause, Registered Office Clause, Capital Clause, etc.

**Ans: Memorandum of association**

3) Document which is subordinate to the Memorandum of Association.

**Ans: Memorandum of association**

4) Document which establishes company's relationship with outsiders.

**Ans: Memorandum of association**

5) Document which states the limits within which a company has to operate.

**Ans: Articles of association**

6) Document which contains rules and regulations for internal management.

**Ans: Articles of association**

7) Term used for acts beyond the scope of Memorandum of Association.

**Ans: Ultra vires**

8) Clause which describes the main activities a company can undertake.

**Ans: Object causes**

9) Clause which gives details of authorized capital or Registered Capital.

**Ans: Capital causes**

10) Clause which describes the extent of liability of members.

**Ans: Liability clauses**

11) Last clause of Memorandum which contains name, signature and other details of all the subscribers to the Memorandum.

**Ans: Association or subscription causes**

12) Document which establishes relationship between a company and its members.

**Ans: Article of association**

13) Document issued by public company inviting public to subscribe to its shares.

**Ans: Prospectus.**

14) Prospectus attached with every share application form.

**Ans: Abridge prospects.**

15) Prospectus used for multiple issue of shares within a year.

**Ans: shelf prospectus**

16) It is an incomplete prospectus.

**Ans: Red herring prospectus**

17) This prospectus does not contain information about quantum of shares to be issued or the price at which shares will be issued.

**Ans: Red herring prospectus**

**D) State whether the following statements are True or False:**

1) Memorandum of Association and Articles of Association is prepared at the time of incorporation of a company.

**Ans: True.**

2) Memorandum of Association describes the nature and character of the company.

**Ans: True.**

3) Memorandum establishes relationship between Company and Members.

**Ans: False**

4) Any act done by the company beyond the powers of Memorandum is Ultra Vires.

**Ans: True.**

5) Articles of Association can have provisions which contradicts the Memorandum.

**Ans: False**

6) Memorandum need not have a Liability Clause.

**Ans: False**

7) Articles of Association is subordinate to Memorandum.

**Ans: True.**

8) Memorandum contains rules and regulations for internal management of a company.

**Ans: False**

9) Every subscriber who signs the Memorandum must also sign the Articles.

**Ans: True.**

10) Entrenched Articles cannot be easily altered.

**Ans: True.**

11) Prospectus can be issued by a private company.

**Ans: False**

12) Only public companies can issue Prospectus.

**Ans: True.**

13) Prospectus must be issued within 1 year from the date of tiling it with the ROC.

**Ans: False**

14) Actions can be taken against a company or its officers for misstatements in prospectus.

**Ans: True.**

15) Every company has to issue shelf prospectus every time it offers shares to the public.

**Ans: False**

16) Red Herring prospectus does not contain details of the price at which shares will be sold by the company.

**Ans: True.**

17) Letter of offer is issued at the time of Rights Issue.

**Ans: True.**

### **E) Find the odd one.**

1) Name, Clause, Rights of Board Directors, Object clause.

**Ans: Rights of Board Directors.**

2) Rights of shareholders, Appointment and remuneration of Directors, Liability clause.

**Ans: Liability clause.**

3) Shelf prospectus, Abridged Prospectus, Articles of Association.

**Ans: Articles of Association.**

**F) Complete the sentences.**

1) The documents which states the aims and objectives of a company is called as .....

**Ans: Memorandum of association**

2) Any act done by the company which goes beyond the powers of Memorandum of Association will be called as.....

**Ans: Ultra vires.**

3) The document which is subordinate to the Memorandum of Association is called .....

**Ans: Article of association.**

4) The document which contains the rules and regulations governing internal management of a company is called.....

**Ans: Article of association.**

5) The document issued by a company to invite investors to buy its securities is called as

**Ans: Prospectus.**

**G) Select the correct option from the bracket.**

Sr no	Group A	Group B
1	<b>Primary documents</b>	Memorandum of association.
2	Liability clause	<b>Detail of liability of members</b>
3	Incomplete prospectus	<b>Red herring prospectus</b>
4	<b>Article of association</b>	Establishes relation between company and its member

**H) Answer in one sentences:**

(1) Which document contains the aims and objectives of the company?

**Ans. Memorandum of Association contains the aims and objectives of the company.**

(2) What does the capital clause describe?

**Ans. The capital clause of Memorandum of Association describes the amount of capital with which the company is registered.**

(3) When is Abridged Prospectus issued?

**Ans. Abridged prospectus is issued when company offers its securities to the public.**

**I) Correct the underlined word and rewrite the following sentences:**

(1) Articles of Association state the aims and objectives of the company.

**Ans. Memorandum of Association states the aims and objectives of the company.**

(2) Prospectus is subordinate to Memorandum of Association.

**Ans: Articles of Association is subordinate to memorandum of Association.**

(3) Prospectus contains liability clause.

**Ans: Memorandum of Association contains liability.**

**J) Arrange in proper order:**

1) a) Subscription clause.

b) Name clause.

c) Object clause.

**Ans: b) Name clause.**

**c) Object clause.**

**a) Subscription clause.**

**Q.2 explains the following terms and concept:**

**(1) Memorandum of Association.**

**Ans.**

**(1) Meaning:** The Memorandum of Association is the basic, fundamental and principal document of a company with which the company is registered. It serves as the constitution of the company. It defines the scope of the activities of the company, relationship of the company with the outside world, its objects, the extent of and limitations to the powers of a company.

**(2) Clauses :** It contains six clauses, viz., (1) the name clause (2) the address clause (3) the objects clause (4) the liability clause (5) the capital clause and (6) the association or

subscription clause.

**(3) Purpose:** The purpose of the Memorandum is to enable the shareholders, creditors and all those who deal with the company to know the permitted range of the activities of the company.

## **(2) Articles of Association :**

**Ans.**

**(1) Meaning:** The Articles of Association is the second important document of the company. This document is subordinate (Secondary) to Memorandum of Association which contains the by-Laws, the rules and regulations relating to the internal management of the company. It sets out the rights, duties and powers of the Board of Directors, officers and members of the company.

**(2) Contents:** Articles of Association contains rules and regulations of issue of share, calls on shares, forfeiture of shares, procedure for transfer and transmission of shares and debentures, etc. It also lays down the powers, duties and rights of the governing body of the company.

**(3) Other information:** Articles of Association establishes the relationship between company and members and between the members. Companies Act has shown the format in the form of Model Articles of Association, tables F, G, H, I and J for preparing the Articles of Association for different types of companies.

## **3) Name clause:**

**Ans:** Name clause mentions the name of the company. A company can choose any suitable name subject to the following restrictions:

(a) The name of the company should not resemble or be identical with the name of any other existing company.

(b) The name should not use the words like 'Government', 'State', 'Municipality', Emperor, King, Royal, Imperial, President of India, or any words that denote the government support or the patronage of the ruling power.

(c) The name of a public company must end with the word 'Limited'. The name of a private company must end with the words 'Private Limited'.

(d) The name of the company should not be suggestive of the support of any political party.

(e) The name or its words should not offend any section of people or society.

(f) The name of the company should not be objectionable under the provisions of the Emblems and Name Act, 1950.





- (g) The name of the company should not be related with person, leader or party.
- (h) The company should suggest at least 3 names.
- (i) The name of the company can be altered at any time by the company by passing a special resolution in general meeting and by getting the approval of the Central Government in Writing.

#### **4) The objective clause.**

**Ans:** According to Section 13 (1) (d) of the Companies Act, 1956, the objects clause of the Memorandum of Association

states the objects and purposes of the company for which it is formed. It lays down the boundaries for the operations and the powers of the company. The shareholders also come to know as to how and where their investment is employed.

The objects are classified as (1) the main objects (2) incidental objects and (3) other objects. Under the 'main objects', the main objects to be pursued by the company on its incorporation are stated. In 'incidental objects', the secondary Objects to be achieved along with the attainment of the main objects are stated. Under the 'other objects', any other objects, not stated under 'main objects' and 'incidental objects' are stated.

#### **5) Liability clauses:**

**Ans:** As per Section 13 (2) of the Companies Act, 1956, the liability clause of the Memorandum of Association of a company limited by shares states that the liability of its shareholders is limited to the face value of shares purchased by them. It means the shareholders are liable to pay unpaid amount on their shares. In the initial stages, the company may make the liability of the Directors unlimited, if it is agreed by the Directors. This is to create confidence in the minds of the investors. An unlimited company does not have this clause in the Memorandum of Association. In the case of a company limited by guarantee, this clause states that the liability of its members is limited to the amount of the guarantee given by them. The amount payable by each member in the case of winding-up of the company is mentioned in this clause.

#### **6) The capital clauses:**

**Ans:** The capital clause mentions the total share capital of the company with which it is registered, i.e. authorized capital. This is the maximum capital which company is authorised to raise. This clause also mentions types of shares, the face value of each



type of shares, their number, etc. This clause further states the rights attached to each class of shares. According to provisions of the Companies Act, 1956, company is permitted to issue two types of shares, viz. Equity shares and Preference shares. The company has to alter this clause, if company needs more fund than the amount of authorised capital. The Articles of Association of a company gives power to the company to alter its capital clause. A company can alter capital clause by passing an ordinary resolution in the General meeting of the company.

### **7) Registered Office Clause:**

**Ans:** This clause of the Memorandum of Association mentions the state in which the registered office of the company is to be situated. The company which is incorporated, must have its registered office within 30 days of its incorporation. The address of registered office helps to : (i) determine its domicile, nationality and jurisdiction of the court under Which it comes (ii) know the place where its various statutory books such as the register of members, register of debenture holders, register of charges, minutes books, documents and papers, etc., must be kept (iii) show where all notices and other communications can be sent.

### **8) Ultra Vires act.**

**Ans.** (1) the term 'ultra' means beyond and the term 'Vires' means powers. Accordingly 'Ultra Vires' means beyond or outside the scope of powers or authorities of Memorandum. Thus the doctrine of ultra Vires specifies that any activity done by a company which is beyond the power or authority of Memorandum or company will be null and void.

(2) The act which is ultra Vires is legally ineffective even if such act is ratified by the members later on. For ultra Vires acts, the company cannot sue anybody in the court of law. Similarly, third party for such ultra Vires act cannot sue company in the court of Law for any compensation. The members of the company can get an order issued from the court to stop the company from doing ultra Vires act.

### **9) Doctrine of Indoor Management.**

**Ans.** (1) In order to maintain business secrecy, it is obligatory on the part of the company management and its officers that certain information which are important and confidential should not be leaked or known to the outsiders. Therefore, directors and officers of the company must act in accordance with the information they get from Memorandum of Association and Articles of Association.

(2) The doctrine indoor management explains that the third parties or persons entering into a contract With the company are not bound to inquire Whether the company or its officers have followed the internal proceedings mentioned in the Articles of the company or not. It is presumed that company acts as per the provisions made in its Memorandum



of Association and Articles of Association. Thus, the doctrine of indoor management safeguards the interest of outsiders Who deal with the company in good faith and without malafide interest.

### 10) Prospectus.

**Ans.** (1) Prospectus refers to any document, statement, notice, circular or advertisement, issued by the company to invite the public to purchase its shares or debentures or to deposit money with it. In other words, a prospectus is a document issued by public company publishing the highlights and business prospects of the company and thereby wishing to sell newly issued shares or debentures to the public. (2) It should satisfy two conditions, viz. (a) It Invites subscriptions for shares or debentures or:ntvtttes deposits, (b) This invitation ts made to the public at large. A private need not me a prospectus With the Registrar. (e) Every person connected with the issue of the prospectus is liable for misstatement in the prospectus. Such liability may be a civil and/ or a criminal liability.

### 11) Misstatement in Prospectus.

**Ans.** (1) Misstatement means and includes a false statement, irrelevant statement or omission to disclose a relevant statements. Prospectus constitutes the basis of the company's contract between the company and the shareholders. Hence. it should contain true and correct information. There should be full and honest disclosure of all essential facts. A prospectus which contains false. misleading, ambiguous or fraudulent statement of material facts, or which suppresses material facts. is considered to be a misleading prospectus.

### 12) Abridged Prospectus.

**Ans.** (1) Accordingly, abridged prospectus is a summary of the prospectus containing such details as prescribed by the Securities Exchange Board of India (SEBI). 'The Companies Act 2013 defines Abridged prospectus as a memorandum containing such salient features of a prospectus as may be specified by the Securities Exchange Board by making regulations in this behalf.

(2) In brief it contains the main contents of a prospectus but in brief. Abridged prospectus 15 always attached with the application form issued by the company while offering its securities. It is issued only in case of public offer made by 3 company.

### 13) Shelf Prospectus.

**Ans.** (1) Shelf prospectus is a type of public offering where certain issuers (companies) are allowed to offer and sell securities to the public without a separate prospectus for each act of offering and without the ' issue of further prospectus. Instead there is a single prospectus for multiple, undefined future offerings. The prospectus may be used to offer

securities for up to one year from the date of first offering of securities under that prospectus.

(2) The issuer (company) is required to file an Information Memorandum which contains latest information about the company With the ROC every time a subsequent offer of securities is made during the validity period of the shelf prospectus.

#### **14) Red Herring Prospectus.**

**Ans:** (1) A red herring prospectus is a first or preliminary prospectus is a document submitted by the issuer (company) as a part of a public offering of securities. Potential investors may not place buy orders for the securities based solely on the information contained within the preliminary prospectus.

(2) Red herring prospectus is an incomplete prospectus as it does not include complete information of quality of securities offered and issued price of securities being offered. It is usually issue by the newly established company at the time of Initial Public Offer (IPO) of the company. A company must file a Red herring prospectus with Registrar of Companies (ROC) at least 3 days prior to the opening of subscription list and the offer.

#### **Q.3 Study the following case / situation and express your opinion :**

(1) The Articles of a company stated that while borrowing any money from outsiders. The document must have the signatures of the Managing Director (MD) and any one of the Director. The Articles of Association clearly stated the procedure to be followed while borrowing money. The Managing Director did not follow all the procedures but still borrowed money from Mr. X. Mr. X assumed that the MD has followed the required procedures:

- (a) Can the MD be held punishable for his act?
- (b) Under which Doctrine can Mr. X take action against the company?
- (c) Explain the Doctrine.

**Ans. (a) The Managing Director (MD) can be held punishable for this act.**

**(b) Under the doctrine of indoor management Mr. X can take action against the company.**

**(c) Doctrine of indoor management specifies that persons (third parties) entering into a contract with the company are not found to inquire or know whether the company or its MD or officers have properly followed the internal proceedings as stated in the Articles or not. As per the doctrine of indoor management it is assumed that the company or its MD or Officer acts as per Memorandum and Articles of Association. This doctrine protects the interest of the outsiders when they are unaware of the correctness of the internal proceedings of the company.**

(2) Mr. A entered into a contract with Star Limited Company and as advance payment gave a cheque of Rs 1 lac to a Director Mr. Sam. Mr. Sam is not the Managing Director. Articles states that only the MD is authorized to sign any contracts or receive any payments on behalf of the company:

(a) Did Mr. Sam have the authority to accept the cheque? Why?

(b) Can Mr. Sam's action be called as Ultra Vires? Why?

**Ans. (a) Mr. Sam does not have authority to accept the cheque from outside party because Mr. Sam although a director but not a managing director of the company. As per' the provisions made in the articles only managing director have authority to sign contracts and receive any payment.**

**(b) Mr. Sam's action can be called as ultra Vires because accepting a cheque of Rs 1 lac, by a director Mr. Sam, is an act beyond the scope and authority or power of articles of the company.**

3) The Object Clause of Memorandum of a company stated the main object as manufacturing of plastic chairs and tables and any other activity in furtherance of achievement of its main

activity. The Board of Directors wants to now also produce TV Serials and feels that the shareholders may give their permission :

(a) Can the company with immediate effect start producing TV. Serials? Why?

(b) How can the object clause of the company be altered?

**Ans. (a) The company (the Board of Directors) cannot start producing TV serials immediately. This is because producing a TV serials is not the main as well as ancillary object for Which company is incorporated. A company cannot do anything beyond or outside the scope of the objects. The object of producing TV serials is completely different object from the main object of manufacturing plastic chairs and tables.**

**(b) Object clause of the company can be changed by passing a special resolution in the General Meeting of the shareholders. The resolution which is passed by 3/4th (75%) majority of votes is called special resolution.**

4) A public limited company has issued all the shares mentioned in its Memorandum as Authorized Capital. Now the Company wants to make a public issue of 10,000 shares at face value of Rs 100 Per share, to raise more funds for its expansion activities :

- (a) Which clause of Memorandum needs to be altered?
- (b) In which meeting the alteration can be approved?
- (c) Which document should the company issue to invite the public to buy its shares?

**Ans. (a) The capital clause needs to be altered to raise capital more than its authorised capital.**

**(b) The capital clause can be altered by passing an ordinary resolution in the General Meeting of the shareholders.**

**(c) The company has to issue the document called 'Prospectus' to invite the public to buy its shares.**

5) A Company stated in its prospectus that it has been making profits since the last 5 years. However, Mr. X. an investor found out that two years back the company had not made any profit. The prospectus was filed with the ROC on 1st Jan, 2017 and was issued to the public on 10th Feb 2018 :

- (a) Can Mr. X state that there was a misstatement in the prospectus?
- (b) If found guilty which two types of liability will the company and its officers face?
- (c) Can the prospectus be valid for issue to the public on 10th Feb 2018.

**Ans. (a) Mr. X can state that there was a misstatement in the prospectus.**

**(b) If found guilty the company and its officers will face civil liability and criminal liability for misstatement in the prospectus.**

**(c) Prospectus cannot be valid for issue to the public on 10th February 2018.**

6) A Company plans to offer Rights Issue;

- (a) Which document must it send to it? Shareholders for offering the Rights Issue?
- (b) Instead of Rights Issue, if the company wants to issue shares to the public, which document must it issue for inviting the public to subscribe for it?
- (c) Name the document which is called as incomplete prospectus.

**Ans. (a) A document (Prospectus) called 'Letter of Offer' a company must send to its shareholders for offering the Right issue.**

**(b) If the company wants to issue shares to the public, for inviting the public to subscribe for it. the company has to issue Abridged prospectus.**

**(c) Red herring prospectus is called incomplete prospectus.**

**Q.4 Distinguish between the following :**

**1) Memorandum of association and articles of association :**

**Ans:**



Sr no	Memorandum of association	articles of association :
1	Memorandum of Association is the primary, fundamental and main document of the company which lays down its constitution and defines its objects and the scope of its activities.	The Articles of Association is a secondary, subsidiary and subordinate document of the company which lays down the rules and regulations for the internal management of the company.
2	It is the basic, fundamental, primary and supreme document of the company. It is life giving document.	It is a secondary and subordinate document. It is subordinate to the Memorandum of Association.
3	It defines the scope of the activities of the company, its objects and their limits or the area beyond Which the activities of the company cannot go. It fixes the area of its operation.	It lays down the rules for carrying out the objects of the company. The rules are meant for the internal management of the company within the area defined by the Memorandum.
4	It defines the relationship of the company with the outsiders, e.g. buyers, sellers, creditors, debtors, etc.	It defines the relationship between company and members and also between members. It has nothing to do with the outsiders.
5	Every company irrespective of its types, nature and size must prepare and file its own memorandum. No company under the Companies Act can be registered Without	Every company must prepare and file its own articles. However, a public company may adopt table A of the Companies Act, 1956, as its articles.



	the Memorandum of Association.	
<b>6</b>	The procedure for the amendment or alteration is very difficult. It requires ordinary or special resolution, sanctioned by the Central Government or the Company Law Board or the Court.	The procedure for alteration is relatively simple. The Articles can be altered subject to the Companies Act and general law, provided the alterations are intra vires the Memorandum and they are in the interest of the company as a whole.

### Q.5 Answer in brief:

#### 1) State any four clauses of memorandum of association:

**Ans:** Clause of Memorandum :

- (1) Name Clause 3 Name clause mentions the name of the company. A company can choose any suitable name subject to the following restrictions :
- The name of the company should not resemble or be identical with the name of any other existing company.
  - The name should not use the words like 'Government', 'State', 'Municipality', Emperor, King, Royal, Imperial, President of India, or any words that denote the government support or the patronage of the ruling power.
  - The name of a public company must end with the word 'Limited'. The name of a private company must end with the words 'Private Limited'.
  - The name of the company should not be suggestive of the support of any political party.
  - The name or its words should not offend any section of people or society.
  - The name of the company should not be objectionable under the provisions of the Emblems and Name Act. 1950.
  - The name of the company should not be related with person. Leader or party.
  - The company should. Suggest at least 3 names.
  - The name of the company can be altered at any time by the company by passing a special resolution in general meeting and by getting the approval of the Central Government in writing.

**(2) Address Clause (Registered Office Clause) :** This clause of the Memorandum of Association mentions the state in which the registered office of the company is to be



situated. The company which is incorporated, must have its registered office within 30 days of its incorporation. The address of registered office helps to : (i) determine its domicile, nationality and jurisdiction of the court under which it comes (ii) know the place where its various statutory books such as the register of members, register of debenture holders, register of charges, minutes books, documents and papers, etc., must be kept (iii) show where all notices and other communications can be sent.

**(3) The Objects Clause :** According to Section 13 (1) (d) of the Companies Act, 1956, the objects clause of the Memorandum of Association states the objects and purposes of the company for which it is formed. It lays down the boundaries for the operations and the powers of the company. The shareholders also come to know as to how and where their investment is employed. The objects are classified as (1) the main objects (2) incidental objects and (3) other objects. Under the 'main objects', the main objects to be pursued by the company on its incorporation are stated. In 'incidental objects', the secondary objects to be achieved along with the attainment of the main objects are stated. Under the 'other objects', any other objects, not stated under 'main objects' and 'incidental objects' are stated.

**(4) Liability Clause :** As per Section 13 (2) of the Companies Act, 1956, the liability clause of the Memorandum of Association of a company limited by shares states that the liability of its shareholders is limited to the face value of shares purchased by them. It means the shareholders are liable to pay unpaid amount on their shares. In the initial stages, the company may make the liability of the Directors unlimited, if it is agreed by the Directors. This is to create confidence in the minds of the investors. An unlimited company does not have this clause in the Memorandum of Association. In the case of a company limited by guarantee, this clause states that the liability of its members is limited to the amount of the guarantee given by them. The amount payable by each member in the case of winding-up of the company is mentioned in this clause.

**(5) The Capital Clause :** The capital clause mentions the total share capital of the company with which it is registered, i.e. authorized capital. This is the maximum capital which company is authorised to raise. This clause also mentions types of shares. The face value of each type of shares, their number, etc.. This clause further states the rights attached to each class of shares. According to provisions of the Companies Act, 1956, company is permitted to issue two types of shares, viz. Equity shares and Preference shares. The company has to alter this clause. if company needs more fund than the amount of authorised capital. The Articles of Association of a company gives power to the company to alter its capital clause. A company can alter capital clause by passing an ordinary resolution in the General meeting of the company.



## **(6) The Association or Subscription**

**Clause :** This clause states that the persons who sign the Memorandum are desirous of forming themselves into a company to achieve the objects mentioned in the Memorandum and those they' agree to take up the number of shares in the company, mentioned against their names. This clause mentions the name, address. Occupation of each subscriber and also states that the signatories have agreed to purchase at least one share of the company. This clause may mention the number of shares agreed to be purchased by the signatories. This clause also contains signatures of signatories.

## **2) State any four content of articles of association:**

**Ans:** The Articles of Association lays down the procedure and rules regarding the following matters or issues:

- (1) Company's share capital and its division into the equity shares and preference shares. Rights of shareholders, variation of these rights.
- (2) Rights of each class of shareholders and procedure for changing their rights.
- (3) Procedure relating to allotment and calls on shares.
- (4) Rules relating to transfer and transmission of shares.
- (5) Lien on shares.
- (6) Increase, reduction or alteration of share capital.
- (7) Procedure for conversion of shares into stock.
- (8) Share warrants.
- (9) Conducting General Meetings.
- (10) Voting rights of members, proxies and polls.
- (11) Directors and officers, their qualification shares, appointment, remuneration, etc.
- (12) Conducting Board Meetings and General Meetings.
- (13) Appointments, powers, duties, qualifications, remuneration, removal, etc. of Managing Directors, Manager and Secretary.
- (14) Audit of accounts, transfer of money to Reserves declaration of dividend, etc.
- (15) Borrowing powers of the company and mode of borrowings.
- (16) Issue of share certificate and procedure for issue of duplicate share certificate.
- (17) Constitution and composition of various committees such as Audit Committee, Remuneration Committee, Corporate Social Responsibility Committee.
- (18) Books of Accounts, registers, annual accounts and audit.
- (19) Capitalisation of profit.
- (20) Investments of the company.
- (21) Use of Common Seal of the company.
- (22) Notices, Indemnity.
- (23) Winding-up.
- (24) Arbitration provisions, if any.



### **(3) State the statutory requirements in relation to Prospectus.**

#### **Ans. The statutory requirements in relation to Prospectus :**

- (1) Availability to the public : Draft Prospectus to be made available to the public. The draft prospectus filed with the Securities Exchange Board of India (SEBI) should be made available to the public as well as to the Stock Exchanges where company wants to list its shares and other securities.
- (2) Signed by the Directors : Prospectus must be signed by all the directors or by the duly authorised attorney.
- (3) Registration of Prospectus : The copy of the prospectus should be filed With the Registrar of Companies (ROC) before it is issued to the public.
- (4) Dating of Prospectus : Prospectus must be dated. The date of publication of the prospectus is to be mentioned on the prospectus.
- (5) Issuing prospectus to the public : The prospectus should be issued to the public within 90 days from the date of registering a copy with the Registrar of Companies (ROC).

### **Q.6 Justify the following statements :**

#### **(1) Memorandum of Association defines the limitations of the powers of the company**

##### **Ans.**

- (i) Memorandum of Association is the basic fundamental and principle document of a company with which the company is registered. It is a charter of the company. It serves as the constitution of the company. It defines company's objects and lays down the fundamental conditions upon which the company is allowed to be formed.
- (ii) According to Lord Cairns, the Memorandum of Association of the company is its charter and defines the Limitations for of the powers of the company. This definition specifies that Memorandum of Association is a document which describes the constitution of the company and its rights or privileges. It states the powers of the company Le. What it can do and what it cannot do. In brief, Memorandum of Association defines the scope of the activities of the company, relationship of the company with the outside world, its objects, the extent of and limitations of the powers of the company.

#### **(2) Ultra Vires acts are null and void :**

- Ans.** (i) A Memorandum of Association of a company lays down the boundaries within which the company must conduct its activities. It also defines the scope or the extent of

the company's powers. The term 'Ultra Vires' means beyond the legal power or authority of a person, corporation, agent, etc. Any act of the company whether it is legal or illegal done outside the permitted range of activities as laid down in the Memorandum is said to be ultra Vires. Ultra Vires acts are null and void, i.e. It will be invalid and legally ineffective and therefore, not binding on the company.

(ii) Any act of the company which is ultra Vires. Is declared void and cannot be ratified later on even by the whole body of the shareholders. On the contrary, any act which is ultra Vires the Articles but intra Vires the Memorandum can be ratified by the shareholders.

### **(3) Contents of Articles can be altered.**

**Ans.** (1) The definition of 'Articles of Association' permits its alteration from time to time whenever found necessary. However, the proposed alteration must be subject to the provisions of the Companies Act and the conditions contained in the Memorandum. The alteration must be approved by passing a Special resolution in general meeting. Alteration in the articles, bind the members as like original articles.

(2) A company can alter the contents of Articles in the following ways:

- (i) By adopting a new set of an article.
- (ii) By deleting unwanted contents from the articles.
- (iii) By addition of a new content.
- (iv) By substitution of contents.
- (v) By amendment of contents.

### **4) Doctrine of Indoor Management protects outsiders who are unaware of the correctness of internal proceedings of a company.**

**Ans.** (1) In order to maintain business secrecy, it is obligatory on the part of the company management and its officers that certain information which are important and confidential should not be leaked or known to the outsiders. Therefore, directors and officers of the company must act in accordance with the information they get from Memorandum of Association and Articles of Association.

(2) The doctrine indoor management explains that the third parties or persons entering into a contract with the company are not bound to inquire whether the company or its officers have followed the internal proceedings mentioned in the Articles of the company or not. It is presumed that company acts as per the provisions made in its Memorandum of Association and Articles of Association. Thus, the doctrine of indoor management safeguards the interest of outsiders who deal with the company in good faith and without managed interest.



**(5) Prospectus is an important document issued by a public company.**

**Ans.** (1) A prospectus is a legal document because it is an 'invitation to offer'. It consists of the terms and conditions on the basis of which shares and debentures are issued to the public and prospective investor. This document officially informs the public about the formation and establishment of a public limited company. The different aspects of the company, viz. its aims, objects, financial history, capital structure and profitability of the proposed company.

(2) A prospectus is a document (i.e. medium) through which the company creates impression and approaches the public to invite them to buy its shares and debentures. The company in the form of prospectus, creates permanent and authentic record of the terms and conditions on the basis of which the public have been invited to purchase its shares and debentures. By filing a copy of the prospectus with the Registrar of the Companies, before issuing it to the public, a public limited company fulfils the statutory requirements.

**(6) Company and officers responsible for issuing Prospectus are liable for misstatements in Prospectus.**

**Ans.** (1) A prospectus constitutes the basis of the company's contract between the company and the shareholders. Hence it must disclose all the material facts which may influence the judgement of a prospective investor to buy shares or debentures. A Prospectus which contains false misleading, ambiguous or fraudulent statements of material facts, or which suppresses material facts, is considered to be a misleading prospectus. Any misstatement in the prospectus gives rise to civil as well as criminal liability. If a prospective investor is misled by some statement in the prospectus and thereby suffers any loss, he is entitled "to proceed against those who misled him.

(2) A person who purchases the shares on the basis of some misstatements made in the prospectus can avoid the contract and claim compensation for the loss or damage in a civil action against the company concerned. A company may, then, recover the same damages from the Directors or promoters concerned. The victimized person can also rescind the allotment of shares: and claim refund of the money paid by him and sue: the company in the court of law for damages. Every person making the misstatement in the prospectus is punishable with an imprisonment for a period up to 2 years or with a fine up to Rs 5,000 or both. The Companies Act provides that only promoters and Directors are liable for criminal punishment.

**Q.7 Answer the following questions :**



### 1) Briefly explain the clauses of Memorandum of Association.

**Ans.** Clauses of Memorandum :

**(1) Name Clause :** Name clause mentions the name of the company. A company can choose any suitable name subject to the following restrictions :

(a) The name of the company should not resemble or be identical with the name of any other existing company.

(b) The name should not use the words like 'Government', 'State', 'Municipality', Emperor, King, Royal, Imperial, President of India, or any words that denote the government support or the patronage of the ruling power.

(c) The name of a public company must end with the word 'Limited'. The name of a private company must end with the words 'Private Limited'.

(d) The name of the company should not be suggestive of the support of any political party.

(e) The name or its words should not offend any section of people or society.

(f) The name of the company should not be objectionable under the provisions of the Emblems and Name Act, 1950.

(g) The name of the company should not be related with person, leader or party.

(h) The company should suggest at least 3 names.

(i) The name of the company can be altered at any time by the company by passing a special resolution in general meeting and by getting the approval of the Central Government in writing.

**(2) Address Clause (Registered Office Clause) :** This clause of the Memorandum of Association mentions the state in which the registered office of the company is to be situated. The company

which is incorporated, must have its registered office within 30 days of its incorporation.

The address of registered office helps to (1) determine its domicile, nationality and jurisdiction of the court under which it comes (ii) know the place where its various statutory books such as the register of members, register of debenture holders, register of charges, minutes books, documents and papers, etc., must be kept (iii) show where all notices and other communications can be sent.

**(3) The Objects Clause :** According to Section 13 (l) (d) of the Companies Act, 1956, the objects clause of the Memorandum of Association states the objects and purposes of the company for which it is formed. It lays down the boundaries for the operations and the powers of the company. The shareholders also come to know as to how and where their investment is employed.

The objects are classified as (1) the main objects (2) incidental objects and (3) other objects.

Under the 'main objects', the main objects to be pursued by the company on its incorporation are stated. In 'incidental objects', the secondary objects to be achieved



along with the attainment Of the main objects are stated. Under the 'other objects'. any other objects, not stated under 'main objects' and 'incidental objects' are stated.

**(4) Liability Clause :** As per Section 13 (2) of the Companies Act, 1956, the liability clause of the Memorandum of Association of a company limited by shares states that the liability of its shareholders is limited to the face value of shares purchased by them. It means the shareholders are liable to pay unpaid amount on their shares. In the initial stages the company may make the liability of the Directors unlimited, if it is agreed by the Directors. This is to create confidence in the minds of the investors. An unlimited company does not have this clause in the Memorandum of Association. In the case of a company limited by guarantee, this clause states that the liability of its members is limited to the amount of the guarantee given by them. The amount payable by each member in the case of winding-up of the company is mentioned in this clause.

**(5) The Capital Clause :** The capital clause mentions the total share capital of the company with which it is registered, i.e. authorized capital. This is the maximum capital which company is authorised to raise. This clause also mentions types of shares. the face value of each type of shares, their number. etc. This clause further states the rights attached to each class of shares. According to provisions of the Companies Act, 1956, company is permitted to issue two types of shares, viz. Equity shares and Preference shares. The company has to alter this clause, if company needs more funds than the amount of authorised capital. The Articles of Association of a company gives power to the company to alter its Capital clause. A company can alter capital clause by passing an ordinary resolution in the General meeting of the company.

**(6) The Association or Subscription Clause :** This clause states that the persons who Sign the Memorandum are desirous of forming themselves into a company to achieve the objects mentioned in the Memorandum and that they' agree to take up the number of shares in the company mentioned against their names. This clause mentions the name, address, occupation of each subscriber and also states that the signatories have agreed to purchase at least one share of the company. This clause may mention the number of shares agreed to be purchased by the signatories. This clause also contains signatures of signatories.

## **(2) Define Memorandum of Association. Explain its features.**

**Ans. [A] Definitions :** (1) Companies Act, 2013 : Section 2 (56) of the Companies Act, 2013 defines a Memorandum as “Memorandum means the memorandum of association of a company as originally framed or as altered from time to time in pursuance of any previous company law or of this Act. ”

(2) According to Lord Cairns, “Memorandum of Association is the fundamental document of the company. It is the foundation on which the structure of a company stands. It lays





down limitations of its activities”.

According to the definitions, it is the primary, basic and fundamental document of the company and it puts limitations on the powers of a company. Since it is the charter, it restricts the scope of the activities of a company. It is a compulsory document for every company.

### **[B] Features of Memorandum of Association :**

- (1) Memorandum of Association states its aims, objectives and the nature of business activities conducted by the company. It is a primary document of the company.
- (2) It informs about the scope of activities of the company and defines boundaries within which the company must conduct its activities.
- (3) It is prepared by the promoters before registration with the help of experts and the secretary.
- (4) At least 7 members in the case of a public company, 2 members in the case of a private company and 1 person in case of One Person Company (OPC) must sign the Memorandum of Association.
- (5) It is prepared and filed with the Registrar of the companies for the registration, for obtaining 'Certificate of Incorporation'.
- (6) It is a compulsory document for every company whether private or public, with capital or without capital.
- (7) It defines and represents relationship between the company and the outsiders (including its members).
- (8) It contains 6 clauses such as (i) The Name Clause (ii) The Address Clause (iii) The Object Clause (iv) The Liability Clause (v) The Capital Clause and (vi) The Association or Subscription Clause.
- (9) Alteration of a Memorandum of Association is almost impracticable because changes can be made with great difficulties.
- (10) Memorandum of Association is a public document. Being the constitution of the company, it is open to public inspection and scrutiny.
- (11) Any activity which is ultra Vires (beyond the powers of) the Memorandum of Association is void and is treated as illegal.

### **(3) What is Articles of Association? Explain briefly its contents.**

**Ans. [A] Meaning:** The Articles of Association is a secondary, subsidiary and subordinate document which contains the by-laws, rules and regulations for the internal management of a company.

It lays down the rules for carrying out the objects of the company. These rules are meant for the internal management of the company within the area defined by the Memorandum of Association.

According to Section 2 (5) of the Companies Act, 2013, “Articles mean the articles Of



association of a company as originally framed or as altered from time to time in pursuance Of any previous companies law or of this Act”.

According to Lord Justice Bowen. “The articles of association are internal regulations of company and are for the benefits of members of the company”.

### **[B] Contents :**

**The Articles of Association lays down the procedure and rules regarding the following matters or issues :**

- (1) Company’s share capital and its division into the equity shares and preference shares. Rights of shareholders, variation of these rights.
- (2) Rights of each class of shareholders and procedure for changing their rights.
- (3) Procedure relating to allotment and calls on Shares.
- (4) Rules relating to transfer and transmission of shares.
- (5) Lien on shares.
- (6) Increase, reduction or alteration of share capital.
- (7) Procedure for conversion of shares into stock.
- (8) Share warrants.
- (9) Conducting General Meetings.
- 10) Voting rights of members, proxies and polls.
- (11) Directors and officers, their qualification Ares, appointment, remuneration, etc.
- (12) Conducting Board Meetings and General Meetings.
- (13) Appointments, powers, duties, qualifications, remuneration, removal, etc. of Managing Directors, Manager and Secretary.
- (14) Audit of accounts, transfer of money to Reserves declaration of dividend, etc.
- (15) Borrowing powers of the company and mode of borrowings.
- (16) Issue of share certificate and procedure for issue of duplicate share certificate.
- (17) Constitution and composition of various committees such as Audit Committee. Remuneration Committee, Corporate Social Responsibility Committee.
- (18) Books of Accounts, registers, annual accounts and audit.
- (19) Capitalisation of profit.
- (20) Investments of the company.
- (21) Use of Common Seal of the company.
- (22) Notices. Indemnity
- (23) winding-up
- (24) Arbitration provisions. If any.

### **(4) Define Prospectus. Explain its contents.**

**Ans. [A] Definition :** Section 2 (70) of the Companies Act, 2013, defines a prospectus as “any document described or Issued as a prospectus and includes a red herring prospectus referred to in Section 32 or shelf prospectus referred to in section 31 or any

notice, circular; advertisement or other document inviting offers from the public for the subscription or purchase of any securities Of, a body corporate.”

Prospectus is a document issued by public company publishing the highlights and business prospects of the company and thereby wishing to sell newly issued shares or debentures to the public. In precise words, a prospectus refers to any document, statement, notice, circular or advertisement, issued by the company to invite the public to purchase its shares or debentures or to deposit money with it.

A document shall be called a ‘Prospectus’ if it satisfies two conditions, viz. (1) It invites subscriptions for shares or debentures or invites deposits. (2) This invitation is made to the public at large.

**[B] Contents :** The prospectus of a public company contains detailed information about the various aspects of the company. It contains information mainly about the following matters :

- (1) The name of the issuing company.
- (2) The address of its registered office of the company with phone numbers, e-mail address, etc.
- (3) Particulars of capital structure, i.e. authorised capital, issued capital, paid-up capital, etc.
- (4) The number and classes of shares, their face value, amount payable on application and allotment.
- (5) The name of the Stock Exchange where the shares or debentures are proposed to be enlisted.
- (6) The main objects of the company and future prospects of the company.
- (7) Nature of business of the company.
- (8) Future plans of the company.
- (9) Location of factory.
- (10) Particulars of assets or any property proposed to be purchased by the company and the purchase consideration, names and addresses of the vendors.
- (11) Information about the promoters, directors, managing director, managers, bankers, brokers, solicitors, underwriters, etc. mentioning their names, addresses, descriptions, occupations and the remunerations payable to them.
- (12) Interest of Directors
- (13) Rights of Directors in respect to allotment.
- (14) The details of preliminary contracts.
- (15) The amount of the minimum subscription and the declaration about refund of application money if the minimum subscription is not received.
- (16) Procedure for the application of shares.
- (17) Opening and closing dates of subscription list.
- (18) Date and signature of all Directors.

(19) Declaration by the company stating that all the provisions of the companies Act have been complied with and that the prospectus does not contain anything contrary to the provisions made in Companies Act, Securities Contracts (Regulation) Act, 1956 and the SEBI Act, 1992.

(20) A statement made by the experts like Company Secretary, Chartered Accountant, Cost Accountant, Value, Engineer, etc. relating to the matters that they have looked into. They have to give written consent to issue prospectus.