CHAPTER II

VARIOUS PROTECTIONS AVAILABLE TO
INVESTORS UNDER COMPANIES ACT, 2013 AND
THE SECURITY & EXCHANGE BOARD OF INDIA
ACT, 1992

2.1 INTRODUCTION

An investor may be a member, shareholder, debenture holder or depository of a company and he does investment of money with the hope of financial return. The assets which he may buy range broadly, but include stocks, mutual funds, bonds, real estate etc. The portfolio of investors generally includes a variety of assets that balance the rewards and risks of each investment. Generally, an investor has no role to play in the routine management of the business of the company or its control except as permitted by the law. He is a blind person and he does not know any activities made by the company. In these circumstances he requires protection of his interest of investment made in a particular company. The Companies Act, 2013 provides several protections to investors which have been dealt in this chapter. Judiciary and Company Law Board (Now, Tribunal) has also pronounced several landmark judgments to protect the investors and same has also been mentioned at due places. Similarly an investor also requires protection in the capital market against numbers of frauds. As a powerful regulator, Securities and Exchange Board of India under the SEBI Act, 1992 was constituted for the protection of the investors’ interest and to promote the healthy development of Indian financial markets. This has also been dealt here.

In this chapter, the meaning of investors, types of investor and a brief study on various protections available to them, civil and criminal liabilities of company and
directors, establishment and role of investor’s education and protection fund under Companies Act, 2013 has been dealt. Role of SEBI as regulator of capital market, the investor’s protection measures under the Security and Exchange Board of India (SEBI) Act, 1992 and through various regulations and power to investigate the transactions of securities in the capital market has also been dealt.

2.2 MEANING OF INVESTOR

The term ‘investor’ is not defined in the Companies Act, 2013, SEBI Act as well as in other legislations. According to Oxford dictionary, investor is the person who put money into a bank, business, property etc. in the hope that he will make a profit and an act of putting money is called investment. Therefore, an individual who commits money to investment products with the hope of financial return is called an investor. He is a person or entity that purchases assets with the objective of receiving a financial return. The assets which he may buy range broadly, but include stocks, mutual funds, bonds, real estate etc. The portfolio of investors generally includes a variety of assets that balance the rewards and risks of each investment. Investors are also called the backbone of the security market. The Companies Act, 2013 describes various categories of investors. They may be members or shareholders or creditors or debenture-holders or other depositories of the company.

An investor is a person who is an individual or a corporate legal entity investing his capital in another venture or business but does not do the business himself or itself. The investor has no role to play in the routine management of the business or its control except as permitted by the law. Investor carries on business when they purchase and sell assets, arranges for other to purchase and sell assets, manages assets belonging to others, or operates collective investment schemes. An investor engages these activities, but they are not having any control over the day-to-day activities of any corporate. Normally, an investor is a blind person and he does not

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know any activities made by the company. Investor cannot guide the fortune or
destiny of the company in which he has invested money. An investor to that extent
is quite fragile and is exposed to certain risks because the utiliser of his money can
commit mistakes. Normally they are contributing the funds for fruitful purpose of
the company, and they are exposing him to the business decisions that the
company has taken or will be taking.²

If the investor does capital investment in a company and owns stocks, he is called
as shareholder of the company. The main objectives of an investment are-

(a) To secure his capital (i.e. principal money)

(b) To get profit or enhancement or dividend.

An angel investor or angel (also known as an informal investor) is a person with
significant financial resources who provides capital for a business to begin.
Usually such investor provides capital in exchange of a percentage of return on his
investment or for partial ownership in the company and a say in management
decisions. Angels usually invest their own funds, unlike venture capitalists who
manage the pooled money of others in a professionally-managed fund.³

The Companies Act, 2013 provides for a variety of companies that may be
promoted and registered under the Act. The two common types of companies
which may be registered under the Act are-

(a) Private Company

(b) Public Company

Private companies can raise the capital through private relations from its relations
or from friends but public companies can raise its capital by inviting offers from
the members of the public to subscribe for the shares or debentures through
prospectus.

² Jain Sankalp, “Investors’ Protection in India: Regulatory Framework and Investors’
Rights, Obligations & Grievances,” retrieved from SSRN, Id-2462944
³ Pradhan K, “Protection of Investors : An Analysis,” retrieved from SSRN, Id-2377855
The Companies Act, 2013 has, for the first time, allowed formation of one person company (OPC), a limited liability company on the recommendation of J.J Irani Expert Committee. Such a company is described under section 3(1) (c) as a private company. ‘One Person Company’ is a one shareholder corporate entity.\(^4\)

In these way shareholders, members and debenture holders do investment of money in the company are called investors according to Companies Act. In addition to these, depositories of the company are also called investors.

### 2.3 TYPES OF INVESTORS

Here, it is necessary to know the various types of investors. Under the Companies Act, 2013, following persons are called investors-

(i) Members
(ii) Shareholders
(iii) Debenture holders
(iv) Depositories

### 2.4 MEMBERS

Generally members of the company are its shareholders. The term shareholder is not defined in the Companies Act, 2013. However section 2(55) of the Act of 2013 [corresponding to section 41 of the Companies Act, 1956] has defined the term ‘member’ which is as follow-

(a) The subscribers of the memorandum of a company shall be deemed to have agreed to become members of the company, and on its registration, shall be entered as members in its register of members.

(b) Every other person who agrees in writing to become a member of a company and whose name is entered in its register of members shall be a member of the company.

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4. S. 2(62) of the Companies Act, 2013 (hereafter, referred as the Act)
(c) Every person holding equity share capital of company and whose name is entered as beneficial owner in the records of the depository shall be deemed to be a member of the concerned company.

In case of a company limited by guarantee having no share capital or an unlimited company having no share capital, there will be only ‘members’ but no ‘shareholders’.

In *Vijay Kumar Narang v. Prakash Coach Builders (P) Ltd.*,\(^5\) it was held that section 41 of the Companies Act, 1956 [Now section 2(55) of the Act of 2013] statutory obligation for a member that his name shall be entered as member in the register of members, when he subscribed and in reference to other there should be an application in writing and the name should be there in the register of members.

In *Herdilia Unimers Ltd. v. Renu Jain*,\(^6\) it was held that when the name of the shares allottee is entered in the Registered of members, he becomes member of the company. It is immaterial whether he has received the shares certificates or not.

In *Balaji textiles Mills (P) Ltd v. Ashok Kayle*,\(^7\) it was held by the Kerala High Court that a person may be regarded as a member if he has acquired the right of membership through his name is not in the register and a person whose name is in the register may not be regarded as a member if he did not agree to be a member in writing or is not accepting his position as such.

In *Jayalakshmi Acharya v. Kal Electronics and Consultants (P) Ltd.*,\(^8\) it was justified that where one joint holder died and the shares were registered in the name of surviving joint holder though the legal heirs were claiming registration in their name as shares can be held jointly and principles relating to rights and liabilities under joint promises would apply.

\(^5\) [(2005) 128 Comp. Cas. 976, CLB]  
\(^6\) [(1995) 4 Comp. L. J. 45 (Raj.)]  
\(^7\) [(1989) 66 Comp. Cas. 654 (Ker.)]  
\(^8\) [(1999) 90 Comp. Cas 200]
A person who holds equity shares in a demat form and his name does not appear in the company’s register of members still he will be regarded as member of the company.9

In view of above, there are following two prerequisites for a person to become member of a company-

(a) the agreement in writing to take shares of the company and

(b) the registration of his name in its register of members.

2.5 MODES OF ACQUIRING MEMBERSHIP OF THE COMPANY

It will be worth to know the various modes to become member of a company. A person may become a member in a company in any of the following ways:

2.5.1 BY SUBSCRIBING TO THE MEMORANDUM OF ASSOCIATION

A Memorandum of Association (MOA) is an important legal document of a company and it is prepared in the formation and registration process of a limited liability company to define its relationship with members (shareholders). The MOA is accessible to the public and describes the name of the company, physical address of its registered office, names of shareholders and the distribution of shares. The MOA along with Articles of Association serve as the constitution of the company.

According to Section 2(55) of the Act the subscribers of the memorandum of a company shall be deemed to have agreed to become members of the company, and on its registration shall be entered as members in its register of members.

It means that the subscribers of the memorandum of a company become *ipso facto* members on its incorporation and their name will be entered in the Register of

9. S. 8 of the Depository Act, 1996
Members. Therefore, the signatories to the memorandum become members of the company, simply by reason of their having signed the memorandum.

It is also to be noted that section 3 of the Act requires that any seven or more persons for the lawful purpose of forming a public company and two or more person for the purpose of forming a public company and one person for the purpose of forming OPC may subscribe their names to the memorandum.

In *Official Liquidator v. Suleman Bhai*,¹⁰ it was held that neither application form nor allotment of shares is necessary for becoming a member of the company if subscribed the memorandum of the company. Even an absence of entry in the register of members can not deprive him of his status. He acquires, as soon as the company is registered, the full status of a member with all rights and liabilities.

### 2.5.2 BY AGREEMENT

A person may also become the member of the company if he agreed in writing to purchase the shares of the company and the company has duly accepted the request of the person. It means when the company has allotted the requisite number of shares on the basis of application then it shall be presumed that the company has accepted the request. Thereafter the name of the person is entered in the register of the members.¹¹

It means except in the case of subscribers of memorandum, to become a member of the company, two conditions must be satisfied namely-

(a) that there is an agreement in writing to become a member and

(b) his name is entered in the Register of the member of the company.

In *Balkrishna Gupta v. Swadeshi Polytex Ltd.*,¹² the Supreme Court has held that both the conditions of section 41(2) of the Act of 1956[corresponding section 2(55) (ii) of the Act of 2013] are cumulative and both the conditions have to satisfied to enable him to exercise the rights of a member.

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¹⁰. AIR 1955 M.P. 166
¹¹. S. 2(55) (ii)
¹². [(1985) 58 Comp. Cas. 563]
In *Kumaranpotty v. Vinod Pharmaceuticals Chemical Lt.*, the Kerala High Court has held that it is necessary that agreement should be in writing to become a member of the company and merely oral agreement will not suffice the purpose.

**2.5.3 BY ALLOTMENT OF SHARES**

The second part of section 2 (55) of the Act is related to those persons who become members of the company by a method other than by subscribing to the memorandum. Shares may be issued directly from the company and such a transaction is referred to as "allotment" as compared with the term "transfer" which applies when shares are purchased from another shareholder of the company. Section 2 (55) lays down two conditions which must be fulfilled before membership may be obtained by this method-

(a) There must be an agreement in writing by the applicant to become a Member and

(b) the name of the applicant must be entered in the register of members.

Offers for shares are made on application forms supplied by the company. When an application is accepted, it is an allotment. Generally a person becomes a member of the company by applying for the shares in writing and securing the allotment thereof directly from the company. A valid allotment has to comply with the requirements of the Companies Act and principles of the law of contract relating to acceptance of offer.

**2.5.4 BY BENEFICIAL OWNER OF THE COMPANY**

Clause (iii) of section 2(55) states that every person holding equity share capital of company and whose name is entered as beneficial owner in the records of the depository shall be deemed to be a member of the concerned company.

According to section 8 of the Depository Act, 1996, a person can hold shares of the company to the depositories in place of having share certificates. A person who holds equity shares in a demat form and his name does not appear in the

13. *(1989) 65 Comp. Cas. 246*
company’s register of members still he will be regarded as member of the company.

2.5.5 BY TRANSFER

A person may also become a member of the company by purchasing shares in the open market and then getting them registered in his name. A person may also become a shareholder by obtaining a transfer of shares from another shareholder either for a consideration or as a gift but the conditions of agreement and entry on the register of members are necessary. Until the name of the transferee is put on the register of members, he only holds an equitable title; the legal title rests with the transferor whose name is entered on the register of members. In such situation, the expressions "holder of shares" and "shareholders" become relevant because the transferor will remain "shareholder" and the transferee will be the "holder of shares" till the name of the transferor is struck down from the register of members and the name of the transferee is entered in the register. As soon as this formality is completed, "the holder of share" and "shareholder" would be the same person.

2.5.6 BY TRANSMISSION OR SUCCESSION

A person may become a shareholder by succession or operation of law, for instance in the case of death, insolvency or lunacy of a member, or insolvency of a member. Transmission is different from transfer. It is an involuntary transfer. It takes place by operation of law, to a person who is entitled under the law to succeed to the estate of the deceased or lunatic automatically and does not require an instrument of transfer like transfer deed, execution, attestation and stamp duty etc.

Section 56(6) which provides the formalities of transfer specially provides that nothing in the section shall prejudice the power of the company to register as shareholder any person to whom the right to any shares has been transmitted by operation of law. Provisions relating to transmission are generally found in the
company’s articles which are similar to provision of transfer. Clauses 23 to 27 of schedule I contain such provisions.

2.5.7 BY PRINCIPLE OF ESTOPPEL

This arises when a person holds himself out as a member or knowingly allows his name to remain on the register when he was actually parted with his shares. In the case of winding up, he will be liable like other genuine members as a contributory.14

Under the principle of estoppel if a person holds himself out being in a position of membership which is not true, he will then be estopped from denying that he is a member.

It is important to note that such a person whose name has been wrongly entered in the Register of Members, does not become liable as a member unless either he agrees in writing to become a member of the company or he has in fact accepted the position and acted as a member. A person cannot be deemed to have become a member by means of ‘estoppel’ simply because his name is entered wrongly in the 'Register'.

It is very difficult to become a member by estoppel although the possibilities of such a situation cannot be entirely overruled. If a person finds himself on a company's register of members and in some manner deals with the shares as if he were really a member, the court may consider him to have held himself out as a member. The remedy of being removed from the register may be denied to such a person and he might be held liable for debts in a winding up as one of the contributories. It was brought to the notice of the Sastri Committee (1957) in India that in some cases, on the verge of liquidation, entries were made in the register of members of the names of persons who never applied for shares, in order to fasten liability on those persons as contributories. To avoid this contingency, in 1960, the

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words "in writing" after the word "agrees" were added. This amendment has prevented a person from becoming a shareholder by estoppel in India.

2.6 WHO CAN BE A MEMBER OF THE COMPANY?

Here, it is also necessary to know who can become a member of the company. Any person *sui juris* can become the member of the company subject to the memorandum, articles of the company and other provisions of the law of the land. The legal position of minor, a company, a partnership firm, a registered society, a receiver or official liquidator and a foreigner to become member of the company are discussed below.

2.6.1 MINOR

A minor cannot become a member of company. This is so because under the Indian Contract Act, 1872, a minor is declared to be, incompetent to contract\(^\text{15}\) and, therefore, he cannot contract to take shares. Such a contract would be void under contract law and would be equally unenforceable at the instance of the minor as well as of the company. As soon as the memorandum and articles of association are registered, these documents have contractual effect and section 10 of the Companies Act, 2013 supports this view when it provides that

"... *the memorandum and articles shall, when registered, bind the company and the members thereof to the same extent as if they respectively had been signed by the company and by each member and contained covenants on its and his part ...*"

Under these circumstances, a minor can neither give his consent in writing as has been contemplated in section 2(55) nor according to section 10 of the Act, he can become a party to the memorandum or articles of association.

However, under U.K Companies Act, an infant can become a *bona fide* member of the company either by virtue of his subscription to the memorandum or by accepting the allotment of shares and he remains as such until he repudiates his contract, which he must do before reaching 21 or within a reasonable time.

\(^{15}\) Ss. 10 and 11 of the Contract Act, 1872
thereafter\textsuperscript{16}. In the latter case he must act with speed or he will be deemed to be bound by acquiescence. If he avoids he cannot recover the money paid for the shares unless there has been a total failure of the consideration for which the money was paid\textsuperscript{17}.

In \textit{Palaniappa v. Official Liquidator, Pashupati Bank Ltd.},\textsuperscript{18} it was held that if an application for shares is made by a father as guardian of his infant and the company registers the shares in the name of the infant describing him as minor, neither the guardian nor infant can be placed on the list of contributories at the time of winding up of the company.

In \textit{Fazulbhoy Zafar v. Credit bank of India Ltd.},\textsuperscript{19} it was held that if somehow the name of a minor appears on the registered members and in the meantime he attains majority, and if he does not want to continue to be a member, then he must repudiate his liability on the shares on the ground of minority.

In \textit{Devan Singh v. Minerva Films Ltd.},\textsuperscript{20} it was held that there is no legal bar to a minor becoming a member of a company by acquiring shares by way of transfer of transmission provided the shares are fully paid up and no further obligation or liability is attached to them.

\section*{2.6.2 A COMPANY}

A company, being a juristic person and a separate legal entity may become a member of another company, if it is so authorized by MOA to purchase or invest in shares. Here it is important to note that a subsidiary company cannot be a member of its holding company. Similarly, according to section 67 of the Act, a company cannot purchase its own shares and therefore, cannot become member of itself. However section 68 of the Act states that company can purchase its own shares in

\begin{thebibliography}{99}
\bibitem{16} Re Laxon & Co. N 29 (1892) 3 Ch. 555
\bibitem{17} Charlesworth’s \textit{Company law}, 18th Edn., p. 292, Sweat & Maxwell (South Asian Edn.)
\bibitem{18} [1942] 12 Com. Cas. 89 (Mad.)
\bibitem{19} AIR 1914 Bom. 128
\bibitem{20} AIR 1956 Punj. 106
\end{thebibliography}
the form of buy back if authorised by its articles and a special resolution has been passed by AGM of the company in this regard.

2.6.3 A PARTNERSHIP FIRM

A partnership firm being an unincorporated association and therefore, not having a separate legal entity from the partner, cannot be registered as a member of a company. However, a partnership firm may become a member of a company registered under section 8 of the Act (i.e., association for charitable purpose and not for profit). Partners either individually or in their joint names (as joint members) may hold shares in a company as a part of the partnership property.

2.6.4 A REGISTERED SOCIETY

A society registered under the Societies Registration Act, 1860 is not a body corporate so it cannot be a member of a company. However, the member of the society, as individual capacity, can become member of the company under section 2(55) (ii) of the Act.

2.6.5 RECEIVER OR OFFICIAL LIQUIDATOR

Receiver or official liquidator are, generally, cannot be a member of a company because shares do not vest in them. Merely appointment as a receiver or official liquidator of the company does not entitle them to become member. The privilege of a member can be exercised by only that person whose name is entered in the Register of members of the company.

2.6.6 A FOREIGNER

Subject to the provisions of the Foreign Exchange Management Act (FEMA), 1999 and Indian Contract Act 1872, a foreigner can enter into the contract and therefore, can purchase shares in a company and become member.

2.7 SHAREHOLDERS

The term shareholder is not defined in the Companies Act, 2013. A company registered under the Companies Act, 2013 may be registered with or without share
capital. In case the company has a share capital, the persons who invest money to the capital of the company by subscribing to the shares are known as shareholders. Where the company does not have share capital, the persons who invest money to the capital of the company are known as members. However, generally the term ‘member’, ‘shareholder’ and ‘holder of a share’ are used interchangeably. However section 2(55) of the Act of 2013 [corresponding to section 41 of the Companies Act, 1956] has defined the term ‘member’ instead of the term shareholder which has dealt in Para 2.5 (supra).

Shareholders are categorized on the basis of capital of a company which is divided into shares of a fixed amount. All the shares may be of only one class or may be divided into two different classes of securities. For this purpose securities means securities defined in Section 2(h) Securities Contracts (Regulation) Act, 1956 [S. 2(81)] and includes ‘Hybrid.’ Hybrid means any security which has the characteristics of more than one type of security including their derivatives. The Act permitted only two kinds of shares to be issued, namely-

(a) Equity share capital, that is, ordinary shares, and

(b) Preference shares, which constitute the preference share capital.

Equity share holders of a company are called equity shareholders and holders of preference shares as preference shareholders.

Ordinary share capital or "equity share capital" is defined section 43 of the Act as all share capital which is not preference share capital. The equity share capitals of companies limited by shares are also of two kinds only, namely:-

(i) with voting rights or

(ii) with differential rights as to dividend, voting as otherwise in accordance with such rules and subject to such conditions as may be prescribed.

Preference share capital is also defined in section 43 of the Act. Preference share capital means that part of the share capital of a company which fulfils both the following requirements:
(a) during the continuance of the company it must be assured of a preferential dividend. The preferential dividend may consist of a fixed amount (for example, Rs. 80,000 in a year) payable to preference shareholders before anything is paid to the ordinary shareholders.

(b) on the winding up of the company it must carry a preferential right to be paid, that is, the amount paid up on preference shares must be paid back before anything is paid to the ordinary shareholders. This preference, unless there is an agreement to the contrary, exists only up to the amount paid up or deemed to have been paid up on the shares.

Preference shares have the features of both equity shares and debentures. Like equity shares, dividend on preference shares is payable only when there are profits and at the discretion of the Board of Directors.

Preference shares are also similar to debentures in the sense that the rate of dividend is fixed and preference shareholders do not normally enjoy voting rights. Therefore, preference shares are a hybrid form of financing.

2.8 DIFFERENCES BETWEEN PREFERENCE SHAREHOLDERS AND EQUITY SHAREHOLDERS

There are following differences between preference shareholders and equity shareholders on the basis of shares they hold-

(a) Preference shareholders are entitled to a fixed rate of dividend whereas the rate of dividend on equity shareholders are not fixed and depends upon the availability of net profit.

(b) Dividend on preference shares is paid in priority to the equity shares and equity shares are paid only after the preference dividend has been paid.

(c) Preference shareholders have preference as regards to refund of capital over equity shareholders whereas equity share capital cannot be paid before preference capital.
(d) Redeemable preference share are redeemed by the company on expiry of the stipulated period but equity shares cannot be redeemed.

(e) A company cannot issue bonus shares and rights shares to preference shareholders whereas the bonus shares and rights shares can be issued to existing equity shareholders.

(f) Voting right of preference shares is restricted to resolutions which are directly affect the rights attached to his preference shares except when dividends has remained unpaid in which case he may vote on any resolution in respect of preference share capital but any equity shareholder can vote on all matters.

(g) Arrears of dividend may accumulate in certain cases in preference shares but there is no provision to pay arrears of dividend in equity shares.

(h) Preference shareholders have no right to participate in management of the company whereas equity shareholders have right to participate in management.

(i) Preference share offer a profitable and safe source of investment. While the fixed rate of income is guaranteed, the risk involved is much less as compared to the risk undertaken by the an equity shareholders.

2.9 DIFFERENCES BETWEEN MEMBER AND SHAREHOLDERS

In case of a company limited by shares, a company limited by guarantee and having a share capital and an unlimited company whose capital is definite shares, the term ‘member’ and ‘shareholder’ are synonymous and there can be no membership except through the medium of shareholding. In case of a company limited by shares, the persons whose names are put on the register of members are the members of the company. They may also be called shareholders of the company as they have been allotted shares and are holding them in their own right. When a person is a member of a company limited by shares, his name is placed on the Register of members and he is holding shares in his own right and, therefore, whether we call him a member or a shareholder, it is immaterial. A shareholder is a
person who buys and holds shares in a company having share capital. Such person becomes member of the company once their name is entered in the Register of members. In case of company limited by the equity shares, the following differences can be made between members and shareholders-

(i) **ON SUCCESSION**

A legal representative of a deceased is not a member until he applies for registration of his name in the Register of members. However, he can rightly be called a shareholder even though his name does not appear in such register. When the name of legal representative gets his own name entered in the Register, then the name of deceased will cease to be member of the company.

(ii) **ON BASIS OF REGISTRATION**

A deceased shareholder remains member of the company until his name is not struck off from the Register of members. But he cannot be called shareholder in true sense as the rights to holds shares get transfer to his successor, who may be called shareholder *in stricto* sense. A registered shareholder is a member but a registered member may not be a shareholder because company may not have a share capital.

(iii) **ON SALE OF SHARES**

When a member sells his shares to another person, for consideration, he ceases to be a shareholder of the company. But he continues to be member till the transfer of shares is registered by the company in favour of buyer.

(iv) **ON BECOMING INSOLVENT**

When a shareholder becomes insolvent, then his property including shares vest in the Official Receiver. The Official Receiver holds the shares in his own right. In such circumstances, insolvent is no longer the shareholder, though he continues to be the member of the company.
(v) ON BEARER OF SHARE WARRANT

A person who owns a share warrant is a shareholder but he is not a member as his name is struck off from the register of members. This means that a person can be holder of shares without being a member.

(vi) ON SUBSCRIBING MEMORANDUM

The subscribers of the memorandum of a company become *ipso facto* members on its incorporation and their name will be entered in the Register of Members. Therefore, the signatories to the memorandum become members of the company, simply by reason of their having signed the memorandum even though no shares are allotted to them. The subscriber is a member until shares are allotted to him but not the shareholder of the company.

### 2.10 DEBENTURE HOLDERS

Companies have to frequently borrow large sum of money. The loan requirement of a company may not, therefore, be met by a single lender. The loan amount may have to be split into several units. One very convenient method of doing so is to borrow by issuing debentures. Suppose, for example, the sum to be borrowed is rupees ten lakh. It may be divided into ten thousand units each of the value of hundred rupees. A lender may purchase as many units as he pleases. The company will certify the number of units he holds. This is the concept of a debenture. A debenture is, therefore, a certificate of loan issued by a company. It is a type of security. A person, who purchases the debentures, is called debenture holder. He is also an investor of the company since he lends money to the company.

Section 2(30) of the Act, defines the term as ‘Debenture includes debenture stock, bonds and any other instrument of a company evidencing a debt whether constituting a charge on the company’s assets or not.’

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This definition does not explain the term and its nature, so we have to look into the definition given by imminent persons. According to Justice Chitty

"Debenture means a document which either creates a debt or acknowledges it and any document which fulfills either of those conditions is a debenture."

According to Gower,

"Debenture is a name applied to certain types of documents evidencing an indebtedness which is normally but not necessarily secured by a charge over property."

A company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption, which shall be approved by a special resolution passed at AGM. No company shall issue any debentures carrying any voting rights.

Debenture holders are also called the creditors of the company due to carrying a fixed rate of interest and payable on a debenture is a charge against profit and hence it is also tax deductible expenditure.

2.11 DIFFERENCES BETWEEN SHAREHOLDER AND DEBENTURE HOLDER

There are several similarities between a shareholder and a debenture holder. Both are making investment in the company and getting returns, although one gets it by way of dividend and the other by way of interest. In many respects a debenture is similar to a share. It can be purchased or sold in the stock-market. Like shares, the market value of a debenture can also be used by the holders as collateral security to secure temporary loans. However, there are following points of difference between a shareholder and a debenture holder.

23. S. 71 (2) of the Act
(a) A shareholder is a member of the company and enjoys all rights of membership including voting right while a debenture holder is simply a creditor of the company and does not have voting right in AGM.

(b) A debenture holder is entitled to get return in the form of interest on fixed rate regardless of the amount of profit or loss of the company at the stipulated time but the shareholder does not receive any dividend unless the company makes a profit. Even when the company has made a profit, the payment of dividend normally depends upon the discretion of the directors. Sometimes he may get dividends which may be much higher than the rate of interest.

(c) A debenture holder is entitled to repayment of principal amount at the expiry of a specified period but a shareholder cannot be paid back (except in case of redeemable preference shares) until its winding up. The share capital cannot be repaid without legal formalities.

(d) In the case of winding up, shareholders cannot claim payment unless all outside creditors have been paid in full. Debenture holders, normally, being the secured lenders, have prior claim for repayment.

(e) Dividend on shares is not a charge against the profit. Interest on debentures on the other hand is a charge against profits and is deducted from revenues for the purpose of calculating tax liability.

2.12 DEPOSITORS IN THE COMPANY

It has become an important means to receive deposits from public by the companies to make its financial position sound. It is easier to the companies to receive money by way of deposit or loan from public (small depositors) than financial institutions. This is due to less hassles and also free from guarantees, so without making shareholders of the company, such companies receives large deposit in the form of small deposits from the public. Such persons are also called depositors and hence they are investors of the company. Deposits under the 1956
Act were always treated as “unsecured” and there was no provision for deposit insurance.24

According to Section 2 (31) of the Act of 2013 (corresponding to Explanation of Section 58 A of the companies Act, 1956), deposit includes any receipt of money by way of deposit or loan or in any other form by a company but does not include such categories of amount as may be prescribed in consultation with the Reserve Bank of India.

The Company (Acceptance of Deposit) Rules 2014 has further elaborated this term and stated that "deposit" includes any receipt of money by way of deposit or loan or in any other form, by a company, but does not include-

(i) any amount received from the Central Government or a State Government, or any amount received from any other source whose repayment is guaranteed by the Central Government or a State Government, or any amount received from a local authority, or any amount received from a statutory authority constituted under an Act of Parliament or a State Legislature;

(ii) any amount received from foreign Governments, foreign or international banks, multilateral financial institutions (including, but not limited to, International Finance Corporation, Asian Development Bank, Commonwealth Development Corporation and International Bank for Industrial and Financial Reconstruction), foreign Governments owned development financial institutions, foreign export credit agencies, foreign collaborators, foreign bodies corporate and foreign citizens, foreign authorities or persons resident outside India subject to the provisions of Foreign Exchange Management Act, 1999 (42 of 1999) and rules and regulations made there under;

(iii) any amount received as a loan or facility from any banking company or from the State Bank of India or any of its subsidiary banks or from a banking

institution notified by the Central Government under section 51 of the Banking Regulation Act, 1949 (10 of 1949), or a corresponding new bank as defined in clause (d) of section 2 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970) or in clause (b) of section (2) of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 (40 of 1980), or from a co-operative bank as defined in clause (b-ii) of section 2 of the Reserve Bank of India Act, 1934 (2 of 1934);

(iv) any amount received as a loan or financial assistance from Public Financial Institutions notified by the Central Government in this behalf in consultation with the Reserve Bank of India or any regional financial institutions or Insurance Companies or Scheduled Banks as defined in the Reserve Bank of India Act, 1934 (2 of 1934);

(v) any amount received against issue of commercial paper or any other instruments issued in accordance with the guidelines or notification issued by the Reserve Bank of India;

(vi) any amount received by a company from any other company;

(vii) any amount received and held pursuant to an offer made in accordance with the provisions of the Act towards subscription to any securities, including share application money or advance towards allotment of securities pending allotment, so long as such amount is appropriated only against the amount due on allotment of the securities applied for;

Experience has shown that in many cases deposits from the public so taken by the companies have not been refunded on the due dates. In many such cases either the companies have gone into liquidation or the funds are depleted to such an extent that the companies are not in a position to refund the deposits.25

Recently, the **Sahara Groups of Companies** is in big trouble with raising public fund of more than Rs. 24 thousand crores from 29.6 million investors through

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optionally fully convertible debentures (OFCDs) and also received deposits from small depositors from public. The chief of Sahara Mr. Subrata Roy along with two directors of the company have been arrested on the order of the Hon’ble Supreme Court in a dispute related with market regulator Security Exchange Board of India (SEBI). This company has collected money from millions small investors without bringing any IPOs and listing in the stock Exchange of India. Now after repeated order of the Supreme Court, they have started to refund the money to their investors. They have not even provided the correct list of investors to SEBI or to the Court. Subrata Roy has not yet been granted bail and kept in the judicial custody.

It is, accordingly considered necessary to control the companies inviting deposits from the small depositors. The issue of an advertisement in such form and in such form and in such manner as may be prescribed including therein a statement showing the financial position of the company seeking deposits from the public being made obligatory.

The Companies Act, 2013, has now, prohibited the acceptance of deposits from public.

Section 73 of the Act provides that on and after the commencement of this Act, no company shall invite, accept or renew deposits under this Act from the public except in a manner provided under Chapter V of the Act.

The proviso of section 73 (1) further states that nothing in this sub-section shall apply to a banking company and nonbanking financial company as defined in the Reserve Bank of India Act, 1934 and to such other company as the Central Government may, after consultation with the Reserve Bank of India, specify in this behalf.

A company may, subject to the passing of a resolution in general meeting and subject to such rules as may be prescribed in consultation with the Reserve Bank of India, accept deposits from its members on such terms and conditions, including the provision of security, if any, or for the repayment of such deposits with interest,
as may be agreed upon between the company and its members\(^{26}\), subject to the fulfillment of the following conditions, namely:

\( (a) \) issuance of a circular to its members including therein a statement showing the financial position of the company, the credit rating obtained, the total number of depositors and the amount due towards deposits in respect of any previous deposits accepted by the company and such other particulars in such form and in such manner as may be prescribed;

\( (b) \) filing a copy of the circular along with such statement with the Registrar within thirty days before the date of issue of the circular;

\( (c) \) depositing such sum which shall not be less than fifteen per cent. of the amount of its deposits maturing during a financial year and the financial year next following, and kept in a scheduled bank in a separate bank account to be called as deposit repayment reserve account;

\( (d) \) providing such deposit insurance in such manner and to such extent as may be prescribed;

\( (e) \) certifying that the company has not committed any default in the repayment of deposits accepted either before or after the commencement of this Act or payment of interest on such deposits; and

\( (f) \) providing security, if any for the due repayment of the amount of deposit or the interest thereon including the creation of such charge on the property or assets of the company.

The proviso of section 73 (2) further states that in case where a company does not secure the deposits or secures such deposits partially, then, the deposits shall be termed as “unsecured deposits” and shall be so quoted in every circular, form, advertisement or in any document related to invitation or acceptance of deposits.

Every deposit accepted by a company under section 73 (2) shall be repaid with interest in accordance with the terms and conditions of the agreement referred to in

\[^{26}\text{S. 73(2) of the Act}\]
that sub-section\textsuperscript{27}. If a company fails to repay the deposit or part thereof or any interest, the depositor concerned may apply to the Tribunal for an order directing the company to pay the sum due or for any loss or damage incurred by him as a result of such non-payment and for such other orders as the Tribunal may deem fit.\textsuperscript{28}

The deposit repayment reserve account referred to in clause (c) of sub-section (2) of section 73, shall not be used by the company for any purpose other than repayment of deposits.\textsuperscript{29}

It will be worth to mention here that the section 74 of the Act has made a provision of repayment of deposits accepted before commencement of the Act of 2013. Subsection (1) states that where in respect of any deposit accepted by a company before the commencement of this Act, the amount of such deposit or part thereof or any interest due thereon remains unpaid on such commencement or becomes due at any time thereafter, the company shall—

(a) file, within a period of three months from such commencement or from the date on which such payments, are due, with the Registrar a statement of all the deposits accepted by the company and sums remaining unpaid on such amount with the interest payable thereon along with the arrangements made for such repayment, notwithstanding anything contained in any other law for the time being in force or under the terms and conditions subject to which the deposit was accepted or any scheme framed under any law; and

(b) repay within one year from such commencement or from the date on which such payments are due, whichever is earlier.

Further, the Tribunal may on an application made by the company, after considering the financial condition of the company, the amount of deposit or part

\textsuperscript{27} S. 73(3) \\
\textsuperscript{28} subsection (4) of section 73 \\
\textsuperscript{29} subsection (5)
thereof and the interest payable thereon and such other matters, allow further time as considered reasonable to the company to repay the deposit.\(^{30}\)

If a company fails to repay the deposit or part thereof or any interest thereon within the time specified in section 73 (1) or such further time as may be allowed by the Tribunal under section 73 (2), the company shall, in addition to the payment of the amount of deposit or part thereof and the interest due, be punishable with fine which shall not be less than one crore rupees but which may extend to ten crore rupees and every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years or with fine which shall not be less than twenty-five lakh rupees but which may extend to two crore rupees, or with both.\(^{31}\)

Where a company fails to repay the deposit or part thereof or any interest thereon referred to in section 74 within the time specified or such further time as may be allowed by the Tribunal, and it is proved that the deposits had been accepted with intent to defraud the depositors or for any fraudulent purpose, every officer of the company who was responsible for the acceptance of such deposit shall, without prejudice to the provisions contained in section 74(3) and liability under section 447, be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by the depositors.

Subsection (2) of further states that any suit, proceedings or other action may be taken by any person, group of persons or any association of persons who had incurred any loss as a result of the failure of the company to repay the deposits or part thereof or any interest thereon.

### 2.13 PROTECTIONS AVAILABLE TO INVESTORS UNDER THE COMPANIES ACT, 2013

Companies Act, 2013 provides several protections to investors. Since the main objective of this research work is to discuss in detail the provisions related to

\(^{30}\) subsection (2) of section 73

\(^{31}\) subsection (3)
inspection, investigation and audit as embodied in the Companies Act 2013 and in SEBI Act 1992, and how these are useful in protection of investor’s interests are dealt in chapter III to chapter V respectively. In this chapter, various provisions of the Act related with the protection of investors have been dealt.

2.13.1 PROTECTIONS DURING INCORPORATION OF THE COMPANY

Generally the promoters are the first persons who plays important role during incorporation of a company. Promotion is a term of wide import denoting the preliminary steps taken for the purpose of registration and floatation of the company. The persons who assume the task of promotion are called promoters. A promoter may be an individual, syndicate, association, partner of company, who acts as per the provisions of the companies Act, 2013. A number of sections impose civil as well as criminal liabilities on promoters for misrepresentations in a prospectus or a statement in lieu of prospectus, for misappropriation or misapplication of the money collected. The status of a promoter is generally terminated when the Board of directors has been formed and they start governing the company.

Therefore, promoters are the first person who controls or influence the company’s affairs. It is they who conceive the idea of forming the company, and it is they who take the necessary steps to incorporate it, to provide it with share and loan capital and acquire the business or property which it is to manage. When these things have been done, they hand over the control of the company to its directors, who are often themselves under a different name.

32. S. 2(69) of the Act defines the term promoter as-“promoter” means a person-(a) who has been named as such in a prospectus or is identified by the company in the annual return referred to in section 92; or (b) who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or (c) in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act:
Provided that nothing in sub-clause (c) shall apply to a person who is acting merely in a professional capacity;

The legal position of a promoter is that he stands in a fiduciary position towards the company about to be formed. He is neither agent nor trustee of the proposed company. He is not the agent because there is no company yet in existence and he is not trustee because there is no trust in existence. Lord Cairns has rightly stated the position of promoter in *Erlanger v. New Sombrero Phosphate Co.*, 34

"the promoters of a company stands undoubtedly in a fiduciary position. They have in their hands the creation and molding of the company."

They have the power of defining how and when and in what shape and under whose supervision it shall come into existence and begins to act as a trading corporation. They occupy an important position and have wide unfettered power relating to the formation of a company. There are also chances to misuse this power. The Act contains no provisions regarding the duties of promoters. It merely imposes with criminal and civil liability through section 34 and 35 of the Act, on promoters for untrue statements in the prospectus they are parties to and for fraudulent trading.

The courts, however, have been conscious of the possibility of abuse inherent in the promoters’ position and therefore laid down that anyone who can properly be regarded as promoter stands in a fiduciary position towards the company with all the duties of disclosure and accounting. In particular, the two fiduciary duties imposed on a promoter are-

(i) not to make any secret profit out of the promotion of the company,

(ii) to disclose to the company any interest which he has in a transaction entered into by it.

### 2.13.1.1 CRIMINAL LIABILITY OF THE COMPANY

The following corporate activities during incorporation of a company, have been regarded as fraud and kept under the category of cognizable as well as non-bailable offences and punishable under section 447 of the Companies Act, 2013.

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34. 39 LT 269 & [1878] 3 App. Cas.1218
(a) **Furnishing False or incorrect information during registration of company**- If any person furnishes any false or incorrect particulars of any information or suppresses any material information, of which he is aware in any of the documents filed with the Registrar in relation to the registration of a company.\(^{35}\)

(b) **Incorporation of company by fraudulent means**- Any company incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company, or by any fraudulent action\(^{36}\).

(c) **Untrue or Misleading Prospectus**- When a prospectus issued, circulated or distributed includes any statement which is untrue or misleading in form or context in which it is included or where any inclusion or omission of any matter is likely to mislead\(^{37}\).

(d) **Inducing a person to enter into financial matter**- Any person who, either knowingly or recklessly makes any statement, promise or forecast which is false, deceptive or misleading, or deliberately conceals any material facts, to induce another person to enter into, or to offer to enter into.

(i) any agreement for, or with a view to, acquiring, disposing of, subscribing for or underwriting securities; or

(ii) any agreement, the purpose or the pretended purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities; or

(iii) any agreement for, or with a view to obtaining credit facilities from any ank or financial institution\(^{38}\).

\(^{35}\) S. 7(5) of the Act  
\(^{36}\) S. 7(6)  
\(^{37}\) S. 34  
\(^{38}\) S. 36
(e) Any person who makes or abets making of an application in a fictitious name to a company for acquiring, or subscribing for, its securities; or makes or abets making of multiple applications to a company in different names or in different combinations of his name or surname for acquiring or subscribing for its securities; or otherwise induces directly or indirectly a company to allot, or register any transfer of, securities to him, or to any other person in a fictitious name.\textsuperscript{39}

Any person including promoter, who is found to be guilty of fraud, will be punished with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.\textsuperscript{40}

2.13.1.2 CIVIL LIABILITY AGAINST MIS-STATEMENTS IN PROSPECTUS

There is also provision for making the person with civil liability against mis-statements in prospectus. Section 35 of the Act (corresponding to section 62 of the Act of 1956) imposes civil liability on the directors, promoters or any authorized person for mis-statements in prospectus to pay the compensations to those who suffered losses.

Subsection (1) states that where a person has subscribed for securities of a company acting on any statement included, or the inclusion or omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company and every person who-

\begin{itemize}
  \item [(a)] is a director of the company at the time of the issue of the prospectus;
  \item [(b)] has authorised himself to be named and is named in the prospectus as a director of the company, or has agreed to become such director, either immediately or after an interval of time;
\end{itemize}

\textsuperscript{39} S. 38(1)  \textsuperscript{40} S. 447
(c) is a promoter of the company;

(d) has authorised the issue of the prospectus; and

(e) is an expert referred to in sub-section (5) of section 26,

shall, besides punishment under section 36 (discussed supra), be liable to pay compensation to every person who has sustained such loss or damage.

Subsection (2) provides defences to abovementioned person to avoid civil liability. It provides that no person shall be liable under sub-section (1), if he proves-

(a) that, having consented to become a director of the company, he withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent; or

(b) that the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent.

However, if it is proved that a prospectus has been issued with intent to defraud the applicants for the securities of a company or any other person or for any fraudulent purpose, every person referred to in subsection (1) shall be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by any person who subscribed to the securities on the basis of such prospectus.  

In Probir Kumar Mishra v. Ramaniamaswamy, it was held that promoters are liable to the company as well as third parties in respect of their conduct and contracts entered into by them during pre-incorporation stage (including statement in prospectus), either treating them as agents or trustees of company to be incorporated and company is entitled to make a claim against a promoter on basis of principles of breach of trust in case it is found that conduct of promoter is detrimental to interest of company.

41. S. 35 (3) of the Act
42. [2010] 104 SCL 174(Mad.)
2.13.2 PROTECTIONS THROUGH MEMORANDUM OF ASSOCIATION AND ARTICLE OF ASSOCIATION

The two important documents of company i.e., Memorandum of Association (MOA) and Articles of Association (AOA) provide various important protections to its shareholders/members.

The memorandum of association (MOA) of a company is an important document which contains the fundamental conditions upon which alone the company has been incorporated. According to section 2 (56) of the Act, memorandum means 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. It contains the objects for which the company is formed and therefore identifies the possible scope of its operations beyond which its actions cannot go. It defines as well as confines the powers of the company. If anything is done beyond these powers that will be *ultra vires* the company and so void. MOA can be altered only under certain circumstances and in the manner prescribed in the section 13 of the Act. In most of the cases permission of the Central Government is required when special resolutions of the companies are passed.

The articles of association (AOA) of a company are its bye laws or rules and regulations that govern the management of its internal affairs and the conduct of its business. According to section 2 (5) of the Act, articles means articles 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. The AOA regulates the internal management of the company. It defines the powers of its officers and determines how the object of the company shall be achieved. AOA can only be altered by the members by passing a special resolution only.

MOA and AOA constitute a contract between the company and its member. The contract contained in MOA and AOA is one of the original incidents of shares. In other words, it can be said that the memorandum and articles constitutes a contract of some sort between the company and its shareholders, and it is these documents
which directly or indirectly define and affect the rights and interests of shareholders conferred by the shares.

The provision mentioned in the MOA is mandatory for the company to abide with its members. Such rights includes, right to have his name on the Register of members, to vote at the meeting of members, to receive dividends when declared, to exercise the right of pre-emption, return of capital on winding-up or on reduction of share capital of the company etc. Since MOA provides the Object Clause of the Company, the member has a right to bring action to restrain the company from doing an *ultra-vires* act.

The rule of *ultra vires* was for the first time laid down by the House of Lords in *Ashbury Rly. Carriage & Iron Company v. Riche*,\(^{43}\) In this case, the object of the doctrine was explained by Lord Justice Cairns as follows:

(i) to protect investors of the company so that they may know the objects in which their money is to be employed and

(ii) to protect the creditors by ensuring that the company funds, to which they must look for payment are not dissipated in unauthorised activities.

If a company is not working according to the ‘Object clause’, the act will be held *ultra vires* and will have *null and void ab initio* effect.

In *Lashmanaswamy Mudaliar v. L.I.C.*,\(^{44}\) the directors of the company were authorised to make payments towards any charitable or any benevolent object or for any general public or useful object. As per the shareholder’s resolution, the directors paid Rs. 2 lakhs to a trust for the purpose of promoting technical and business knowledge. The company’s business having been taken by the Life Insurance Corporation of India (LIC), it had no business left of its own. The Apex Court held that the payment was *ultra vires* the company. They could spend for the

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\(^{44}\) AIR 1963 SC 1185
promotion only on such charitable objects as would be useful for the attainment of the company’s own object.

In *Smt. Claude Lila Parulekar v. Sakal Papers (P) Ltd.*,\(^{45}\), it was held that the articles will have a contractual force between the company and its members as also between members *inter se* in relation to their rights as such members. Therefore the articles binds the member *inter se*, i.e., one to another as far s rights and duties arising out of the articles are concerned.

In *V.B Rangaraj v. V.B. Gopalkrishnan*,\(^{46}\) it was decided that the AOA are the regulations of the company binding on the company and its shareholders. Shareholders, therefore, cannot among themselves, enter into an agreement which is contrary to or inconsistence with articles of the company.

In *Wood v. Odissa Waterworks*,\(^{47}\) it was held that the directors proposed to pay dividend in kind by issuing debentures. The AOA provided for payment of dividends. The court decided that payment means payment in cash and therefore the company could be compelled to pay dividends in terms of the articles.

In *World India (P) Ltd v. WPI Group Inc., U.S.A.*,\(^{48}\) where respondent shareholder asserted affirmative vote in board meeting in terms of JVA entered into between parties but AOA had not been amended to incorporate affirmative vote provided to respondent, it was held that JVA was not binding on company and respondent could not insist on exercise of affirmative vote.

### 2.13.3 PROTECTION THROUGH ADVERTISEMENT OF PROSPECTUS AND OTHER ESSENTIAL DOCUMENTS:

Disclosure is the basic principle of corporate governance. Companies are required to make relevant and correct disclosure on its status, object, financial position, joint ventures etc. in the general meeting to its shareholders. Every member of the

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\(^{45}\) [(2005) 59 SCL 414 (SC)]

\(^{46}\) [(1992) 73 Comp. Cas. 201 (SC)]

\(^{47}\) [(1889) 42 Ch. D. 636]

\(^{48}\) [2013] taxmann.com 238
company would like to know its financial soundness. These disclosures are available through following four ways in the companies Act-

(a) Notification in Official Gazette

(b) Registration of the company at Registrar of the Company

(c) Compulsory keeping of various registers/documents of the company

(d) Compulsory disclosure of the financial status of the company

Investors get valuable information of a company through various notifications published in official gazette. Official gazette is an authorised legal document of Government of India, which is authentic in content, accurate and strictly in accordance with the Government policies and decisions. Prospectus is the first document of a company which provides many important information to prospective investors.

According to section 2 (70), a **prospectus** means any document described or issued as a prospectus and includes a red herring prospectus or shelf prospectus 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. A document shall be called a prospectus if it satisfies two things-

(i) when it invites subscription to or purchase of, shares or debenture or any other securities of a body corporate

(ii) the aforesaid invitation is made to the public.

According to section 26 of the Act and Rule 3 of the Companies (Prospectus and Allotment of Securities) Rules 2014, a prospectus requires to state the **following information of the company**-

(a) the names, addresses and contact details of the registered office of the company, company secretary, CFO, auditors, legal advisor, trustee if any, compliance officer of the issuer company, merchant bankers and co-managers to the issue, registrar to the issue, bankers to the issue, stock brokers to the
issue, credit rating agency for the issue, arrangers, if any, of the instrument, names and addresses of such other persons as may be specified by the Securities and Exchange Board in its regulations;

(b) the dates relating to opening and closing of the issue;

(c) a declaration which shall be made by the Board or the Committee authorised by the Board in the prospectus that the allotment letters shall be issued or application money shall be refunded within fifteen days from the closure of the issue or such lesser time as may be specified by Securities and Exchange Board or else the application money shall be refunded to the applicants forthwith, failing which interest shall be due to be paid to the applicants at the rate of fifteen per cent per annum for the delayed period.

(d) a statement given by the Board that all monies received out of the issue shall be transferred to a separate bank account maintained with a Scheduled Bank;

(e) the details of all utilized and unutilized monies out of the monies collected in the previous issue made by way of public offer shall be disclosed and continued to be disclosed in the balance sheet till the time any part of the proceeds of such previous issue remains unutilized indicating the purpose for which such monies have been utilized, and the securities or other forms of financial assets in which such unutilized monies have been invested;

(f) the names, addresses, telephone numbers, fax numbers and e-mail addresses of the underwriters and the amount underwritten by them;

(g) the consent of trustees, solicitors or advocates, merchant bankers to the issue, registrar to the issue, lenders and experts;

The capital structure of the company shall be presented in the manner as prescribed in Rule 3 (2) and should contain the following details -

(i) (a) the authorised, issued, subscribed and paid up capital (number of securities, description and aggregate nominal value);
(b) the size of the present issue;

(c) the paid up capital- (A) after the issue and (B) after conversion of convertible instruments (if applicable);

(d) the share premium account (before and after the issue)

(ii) the details of the existing share capital of the issuer company in a tabular form, indicating therein with regard to each allotment, the date of allotment, the number of shares allotted, the face value of the shares allotted, the price and the form of consideration:

Provided that in the case of an initial public offer of an existing company, the details regarding individual allotment shall be given from the date of incorporation of the issuer and in the case of a listed issuer company, the details shall be given for five years immediately preceding the date of filing of the prospectus.

Provided that the issuer company shall also disclose the number and price at which each of the allotments were made in the last two years preceding the date of the prospectus separately indicating the allotments made for considerations other than cash and the details of the consideration in each case.

According to Rule 3(3), the prospectus to be issued shall contain the following particulars, namely:

(a) the objects of the issue;

(b) the purpose for which there is a requirement of funds;

(c) the funding plan (means of finance);

(d) the summary of the project appraisal report (if any);

(e) the schedule of implementation of the project;

(f) the interim use of funds, if any.
In this way prospectus contains important information of a company which serve important role in protection of the investors.

Section 128 of the Companies Act, 2013 provides that every company should prepare and keep at its registered office books of account and other relevant books and papers and financial statement for every financial year which gives a true and fair view of the state of the affairs of the company. The definition of ‘book of account’ is given in section 2(13) of the Act which states that the ‘books of account’ includes records maintained in respect of-

(i) all sums of money received and expended by a company and matters in relation to which the receipts and expenditure take place;

(ii) all sales and purchases of goods and services by the company;

(iii) the assets and liabilities of the company; and

(iv) the items of cost as may be prescribed under section 148 in the case of a company which belongs to any class of companies specified under that section.

To satisfy the above requirements, companies usually maintain the following books and records:

(a) Cash book to record cash and bank receipt and payment, cash discount received and allowed,

(b) Purchase Day Book, Purchase Book, Invoice Book or Bought Book for recording credit purchase,

(c) Sale Day Book, Sales Book or Sold Book for recording credit sales,

(d) Purchase Return Book or Returns Outward Book for recording goods returned by the company,

(e) Sales Return Book or Returns Inward Book to record goods returned to the company,

(f) Bills Receivable Book to keep a record of bills of exchange receivable,
(g) Bills payable Books to keep e record of bills of exchange payable,

(h) Journal to record opening entries, transfers from one account to another,

(i) Customers’ Ledger or Debtors’ ledger showing the position of account with company’s customers enjoying credit facilities,

(j) Suppliers ledger or Creditors’ Ledger showing the company’s indebtedness to parties which supplied goods to the company on credit,

(k) General Ledger showing accounts other than those of customers and suppliers mentioned in (i) and (j),

(l) Cost Accounting Records as prescribed.

Apart from the above Books of Account, companies also maintain Vouchers, Bills, Invoices and other documents supporting each entry in the Books of Account as well as other records such as Stock records, Stock-taking statements, Bank reconciliation statement etc. These are only an illustrative list and many companies maintain other books of account also. Many companies combine some of the above books and records.\textsuperscript{49}

Section 128 of the Companies Act, 2013 provides that every company should prepare books of account, other relevant books and financial statement for every financial year and to be kept at its \textbf{registered office}. The following persons of the company are responsible for keeping proper books of account and records of the company as per the section 128(6)-

(a) the managing director of the company,

(b) the whole time director in charge of finance,

(c) the Chief Financial Officer or

(d) any other person of the company charged by the Board

In case of contravention, the company itself is not punishable but abovementioned persons are held liable and they may be punished with imprisonment or with heavy

fine or with both as prescribed in the Act. The following punishments are prescribed for non-compliance with this section-

(a) imprisonment which may extend up to one year, or,

(b) with fine of not less than rupees fifty thousand but may be extended to rupees five lakh, or,

(c) with both.

Section 128(2) of the Companies Act, 2013 further prescribes that where a company has a branch office, whether in India or outside India, the company shall be deemed to have complied with the provisions of section 128(1), if proper books of account relating to the transactions effected at the branch office are kept at that office and proper summarized returns, made up to date, at the intervals of not more than three months, are sent by the branch office to the registered office of the company or at such other address where the books of account are kept by fulfilling the requirements mentioned earlier. This requirement is specific that a foreign branch has also to maintain proper books of account as required by section 128(1) of the Act, irrespective of the requirement, if any, in the country where the branch is located.

Every company is required to preserve the books of accounts, related vouchers and other relevant records in good condition for a period of not less than eight years immediately preceding the current year. Where the company had not been in existence for a period less than eight years, the books of account and related vouchers should be preserved in good order right from the first accounting year of the company. A new provision has been added in the Act of 2013, that where an investigation has been ordered in respect of the company under Chapter XIV, the Central Government may direct that the books of account may be kept for such longer period as it may deem fit.  

50. S. 128(5) of the Act of 2013
Section 135 of the Act of 2013 made it mandatory for every company having specified net worth or turnover or net profit during any financial year, to spend in every financial year, at least two percent of the average net profits made during the three immediate preceding financial years, in pursuance of its corporate social responsibility policy. It requires such companies to constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director. The companies specified for this purpose are those having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year. The composition of the committee formed under Section 135 needs to be disclosed in the Board’s report. Clause (o) of the Section 134(3) requires disclosure of company’s policy and initiatives taken during the year. The Companies (Social Responsibility Policy) Rules 2014 states that the Board’s report shall include an annual report on CSR containing particulars specified in the Annexure to the rules and also be disclosed on the company’s website.

The Companies Act, 2013 also permits the company to maintain the books of account and other relevant paper in an electronic mode. If a company decides to maintain the books of account in the electronic mode, the Rule 3 of the Companies (Accounts) Rules, 2014 requires that such books of account and records to remain accessible in India for being usable subsequently. Such books and records must be maintained in the format in which they were originally generated, sent or received. Such books of account kept in electronic mode are also subject matter of inspection.

Section 137 of the Act has prescribed that a copy of financial statement of a company is required to be filed with Company Registrar. It states that a copy of the financial statements, including consolidated financial statement, if any, along with all the documents which are required to be or attached to such financial statements under this Act, duly adopted at the annual general meeting of the company, shall be filed with the Registrar within thirty days of the date of annual
general meeting in such manner, with such fees or additional fees as may be
prescribed within the time specified under section 403. The proviso states that
where the financial statements are not adopted at annual general meeting or
adjourned annual general meeting, such unadopted financial statements along with
the required documents shall be filed with the Registrar within thirty days of the
date of annual general meeting and the Registrar shall take them in his records as
provisional till the financial statements are filed with him after their adoption in the
adjourned annual general meeting for that purpose.

The proviso of section 137 further provides that financial statements adopted in the
adjourned annual general meeting shall be filed with the Registrar within thirty
days of the date of such adjourned annual general meeting with such fees or such
additional fees as may be prescribed within the time specified under section 403.

In case of a One Person Company shall file a copy of the financial statements duly
adopted by its member, along with all the documents which are required to be
attached to such financial statements, within one hundred eighty days from the
closure of the financial year.

Section 137(2) of the Act also states that where the annual general meeting of a
company for any year has not been held, the financial statements along with the
documents required to be attached duly signed along with the statement of facts
and reasons for not holding the annual general meeting shall be filed with the
Registrar within thirty days of the last date before which the annual general
meeting should have been held and in such manner, with such fees or additional
fees as may be prescribed within the time specified, under section 403.

There is provision of punishment under section 137(3) of the Act. It prescribes
that if a company fails to file the copy of the financial statements before the expiry
of the period specified in section 403, the company shall be punishable with fine of
one thousand rupees for every day during which the failure continues but which
shall not be more than ten lakh rupees, and the managing director and the Chief
Financial Officer of the company, if any, and, in the absence of the managing
director and the Chief Financial Officer, any other director who is charged by the Board with the responsibility of complying with the provisions of this section, and, in the absence of any such director, all the directors of the company, shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees, or with both.

In this way prospectus provides important information of a company to its intending investors who decides whether or not they should subscribe to the shares or debentures. The company law requires fair disclosure of various matters through prospectus and forbids variations of any terms and conditions of a contract contained therein except with the approval and authority of the company in AGM. In case of any mis-statement in the prospectus criminal liabilities as well as civil liability are imposed to the promoter, director and all those persons, responsible for fraud. Stock Exchange Board of India (SEBI) has also issued guidelines for the protection of the investors through the Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2009, which has been discussed in Para 2.15.4 in detail (infra).

2.13.4 PROTECTIONS THROUGH INSPECTION, INQUIRY, INVESTIGATION AND AUDIT OF THE DOCUMENTS AND RECORDS

Every company maintains the register of their members indicating separately for each class of equity and preference shares holders, debenture holders and other security holders at the registered office of the company or at any such places as prescribed by the Companies Act, 2013. It is also necessary by every company to prepare annual return every year as prescribed by the Act, duly signed by a director and the company secretary and to be kept at the registered office of the company. These all registers, copies of annual returns and other records are kept open for inspection by any member, debenture-holder, other security holder or beneficial
owner during business hours without payment of any fees. They can also take extracts from any register or records without payment of any fees.\textsuperscript{51}

Periodic inspection of these important documents of a company is necessary to know the fairness and transparent functioning of the company, which is also important to protect the interests of investors of the company. The Company Registrar is empowered by section 206 of the Companies Act, 2013, to call for further information, inspection of books and conduct inquiries in case he is not satisfied after scrutiny of documents filed by the company before him or any information received by him.

Investigation of a company is the process to examine the management of the company’s affairs to find out whether any irregularities have been committed or not. Under section 210 an inspector is appointed only to investigate the affairs of a company and to make a report thereon. The Act also empowers the Central Government with the right to investigate the affairs of the company, especially in cases of an alleged fraud or even in the oppression of the minority shareholders.

There are following three types of investigation mentioned in the Companies Act 2013:-

(i) Investigation into the affairs of the Companies
(ii) Investigation into company’s affairs in other cases
(iii) Investigation into the ownership of the Companies

The provisions related to inspection, inquiry and investigation are available from Sections 139 to 148 of the Act and detail studies have been made in chapter III and IV respectively.

Audit has become an essential requirement for good corporate governance and it plays a major role in ensuring transparency and accountability in the corporate financial administration. A company carries on business with capital provided by persons who are not in control of the use of the money supplied by them. They would, therefore, like to see their investments are safe, being used for intended

\textsuperscript{51} s.94(3) of the Companies Act, 2013
purposes and the annual accounts of the company present a true and fair view of the state of affairs of the company. For this purpose, the accounts of the company must be checked and audited by a duly qualified and independent person who is neither employed in the company nor is in any way indebted or otherwise obliged to the company. Sections 206 to 229 of the Act deal with the audit and detail study has been made in chapter V.

2.13.5 PROTECTION AVAILABLE THROUGH VARIOUS MEETINGS OF THE COMPANY

It is important to call meeting to pass resolutions to protect the interest of the investors. Protection of investors is one of the primary objects of the Act of 2013. Section 96 of the Act provides the shareholders/members with a forum of self protection. This forum is the general meeting of the shareholders. One meeting that is compulsory to be held every year is the annual general meeting (AGM). Other meetings are left to the choice of the management or to a given percentage of shareholders to exercise their power to compel the company to convene a meeting. A number of important managerial decisions are approved by the shareholders in AGM. For this purpose, they must have adequate information supplied to them well in advance of the date of meeting. When members are fully equipped with information only then will they be able to fulfill the underlying purpose of requiring companies to hold meetings, which is that the members shall be able to attend in person so as to debate and vote on matters affecting the company. The members should be adequately represented at the meeting in the form of quorum. They should have a free and fair opportunity of considering matters that come before the meeting. The members can use the forum for exercising their rights as members in appointing and removing directors, i.e. to constitute management, appoint auditors and participate in other decisions which requires approval of the members and therefore, there can be no disproportionate voting rights for shareholders holding shares of the same class.

52. Ramaiya, Guide to the Companies Act (18th edn.), p. 1623, Lexis Nexis
The Act of 2013 provides following three types of meeting with which shareholders are directly concerned.

1. Annual General Meeting (AGM)

2. Extra-ordinary general meeting and

3. Class meeting

Here, it is worth to be mentioned that the provisions related to Statutory meeting of the company under the Act of 1956 is now omitted in the Act of 2013.

2.13.5.1 ANNUAL GENERAL MEETING

The most important meeting of the shareholders, at which the ‘ordinary business’ of the company is transacted is the AGM. This meeting provides a forum to members for expressing their views and discussing important matters related to the company’s affairs. This is the forum at which policy making decisions are taken and in the meeting shareholders exercise their corporate powers and control over Board of directors. In the interest of general public and the shareholders who are less conversant with the complexities of the company law, it becomes essential that the company statute should regulate the holding and conduct of this meeting and ensures that interests of all shareholders are properly safeguarded.

According to section 96 of the Act, every company other than a One Person Company shall in each year hold in addition to any other meetings every year, a general meeting as its annual general meeting and shall specify the meeting as such in the notices calling it. The Act provides two conditions as regards the holding of an AGM:

(a) it should be held every year and

(b) not more than fifteen months should elapse between the date of one AGM of a company and that of the next.

But in case of the first AGM, it shall be held within a period of nine months from the date of closing of the first financial year of the company and in any other case,
within a period of six months, from the date of closing of the financial year and then no meeting will be necessary for the year of incorporation.

In *T.V.Mathew v. Nadukara Agro Processing Co. Ltd*\(^5\), the Kerala High Court held that the first AGM cannot be deferred as there is no provision in the company Act.

The Registrar is empowered to extend the time within which any AGM, other than the first AGM, shall be held, by a period not exceeding three months, for any special reason.\(^5\)

Section 97 of the Act provides that if any default is made in holding the AGM of a company under section 96, the Tribunal may, notwithstanding anything contained in this Act or the articles of the company, on the application of any member of the company, call, or direct the calling of, an AGM of the company and give such ancillary or consequential directions as the Tribunal thinks expedient.

Directions given by the Tribunal may include a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting. A general meeting held in pursuance of section 97 shall, subject to any directions of the Tribunal, be deemed to be an AGM of the company under this Act.

If any default is made in holding a meeting of the company in accordance with section 96 or section 97 or section 98 or in complying with any directions of the Tribunal, the company and every officer of the company who is in default shall be punishable with fine which may extend to one lakh rupees and in the case of a continuing default, with a further fine which may extend to five thousand rupees for every day during which such default continues.\(^5\)

**IMPORTANCE OF AGM**

AGM is an important institution for the protection of members/shareholders of a company. The ultimate control and destiny of a company should be in hands of its

\(^5\) Proviso of S.96 of the Act

\(^5\) S. 99 of the Act
shareholders. It is, therefore, desirable that the shareholders should come together in a year to review the working of the company. This meeting affords that opportunity to them. It is not practical to list all business which can be transacted at the AGM. Any business can be transacted at the AGM and as to what business can be conducted at AGM generally depends upon the articles of association. The companies Act, however, requires certain business to be transacted at the AGM. They are:

(i) consideration of accounts, balance sheet, report of directors and auditors—Chairman delivers a speech listing the advances of the company during the year. Directors have to present annual accounts for consideration of the shareholders. A failure to present the account is punishable offence. The shareholders can ask any questions relating to accounts or affairs of the company.

(ii) the election or re-election of a director— it is at this meeting that some of the directors will retire and come up for re-election and the shareholders will be able to exercise real control by refusing to re-elect a director whose action and policy they disapprove.

(iii) auditors retire at this meeting enabling the shareholders to considered whether they should be re-appointed or replaced.

(iv) fixing of remuneration of directors and auditors

(v) generally dividends are declared at AGM.

2.13.5.2 EXTRAORDINARY GENERAL MEETING

As discussed above, AGM is held once in a year but, in practical, it observed that some time, situation may arise in between two AGM that an urgent decision is required to be taken by the shareholders. According to Clause 42 of the Table F (Schedule 1), all general meetings other than AGMs are known as extraordinary general meetings (EOM). According to section 100, the Board may, whenever it

56. s. 136 and 137
57. s. 139
deems fit, call an extraordinary general meeting of the company at the requisition made by,—

(i) in the case of a company having a share capital, such number of members who hold, on the date of the receipt of the requisition, not less than one-tenth of such of the paid-up share capital of the company as on that date carries the right of voting;

(ii) in the case of a company not having a share capital, such number of members who have, on the date of receipt of the requisition, not less than one-tenth of the total voting power of all the members having on the said date a right to vote, call an EOM of the company within the period specified.

Therefore, this provision the Act empowers specific number of shareholders the right to convene an EOM of the company. In such a situation it is obligatory on the part of directors to call EOM provided such requisition is made by holders of not less than one tenth of the equity capital carrying voting rights.

If the Board does not, within twenty-one days from the date of receipt of a valid requisition in regard to any matter, proceed to call a meeting for the consideration of that matter on a day not later than forty-five days from the date of receipt of such requisition, the meeting may be called and held by the requisitionists themselves within a period of three months from the date of the requisition.58

The requisition must set out the matters for the consideration of which the meeting is to be called. No other business can be done. For example, where certain shareholders requisitioned a meeting for the appointment of three new directors, and subsequently the chairman wanted to add to the agenda the removal of a director also, the meeting was restrained from considering the matter.59 Only such matters can be taken up at the meeting in respect of which the requisitionists possess the same voting strength as is required to requisition a meeting.

58. S. 100 (4)
59. Ball v. Metal Industries Ltd, 1957 SLT 124 (Scotland)
The class meetings of shareholders may also be called EOMs but they are not so in the strict sense. As they are the meetings of a particular group of shareholders and not all shareholders, it is better to group them separately.

In *Life Insurance Company v. Escorts*, it was held that shareholders have the right to requisition an EOM of a company for removal and appointment of directors and if the company does not issue a notice within 21 days convening the meeting within 45 days, the requisitionists have the right to convene the meeting. Therefore, when the requisitionists convened the EOM in accordance with law, the said meeting cannot be impugned nor the decisions taken threat for removal and appointment of directors.

In *BG Somayaji v. Karnataka Bank Ltd.*, it was also held that a requisition for an EOM drafted by one shareholder who has *locus standi* and signed by the prescribed number of shareholders is valid.

### 2.13.5.3 CLASS MEETINGS

As discussed earlier, the share capital of a company may be divided into different classes. The holders of these shares carry different rights from the holders of equity shares. The holders of shares of each type constitute one class, e.g. preference shareholders, creditors’ etc. class meetings are called when it is proposed to modify or vary any rights or privileges of a particular class of shareholders. These meetings are held to pass resolution which will bind the members of class concerned, and only that class can attend and vote.

Section 48 of the Act, provides that where a share capital of the company is divided into different classes of shares, the rights attached to the shares of any class may be varied with the consent in writing of the holders of not less than three-fourths of the issued shares of that class or by means of a special resolution passed at a separate meeting of the holders of the issued shares of that class.

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60. AIR 1986 SC 1370
61. [2011] 3 Comp LJ 547 (CLB)
62. AIR 1995 Kant 344
(a) if provision with respect to such variation is contained in the memorandum or articles of the company; or

(b) in the absence of any such provision in the memorandum or articles, if such variation is not prohibited by the terms of issue of the shares of that class:

In case variation by one class of shareholders affects the rights of any other class of shareholders, the consent of three-fourths of such other class of shareholders shall also be obtained.

Unless the articles of the company or a contract binding on the person or class concerned otherwise provides, all provision pertaining to calling of a general meeting and its conduct, apply to such meetings.

2.13.6 PROTECTION AGAINST OPPRESSION AND MISMANAGEMENT:

Democratic decisions are made in accordance with the majority decision and are deemed to be fair and justified while overshadowing the minority concerns. The corporate world has adopted this majority rule in decision making process and management of the companies. Statutory provisions in this regard have been provided under the Companies Act, 2013. “Despite the fact provisions have been in place under the Companies Act, 1956 to protect the interest of the minority shareholders, the minority has been incapable or unwilling due to lack of time, recourse or capability, financial or otherwise. This has resulted in the minority to either let the majority dominate and suppress them or squeeze them out of the decision making process of the company and eventually the company. The Act of 2013 has sought to invariably provide for protection of minority shareholders rights and can be regarded as a game changer in the tussle between the majority and minority shareholders. Various provisions have been introduced in the Act of
2013 to essentially bridge the gap towards protection and welfare of the minority shareholders.”

The fundamental principle relating to the administration of the internal affairs of a company is that “the court will not, in general, intervene at the instance of shareholders in matters of internal administration; and will not interfere with the management of a company by its directors so long as they are acting within the powers conferred on them under the articles of the company” in other words, the court will not interfere so long it as they are performing on the basis of “Principle of majority.” This principle is evolved in the famous case, Foss v. Harbottle. Once a resolution is passed by requisite majority then it is binding on all the members of the company.

The protection of the minority shareholders within the domain of corporate activity constitutes one of the most difficult problems facing modern corporate laws. The aim must be to strike a balance between the effective control of the company and interests of small individual shareholders. According to Palmer- “A proper balance of the rights of majority and minority shareholder’s is essential for the smooth functioning of the company.” The Act of 2013, therefore, contains a large number of provisions for the protection of the interests of investors in companies. The aim of these provisions is to require those who control the affairs of a company to exercise their powers according to certain principles of natural justice. The Act provides special provisions for prevention of oppression and mismanagement and to safeguard the interest of investors including minority shareholders, in chapter XVI, from section 241 to 246.

64. Rajahmundry Electric Supply Corp Ltd v. A Nageshwara Rao, AIR 1956 SC 213
65. [1843] 2 Hare 461: 67 ER 189
2.13.6.1 RIGHT TO APPLY TO TRIBUNAL FOR RELIEF AGAINST OPPRESSION AND MIS-MANAGEMENT

The first remedy in the hands of oppressed minority is to move the Tribunal. Whenever the affairs of the company have been or are being conducted in a manner prejudicial to public interest or in a manner prejudicial or oppressive to any other member or members, an application can be made to the Tribunal under section 241(1) (a) of the Act. Alternatively, an application can be made to the Tribunal under sub-clause (b) of this section on the grounds that the material change, not being a change brought about by, or in the interests of, any creditors, including debenture holders or any class of shareholders of the company, has taken place in the management or control of the company, whether by an alteration in the Board of Directors, or manager, or in the ownership of the company’s shares, or if it has no share capital, in its membership, or in any other manner whatsoever, and that by reason of such change, it is likely that the affairs of the company will be conducted in a manner prejudicial to its interests or its members or any class of members.

Section 241 (2) provides that an application may be made to the Tribunal for an order by the Central Government, if it is of the opinion that the affairs of the company are being conducted in a manner prejudicial to public interest. In *N.R Murthy v. Industrial Development Corporation of Orissa Ltd.*⁶⁷, it was held that in the case of a company indented to operate in modern welfare State, the concept of ‘public interest’ takes the company outside the conventional sphere of being a concern in which the shareholders alone are concerned. It emphasises the idea of the company functioning for the public good or general welfare of the community, at any rate, not in manner detrimental to the public goods.

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⁶⁷. [1977] 47 Comp. Cas. 389 (Ori)
2.13.6.2 WHO CAN APPLY

The requisite number of members, who must sign the application, is given in section 241. The requirement varies with the fact as to whether the company has a share capital or not. It states that-

(i) in the case of a company having a share capital, the application must be signed by not less than one hundred members of the company or not less than one-tenth of the total number of its members, whichever is less, or any member or members holding not less than one tenth of the issued share capital of the company, subject to the condition that the applicant or applicants has or have paid all calls and other sums due on his or their shares;

(ii) in the case of a company not having a share capital, the application must be signed by not less than one-fifth of the total number of its members:

Here, it is also significant to note that the Tribunal has right to waive all or any of the requirement as aforesaid to enable the members to make the application under section 241, in case of joint holding of the shares, the joint holders will be counted one.68 Further, a member after taking consent of the requisite number of the members may make the application on behalf of all of them.69

2.13.6.3 POWERS OF TRIBUNAL TO GRANT RELIEF

Section 242 provides that the Tribunal is empowered to make order to bring an end to the matter complained of and may provide for the following-

(a) the regulation of conduct of affairs of the company in future;

(b) the purchase of shares or interests of any members of the company by other members thereof or by the company;

(c) in the case of a purchase of its shares by the company as aforesaid, the consequent reduction of its share capital;

(d) restrictions on the transfer or allotment of the shares of the company;

68. Proviso of s. 244 (1).
69. subsection (2) of S. 244
(e) the termination, setting aside or modification, of any agreement, howsoever arrived at, between the company and the managing director, any other director or manager, upon such terms and conditions as may, in the opinion of the Tribunal, be just and equitable in the circumstances of the case;

(f) the termination, setting aside or modification of any agreement between the company and any person other than those referred to in clause (e):

Provided that no such agreement shall be terminated, set aside or modified except after due notice and after obtaining the consent of the party concerned;

(g) the setting aside of any transfer, delivery of goods, payment, execution or other act relating to property made or done by or against the company within three months before the date of the application under this section, which would, if made or done by or against an individual, be deemed in his insolvency to be a fraudulent preference;

(h) removal of the managing director, manager or any of the directors of the company;

(i) recovery of undue gains made by any managing director, manager or director during the period of his appointment as such and the manner of utilisation of the recovery including transfer to Investor Education and Protection Fund or repayment to identifiable victims;

(j) the manner in which the managing director or manager of the company may be appointed subsequent to an order removing the existing managing director or manager of the company made under clause (h);

(k) appointment of such number of persons as directors, who may be required by the Tribunal to report to the Tribunal on such matters as the Tribunal may direct;

(l) imposition of costs as may be deemed fit by the Tribunal;

(m) any other matter for which, in the opinion of the Tribunal, it is just and equitable that provision should be made.
2.13.6.4 CLASS ACTION BY MEMBERS OR DEPOSITORIES AGAINST MIS-MANAGEMENT

Section 245 is a new provision of the Act of 2013 which provides provision for class action by members or depositaries against the mis-management or conduct of the affairs of the company which is conducted in a manner prejudicial to the interests of the company or its members or depositors. The requisite number of members in case of a company having a share capital, not less than one hundred members of the company or not less than such percentage of the total number of its members as may be prescribed, whichever is less can apply to Tribunal for seeking all or any of the following remedial action –

(a) to restrain the company from committing an act which is *ultra vires* the articles or memorandum of the company;

(b) to restrain the company from committing breach of any provision of the company’s memorandum or articles;

(c) to declare a resolution altering the memorandum or articles of the company as void if the resolution was passed by suppression of material facts or obtained by mis-statement to the members or depositors;

(d) to restrain the company and its directors from acting on such resolution;

(e) to restrain the company from doing an act which is contrary to the provisions of this Act or any other law for the time being in force;

(f) to restrain the company from taking action contrary to any resolution passed by the members;

(g) to claim damages or compensation or demand any other suitable action from or against—

(i) the company or its directors for any fraudulent, unlawful or wrongful act or omission or conduct or any likely act or omission or conduct on its or their part;
(ii) the auditor including audit firm of the company for any improper or misleading statement of particulars made in his audit report or for any fraudulent, unlawful or wrongful act or conduct; or

(iii) any expert or advisor or consultant or any other person for any incorrect or misleading statement made to the company or for any fraudulent, unlawful or wrongful act or conduct or any likely act or conduct on his part;

(h) to seek any other remedy as the Tribunal may deem fit.

In Bajirao G. Ghatke v. Bombay Docking Co. (P.) Ltd.,\textsuperscript{70} it was held that non maintenance of statutory records and not conducting affairs of the company in accordance with the Companies Act is an act of oppression.

In re Hindustan Co-operative Insurance Society Ltd.,\textsuperscript{71} it was held oppression if the shareholders are kept in dark and not calling a general meeting of the company.

In Mohan Lal Chandu Mal v. Punjab Company Ltd.,\textsuperscript{72} it was held that act of the company depriving a member of the right of getting dividend, oppressive.

In Radhe Shyam Tulsian v. Panchmukhi Inv. Ltd.,\textsuperscript{73} it was held that irregular appointment of director on the strength of irregular allotment of shares is an act of oppressive.

In Birla Education Trust v. Birla Corporation Ltd.,\textsuperscript{74} it was held that illegal and ultra virus action by the Board controlling by Chief managing director and his group constituting majority is an act of as a consequences of mismanagement.

In Rajiv Kant Laxman v. Bobby Electronics (P) Ltd.,\textsuperscript{75} the share capital of a company was increased to meet out urgent requirement of funds. The holding of EOGM and allotment of shares was not strictly in accordance with the requirement

\textsuperscript{70.} [1984] 56 Comp.Cas. 428 (Bom.)
\textsuperscript{71.} [1961] 31 Comp. Cas. 193 (Cal.)
\textsuperscript{72.} [1962] 32 Comp. Cas. 937 (Punj.)
\textsuperscript{73.} [2002] 35 SCL 849 (CLB)
\textsuperscript{74.} [2012] 114 SCL 31 (CLB)
\textsuperscript{75.} [2014] 43 taxmann. Com 54 (Mumbai)
of the Companies Act. It was held that as share capital was increased to meet out urgent requirement of funds, holding of EOGM and allotment of impugned shares, even if not be strictly in accordance with provisions of the Act, did not amount to an act of oppression.

In *P.N.Nahar v. Nahar Textile (P) Ltd.*,\(^{76}\) it was held that an attempt by the persons managing company to sell immovable property of company at under price for their personal gain was held to be oppressive and prejudicial conduct detrimental to interest of all stakeholders.

### 2.13.7 PROTECTION DURING WINDING UP OF THE COMPANY

Winding up of a company is the process whereby its life is ended and its property administered for the benefit of its creditors and members. An administrator, called a liquidator, is appointed and he takes control of the company, collects its assets, pays it debts and finally distributes any surplus among the members in accordance with their rights.\(^{77}\)

According to Pennington, “Winding up or liquidation is the process by which the management of a company’s affairs is taken out of its director’s hand, its assets are realized by a liquidator and its debts and liabilities are discharged out of the proceeds of realization and any surplus of assets remaining is returned to its members or shareholders. At the end of the winding up the company will have no assets or liabilities and it will therefore be simply a formal step for it to be dissolved, that is, for its legal personality as a corporation to be brought to an end”.\(^{78}\)

There are two modes of winding up of a company, prescribed in the Act-

(i) by the Tribunal making a winding up order. This is also known as compulsory winding up.

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76. [2014] 46 taxmann. Com 86 (Mumbai)
78. Pennington’s *Company Law*, 5th Edn., p.839
(ii) by passing of an appropriate resolution for voluntary winding up at a general meeting of members. This is also known as voluntary winding up.

2.13.7.1 COMPULSORY WINDING UP

Compulsory winding up of a company takes place by the Tribunal on the petition filed under the Act (section 272). Section 271 of the Act provides the following circumstances under which a company will be wound up-

(a) if the company is unable to pay its debts;

(b) if the company has, by special resolution, resolved that the company be wound up by the Tribunal;

(c) if the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality;

(d) if the Tribunal has ordered the winding up of the company under Chapter XIX (i.e. if revival and rehabilitation of sick company is found unlikely by the Tribunal);

(e) if on an application made by the Registrar or any other person authorised by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up;

(f) if the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years; or

(g) if the Tribunal is of the opinion that it is just and equitable that the company should be wound up.
2.13.7.2 VOLUNTARY WINDING UP

When a company is wound up by the members or creditors without intervention of Tribunal, it is known as Voluntary winding up. In this type of winding up, the company and its creditors are left free to settle their affairs without going to the Tribunal although they may apply to Tribunal for directions or order if and when necessary. Section 304 of the Act prescribes circumstances in which a company may be wound up voluntarily in the following two ways-

(a) if the company in general meeting passes a resolution requiring the company to be wound up voluntarily

(i) where the period fixed by the Articles for the duration of the company has expired, or

(ii) the event has occurred on which under the Articles the company is be dissolved;

(b) if the company passes a special resolution that the company be wound up voluntarily.

2.13.7.3 PUBLICATION OF RESOLUTION TO WIND UP VOLUNTARILY

Section 307 of the Act provides that where a company has passed a resolution for voluntary winding up and a resolution is passed, it must within fourteen days of the passing of the resolution give notice of the resolution by advertisement in the Official Gazette and also in a newspaper which is in circulation in the district where the registered Office or the principal office of the company is situated. In case of contravention, the company and every officer of the company who is in default shall be punishable with fine which may extend to five thousand rupees for every day during which such default continues.
2.13.7.4 PROTECTION OF INVESTORS DURING WINDING UP OF A COMPANY

(a) According to section 313 of the Act, on the appointment of a Company Liquidator, all the powers of the Board of Directors and of the managing or whole-time directors and manager, if any, shall cease, except for the purpose of giving notice of such appointment of the Company Liquidator to the Registrar.

(b) Where the Company Liquidator has made a report to the Tribunal stating that in his opinion a fraud has been committed by any person in the promotion, formation, business or conduct of affairs of the company since its formation, the Tribunal under section 300, may direct that such person or officer shall attend before the Tribunal and be examined as to the promotion or formation or the conduct of the business of the company or as to his conduct and dealings as an officer thereof.

(c) Section 283 has prescribed that where a winding up order has been made or where a provisional liquidator has been appointed, the Company Liquidator or the provisional liquidator, as the case may be, shall, on the order of the Tribunal, forthwith take into his or its custody or control all the property, effects and actionable claims to which the company is or appears to be entitled to and take such steps and measures, as may be necessary, to protect and preserve the properties of the company.

(d) According to section 279 of the Act, when a winding up order has been passed or a provisional liquidator has been appointed, all actions and suits against the company except cases on appeal pending before the Supreme Court or the High Court are stayed, unless the Tribunal gives leave to continue or commence proceedings.

(e) Section 328 provides the provision to prevent fraudulent preference transfer of movables or immovable to creditors. Tribunal may declare such fraudulent preference of transaction invalid which serves as protection to bonafide investors.
(f) Any floating charge created within 12 months immediately preceding the commencement of winding up is void unless it is proved that the company after creation of the charge was solvent. However, any cash advanced at the time of or subsequent to the creation of, and in consideration for, the charge together with or to any interest on that amount @ 5% p.a. or such other rate notified by the Central Government in Official Gazette shall not be invalid. This provision under section 332 of the Act also serves protection to investors.

(g) Section 335 (1) (a) provides that any attachment, distress or execution put in force, without leave of the Tribunal against the estate or effects of the company after the commencement of the winding up shall be void. However this provision will not apply to any proceeding for the recovery of any tax or impost or any dues payable to Government.

(h) Section 335 (1) (b) provides that any sale held without leave of the Tribunal, of any properties of effects of the company after commencement of winding up shall be void.

(i) As soon as the affairs of a company are fully wound up, the Company Liquidator shall

   (i) prepare a report of the winding up showing that the property and assets of the company have been disposed of and its debt fully discharged or discharged to the satisfaction of the creditors; and

   (ii) call a general meeting of the company for the purpose of laying the final winding up accounts before it and giving any explanation thereon.

   (iii) If the majority of the members of the company after considering the report of the Company Liquidator is satisfied that the company shall be wound up, they may pass a resolution for its dissolution.

(j) The Company liquidator may, with the leave of the Tribunal, disclaims the onerous properties belonging to company as mentioned in section 333 of the Act. Such property may consists-
(i) land of any tenure, burdened with onerous covenants;
(ii) shares or stocks in companies;
(iii) any other property which is not saleable or is not readily saleable by reason of the possessor thereof being bound either to the performance of any onerous act or to the payment of any sum of money; or
(iv) unprofitable contracts.

In *ONGC Ltd. v. Official Liquidator*, the Supreme Court of India held that claim for preferential payment as secured creditor merely on the basis of an undertaking given by company-in-liquidation would not amount to creation of charge. The application was denied preferential payment in priority to secured creditors and workmen and the claims would be payable as per provisions of sections 529 and 529A [corresponding to section 325/326 of the Act of 2013].

In *Kitti Steels Ltd. v. Sanghi Industries Ltd.*, it was held that when a suit has been decreed and the same decree is under appeal, a petition for winding up based on the decree is not tenable.

In *Atlanta Pums (P.) Ltd. v. Mrs Kunda J Majli*, Karnataka High Court held that order of admission of winding up petition has to be speaking and reasoned order. As the admission order of the court was non-speaking and unreasoned, appeal against that order is admissible as the interest of the company concerned can be affected.

**2.14. INVESTOR EDUCATION AND PROTECTION FUND**

Section 125 of the Act corresponds to section 205 C of the Act of 1956. This provision was not the part of the original 1956 Act and was inserted by the Companies (Amendment) Act, 1999 to provide for establishment of investor education and protection fund for the protection and education of investors (IEPF).

**J.J Irani Committee report, 2005** has also recommended for promotion of
investors awareness and education program and establishment of investor’s protection fund. Section 125 of Companies Act, 2013 has incorporated this recommendation to equip the investors with better knowledge of protection against frauds. IEPF is meant for promotion of investors’ awareness and protection of their interests. The IEPF accounts for unclaimed funds from dividends, matured deposits, matured debentures or share application money, which is transferred to the Government by companies if they are not claimed for seven years. The fund is utilized for the purpose of protection of investors and promotion of investor education and awareness. This fund is managed by a Committee that consists of the Secretary, Company Affairs, as well as members from RBI, SEBI and experts on investor protection. The committee considers investor education and protection activities keeping in view the purpose of utilization of fund. Meeting of the committee is convened at least once in 3 months by the convener and in his absence, by any member nominated by the convener, on his behalf. The SEBI ensures maintenance of proper and separate accounts and other relevant records in relation to the fund. Accordingly, SEBI has made regulations for investors’ protection and education fund, 2009, with a view to strengthen its activities for protection of investors, which has been discussed in Para 2.15.8 (infra).

In *Nivedita Sharma v. ICICI Bank Ltd.*\(^{82}\), the constitutional validity of section 205 C of the Act of 1956 was challenged and it was observed that it was enacted with the object to ensure that a company does not unjustified and unduly enrich itself of the money which has not been claimed by the depositors for seven years. Therefore, section 205 C cannot be held to be unconstitutional or violative of Article 14 of the Constitution. The word ‘unclaimed’ used in the proviso to subsection (2) of the section 205 C clarifies that in case a claim is made within a period of 7 years from the date the amount become due and payable, the amount shall not be transferred to the Investor Education and Protection Fund and as such the provisions of the section shall not apply.

\(^{82}\) [2012] 106 CLA 23 (Del)
According to Section 125 of the Act, the following monies shall be credited to this fund-

(a) the amount given by the Central Government by way of grants after due appropriation made by Parliament by law in this behalf for being utilised for the purposes of the Fund;

(b) donations given to the Fund by the Central Government, State Governments, companies or any other institution for the purposes of the Fund;

(c) the amount in the unpaid dividend account of companies transferred to the Fund under sub-section (5) of section 124;

(d) the amount in the general revenue account of the Central Government which had been transferred to that account under sub-section (5) of section 205A of the Companies Act, 1956, as it stood immediately before the commencement of the Companies (Amendment) Act, 1999, and remaining unpaid or unclaimed on the commencement of this Act;

(e) the amount lying in the Investor Education and Protection Fund under section 205C of the Companies Act, 1956;

(f) the interest or other income received out of investments made from the Fund;

(g) the amount received under sub-section (4) of section 38;

(h) the application money received by companies for allotment of any securities and due for refund;

(i) matured deposits with companies other than banking companies;

(j) matured debentures with companies;

(k) interest accrued on the amounts referred to in clauses (h) to (j);

(l) sale proceeds of fractional shares arising out of issuance of bonus shares, merger and amalgamation for seven or more years;
(m) redemption amount of preference shares remaining unpaid or unclaimed for seven or more years; and

(n) such other amount as may be prescribed:

This fund is utilised for following purposes-

(i) the refund in respect of unclaimed dividends, matured deposits, matured debentures, the application money due for refund and interest thereon;

(ii) promotion of investors’ education, awareness and protection;

(iii) distribution of any disgorged amount among eligible and identifiable applicants for shares or debentures, shareholders, debenture-holders or depositors who have suffered losses due to wrong actions by any person, in accordance with the orders made by the Court which had ordered disgorgement;

(iv) reimbursement of legal expenses incurred in pursuing class action suits under sections 37 and 245 by members, debenture-holders or depositors as may be sanctioned by the Tribunal; and

(v) any other purpose incidental thereto, in accordance with such rules as may be prescribed.

2.15 PROTECTIONS TO INVESTORS UNDER STOCK EXCHANGE BOARD OF INDIA (SEBI) ACT, 1992

Securities Exchange Board of India (SEBI) was set up in 1988 to regulate the securities market of India. It promotes orderly and healthy development in the stock market but initially it was not able to exercise complete control over the stock market transactions. Its status was as a watch dog of the securities market, to observe the activities. Consequently, it was found ineffective in regulating and controlling them. Therefore, in May 1992, it was granted legal status by the Parliament by the Securities Exchange Board of India (SEBI) Act, 1992. It is, now, a body corporate having a separate legal existence and perpetual succession. It’s
Headquarter in Mumbai and having nine regional offices across the country, at present.

The primary function of Security and Exchange Board under SEBI Act, 1992 is the protection of the investors’ interest and the healthy development of Indian financial markets. No doubt, it is very difficult and herculean task for the regulators to prevent the scams in the markets considering the great difficulty in regulating and monitoring each and every segment of the financial markets and the same is true for the Indian regulator also. But what are the responsibilities of the regulators to set the system right once the scam has taken place, especially the responsibility of redressing the grievances of the investors so that their confidence is restored. The redressal of investors’ grievances, after the scam, is the most challenging task before the regulators all over the world and the Indian regulator is not an exception. One of the weapons in the hand of the regulators is the collection and distribution of disgorged money to the aggrieved investors. SEBI had issued guidelines for the protection of the investors through the Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2000. These Guidelines were issued by the Securities and Exchange Board of India under Section 11 of the SEBI Act. Further, stringent guidelines were suggested by the C.V Bhave committee and accordingly SEBI (Disclosure and Investor Protection) Guidelines, 2000 was replaced by SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009, which has been discussed in Para 2.15.3 (infra).

Since the empowerment of the Securities and Exchange Board of India (SEBI) through an Act of Parliament in 1992, SEBI has come up with a number of initiatives aimed at regulating and developing the Indian securities market and improving its safety and efficiency. These initiatives have made an impact on nearly every aspect of the market. Some of those initiatives have transformed the market fundamentally. Particularly noteworthy is the growth in the following:

• Market capitalization

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• Number of listed firms

• Trading volumes and turnover both in the spot and futures markets.

2.15.1 INVESTOR PROTECTION MEASURES BY SEBI

Section 11(2) of the SEBI Act contains measures available with SEBI to implement the legislators’ desire of investor protection. The measures available with SEBI include the following:-

1. Regulating the business in Stock Exchanges (SEs) and any other securities markets.

2. Registering and regulating the working of intermediaries like stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers etc. associated with securities markets.

3. Registering and regulating the working of the depositories, participants, custodians of securities, foreign institutional investors, credit rating agencies and other intermediaries.

4. Registering and regulating the working of venture capital funds and collective investment schemes, including mutual funds.

5. Promoting and regulating self-regulatory organizations.

6. Prohibiting fraudulent and unfair trade practices relating to securities markets.

7. Prohibiting insider trading in securities.

8. Regulating substantial acquisition of shares and takeover of companies.


10. Carry out inspection/ audits of the SEs / intermediaries etc.
11. Call for information from any bank / any authority / corporation / agencies in respect of any transaction in securities which is under investigation or inquiry by SEBI.

12. Performing such functions and exercising such powers under the Securities contracts (Regulation) Act, 1956 (SCRA)

13. Levying fees or other charges

14. Conducting research

15. Performing such other functions as may be prescribed.

2.15.2 POWER OF SEBI TO INVESTIGATE THE TRANSACTIONS OF SECURITIES

Section 11C of the SEBI Act empowers the Board to investigate when there is reasonable ground to believe that the transactions in securities are being dealt with in a manner detrimental to the investors or the securities market; or any intermediary or any person associated with the securities market has violated any of the provisions of this Act or the rules or the regulations made or directions issued by the Board there under, it may, at any time by order in writing, direct any person (Investigating Authority) specified in the order to investigate the affairs of such intermediary or persons associated with the securities market and to report thereon to the Board.

2.15.3 POWER TO INSPECT THE STOCK EXCHANGES

SEBI is also empowered to inspect the Stock Exchanges to review of market operations, organizational structure and administrative control to ascertain as to whether -

(a) It provides a fair, equitable, transparent and growing market to the investors,

(b) Its organization system and practices are in accordance with the Securities Contracts (Regulation) Act, 1956 [SC(R) Act], 1956 and rules framed there under,
(c) It has implemented the directions, guidelines and instructions issued by SEBI/ Government of India from time to time and

(d) It has complied with the conditions, if any, imposed on it at the time of renewal / grant of its recognition under section 4 of the SC(R) Act, 1956.

2.15.4 SEBI (ISSUE OF CAPITAL AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2009

SEBI has got wide powers to regulate the securities market and to protect the interest of investors in primary market as well as secondary market. The Board has powers to regulate the functioning of stock broker, sub brokers or other intermediaries, so that investor’s money cannot be lost by malpractices or in other way. The investment through primary market by investors deemed to the first step in this technical securities market. Therefore, it is primary duty of the SEBI to protect the rights and interest of the investors at the first stage. SEBI had issued guidelines for the protection of the investors through the Securities and Exchange Board of India (Disclosure and investor protection) Guidelines, 2000. These guidelines have been issued by the SEBI under section 11 of the SEBI Act, 1992.

SEBI has been emphasizing on the importance of disclosure standards for corporate in disseminating relevant and correct information to the investors. With this view, SEBI has appointed a committee under the chairmanship of Shri C. B. Bhave to suggest measures for improving the continuing disclosure standards by corporate and timely dissemination of price sensitive information to the public. The committee submitted its report to the SEBI. Previously issue of securities was dealt by SEBI (DIP) Guidelines 2000 but now, issue of securities is regulated by SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009. SEBI (DIP) Guidelines is replaced by the Regulations of 2009. These regulations are called the SEBI (Issue of Capital and Disclosure Requirements) Regulation, 2009 and apply to the following:

84. Regulation 3 of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009
(a) a public issue;

(b) a rights issue, where the aggregate value of specified securities offered is fifty lakh rupees or more;

(c) a preferential issue;

(d) an issue of bonus shares by a listed issuer;

(e) a qualified institutions placement by a listed issuer;

(f) an issue of Indian Depository Receipts.

**Important features of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009**

1. On Disclosure norms, SEBI has directed stock exchanges to disclose all details of complaints lodged by investors against trading members and companies listed on the exchange, on their website. These disclosures would also include details pertaining to arbitration and penal action against trading members. This is a welcome change and an important move to bring in more transparency in the grievance redress mechanism.85

2. An investor has the option to apply for and receive the shares in physical form as well as in allotment in demat form as the shares issued through an IPO/FPO are tradable only in the demat form. In any case, for all IPO/FPOs of any security of issue size of Rs. 10 crore or more, issues have to be compulsorily be only in dematerialized form, while Qualified Institutional buyers and large investors (applying for more than Rs. 2,00,000), can apply only in demat form. There are two depositories in the country-National Securities Depository Ltd. (NSDL) and Central Depository Services (India) Ltd.(CDSL). Both have an extensive network of authorized Depository Participants (DPs). Investor can open demat account with any of these DPs.

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3. On Allotment, refund and payment of interest, the issuer and merchant bankers shall ensure that specified securities are allotted and/or application moneys are refunded within fifteen days from the date of closure of the issue. Where specified securities are not allotted and/or application moneys are not refunded within the period stipulated, the issuer shall undertake to pay interest at such rate and within such time as disclosed in the offer document.

4. On Conditions for initial public offer, an issuer may make an initial public offer, if it has net tangible assets of at least three crore rupees in each of the preceding three full years (of twelve months each), of which not more than fifty per cent are held in monetary assets.

5. On manner of disclosures in the offer document, the offer document shall contain all material disclosures which are true and adequate so as to enable the applicants to take an informed investment decision.

2.15.5 SEBI (PROHIBITION OF FRAUDULENT AND UNFAIR TRADE PRACTICES REGULATING SECURITY MARKET) REGULATIONS, 2003

The object of Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Markets) Regulations, 2003 (hereinafter "FUTP Regulations") is to ensure markets are fair, efficient, and transparent which is closely linked to protecting investors from unfair, manipulative, or fraudulent practices, including synchronized trading, front-running, mis-selling etc.

Regulation 3 of the FUTP Regulations prohibits certain enumerated categories of activity. On the lines of Section 12A of SEBI Act, 1992, regulation 3 of the FUTP Regulations is couched in wide terms so as to cover myriad ways of perpetrators of fraudulent, unfair and manipulative practices, directly or indirectly. For instance, they include the employment of a device, scheme or artifice to defraud in connection with dealing with securities; they also include an act, practice, or
course of business which operates as fraud or deceit upon any person in connection with any dealing in securities in contravention of the provisions of the SEBI Act or the rules and regulations framed there under.

Regulation 4 of the FUTP Regulations prohibits fraudulent and unfair trade practices and specifically states that this is “without prejudice to the generality of Regulation 3”. Further, Regulation 4(2) states that dealing in securities shall be deemed to be a fraudulent or unfair trade practice if it involves fraud and may include certain categories of activity which are listed in sub-regulations (a) to (s).

Regulation 4 of the FUTP Regulations states the power of the Board to order investigation by ‘Investigating Authority so appointed’ when there is reasonable ground to believe that the transactions in securities are being dealt with in a manner detrimental to the investors or the securities market in violation of these regulations or any intermediary or any person associated with the securities market has violated any of the provisions of the Act or the rules or the regulations. Investigating Authority shall have the power to call for information or records from any person specified in section 11(2)(i) of the Act for inspection purpose, where he has reasonable grounds to believe that such company has been conducting in violation of these regulations. They can also keep in his custody any books, registers, other documents and record produced under this regulation for a maximum period of one month which may be extended up to a period of six months by the Board. Regulation 9 prescribes that the Investigating Authority shall, on completion of investigation, after taking into account all relevant facts, submit a report to the appointing authority. Further, the Investigating Authority may also submit an interim report pending completion of investigations if he considers necessary in the interest of investors and the securities market or as directed by the appointing authority.
2.15.6 PROHIBITION OF MANIPULATIVE AND DECEPTIVE DEVICES, INSIDER TRADING AND SUBSTANTIAL ACQUISITION OF SECURITIES OR CONTROL

Section 12 A of Chapter VA of SEBI Act, which was inserted by Amendment Act, 2002, prohibits any person who directly or indirectly-

(a) uses or employs, in connection with the issue, purchase or sale of any securities listed or proposed to be listed on a recognized stock exchange, any manipulative or deceptive device or contrivance in contravention of the provisions of this Act or the rules or the regulations,

(b) employ any device, scheme or artifice to defraud in connection with issue or dealing in securities which are listed or proposed to be listed on a recognized stock exchange;

(c) engage in any act, practice, course of business which operates or would operate as fraud or deceit upon any person, in connection with the issue, dealing in securities which are listed or proposed to be listed on a recognized stock exchange, in contravention of the provisions of this Act or the rules or the regulations,

(d) engage in insider trading,

(e) deal in securities while in possession of material or non-public information or communicate such material or non-public information to any other person, in a manner which is in contravention of the provisions of this Act or the rules or the regulations.

(f) acquire control of any company or securities more than the percentage of equity share capital of a company whose securities are listed or proposed to be listed on a recognized stock exchange in contravention of the regulations made under this Act.
2.15.7 SEBI (PROHIBITION OF INSIDER TRADING) REGULATION, 2015

SEBI has viewed insider trading a very serious offence and regarded it as against the investor’s interests. “Insider trading” means

(i) an act of subscribing, buying, selling, dealing or agreeing to subscribe, buy, sell or deal in any securities by any director or key managerial personnel or any other officer of a company either as principal or agent if such director or key managerial personnel or any other officer of the company is reasonably expected to have access to any non-public price sensitive information in respect of securities of company; or

(ii) an act of counselling about procuring or communicating directly or indirectly any non-public price-sensitive information to any person.

If any person contravenes the provisions of this section, he shall be punishable with imprisonment for a term which may extend to five years or with fine which shall not be less than five lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of insider trading, whichever is higher, or with both.

To tighten gaps in existing norms, SEBI will, soon, introduce the SEBI (Prohibition of Insider Trading) Regulations, 2015, that will replace the existing SEBI (Prohibition of Insider Trading) Regulations, 1992. The new regulations appear to be promising, more practical, and largely in line with the global approach to insider trading. They also seem to be equipped to ensure better compliance and enforcement. The Norms governing insider trading prohibit anyone who has access to inside information in a company from dealing in that firm’s publicly traded shares. If found guilty of insider trading, a person could be sent to prison for up to 10 years or be required to pay a fine of up to Rs.25 crore or thrice the amount of profits made.

86. S. 195 of the Companies Act, 2013
2.15.8 SEBI’S POWER OF ADJUDICATION AND TO PUNISH IN CASE OF CONTRAVENTION

SEBI has been empowered to adjudicate and stipulate penalties in case of contravention of its provision, rule and regulation. Section 15A to 15HB of chapter VIA of the SEBI Act prescribes penalties for the violation of the provisions of the Act, rules and regulation made there under. Section 15I to 15JB provides the power of SEBI for adjudication. For the purpose of adjudging under this chapter, the Board shall appoint any officer not below the rank of a Division Chief to be an adjudicating officer for holding an inquiry in the prescribed manner after giving any person concerned a reasonable opportunity of being heard for the purpose of imposing any penalty. Some of the important powers are discussed below-

2.15.8.1 PENALTY FOR FAILURE TO FURNISH INFORMATION, RETURN, ETC.

Section 15A provides that if any person, who is required under this Act or any rules or regulations made there under-

(a) to furnish any document, return or report to the Board, fails to furnish the same, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

(b) to file any return or furnish any information, books or other documents within the time specified there for in the regulations, fails to file return or furnish the same within the time specified there for in the regulations, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

(c) to maintain books of account or records, fails to maintain the same, he shall be liable to a penalty which shall not be less than one lakh rupees but which
may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

2.15.8.2 PENALTY FOR FAILURE BY ANY PERSON TO ENTER INTO AGREEMENT WITH CLIENTS

Section 15B of the Act provides that if any person, who is registered as an intermediary and is required under this Act or any rules or regulations made there under to enter into an agreement with his client, fails to enter into such agreement, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

2.15.8.3 PENALTY FOR FAILURE TO REDRESS INVESTORS’ GRIEVANCES.

According to section 15C, If any listed company or any person who is registered as an intermediary, after having been called upon by the Board in writing, to redress the grievances of investors, fails to redress such grievances within the time specified by the Board, such company or intermediary shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

2.15.8.4 PENALTY FOR DEFAULT IN CASE OF STOCK BROKERS

Section 15F provides that if any person, who is registered as a stock broker under this Act-

(a) fails to issue contract notes in the form and manner specified by the stock exchange of which such broker is a member, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to for which the contract note was required to be issued by that broker.

(b) fails to deliver any security or fails to make payment of the amount due to the investor in the manner within the period specified in the regulations, he
shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which he sponsors or carries on any such collective investment scheme including mutual funds subject to a maximum of one crore rupees.

(c) charges an amount of brokerage which is in excess of the brokerage specified in the regulations, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to five times the amount of brokerage charged in excess of the specified brokerage, whichever is higher.

2.15.8.5 PENALTY FOR INSIDER TRADING

Section 15G prescribes a very stringent penalty for insider trading. It states that if any insider who,-

(i) either on his own behalf or on behalf of any other person, deals in securities of a body corporate listed on any stock exchange on the basis of any unpublished price-sensitive information; or

(ii) communicates any unpublished price-sensitive information to any person, with or without his request for such information except as required in the ordinary course of business or under any law; or

(iii) counsels, or procures for any other person to deal in any securities of any body corporate on the basis of unpublished price-sensitive information,

He shall be liable to a penalty which shall not be less than ten lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of insider trading, whichever is higher.

2.15.8.6 PENALTY FOR NON-DISCLOSURE OF ACQUISITION OF SHARES AND TAKEOVERS

Section 15H provides that if any person, who is required under this Act or any rules or regulations made there under, fails to,-
(i) disclose the aggregate of his shareholding in the body corporate before he acquires any shares of that body corporate; or

(ii) make a public announcement to acquire shares at a minimum price; or

(iii) make a public offer by sending letter of offer to the shareholders of the concerned company; or

(iv) make payment of consideration to the shareholders who sold their shares pursuant to letter of offer,

He shall be liable to a penalty which shall not be less than ten lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of such failure, whichever is higher.

2.15.8.7 PENALTY FOR FRAUDULENT AND UNFAIR TRADE PRACTICES

According to section 15HA, If any person indulges in fraudulent and unfair trade practices relating to securities, he shall be liable to a penalty which shall not be less than five lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of such practices, whichever is higher.

2.15.8.8 PENALTY FOR CONTRAVENTION WHERE NO SEPARATE PENALTY HAS BEEN PROVIDED

Section 15HB is miscellaneous provision for awarding penalty. It states that whoever fails to comply with any provision of this Act, the rules or the regulations made or directions issued by the Board there under for which no separate penalty has been provided, shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one crore rupees.

2.15.9 SEBI (INVESTOR PROTECTION AND EDUCATION) REGULATIONS, 2009

It is worth to mention here that SEBI has also made regulations for investors’ protection and education fund with a view to strengthening its activities for
protection of investors. The salient features of these regulations are as follow-

1. The Fund shall be used for the purpose of protection of investors and promotion of investors’ education and awareness in ways like:
   
   (a) educational activities including seminars, training, research and publications, aimed at investors;
   
   (b) awareness programmes through media - print, electronic, aimed at investors.
   
   (c) funding investor education and awareness activities of investors’ associations recognized by the Board.
   
   (d) aiding investors’ associations recognized by the Board to undertake legal proceedings in the interest of investors in securities that are listed or proposed to be listed.

2. The Board shall constitute a seven-member advisory committee for recommending investor education and protection activities as mentioned above, to the Board. This Committee would comprise of both SEBI officials and outside experts.

3. These regulations also provide for suitable amendment to the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 1997, to provide for one of the sources of income for the investors’ protection and education fund.

Thus, SEBI is empowered by SEBI Act, 1992 to protect the investors’ interest and promote healthy development of Indian financial markets.

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