

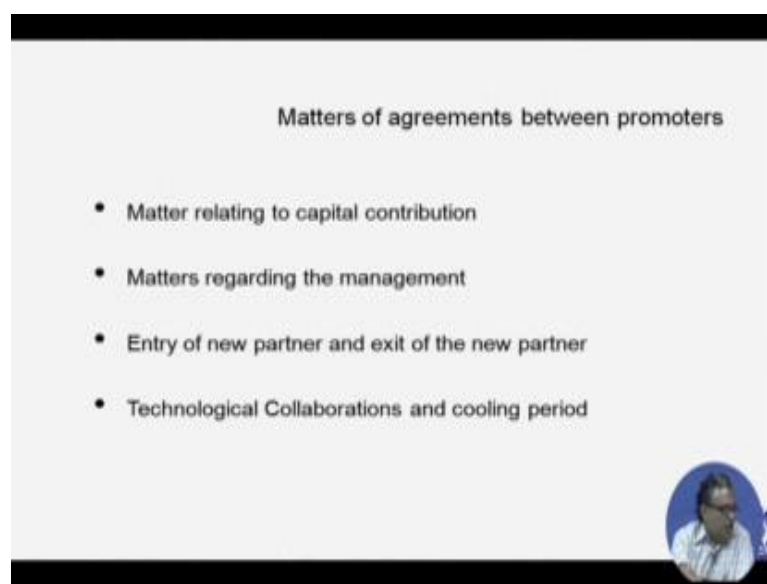
**Legal Compliance for Incorporating Startup**  
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**Lecture - 15**  
**How to incorporate these Companies**

I welcome you in lecture 15, regarding legal compliance for incorporating startup. And I am in the module of incorporation of one person private limited company and public limited company. And more specifically now I will concentrate on how to incorporate these companies. Though I have touched upon these particular issues in my previous lectures, but these lectures I will concentrate on how to draft or what are the matter issues incorporated corporate in the constitution of the company.

So, under the present act section 3 to section 22 of the company's act, read with company's incorporation rule 2014 provides the details of, how a company can be incorporated, and if you look into these particular details, you will have some idea about the process which you need to follow, the document which you need to prepare, the compliance which you need to improve, and certificate which you need to get from the concerned people who are going to going to certify that all the documentation which you are submitting before ROC are complete for the incorporation.

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Now, uh there is an important issue which you might not require for your startup because

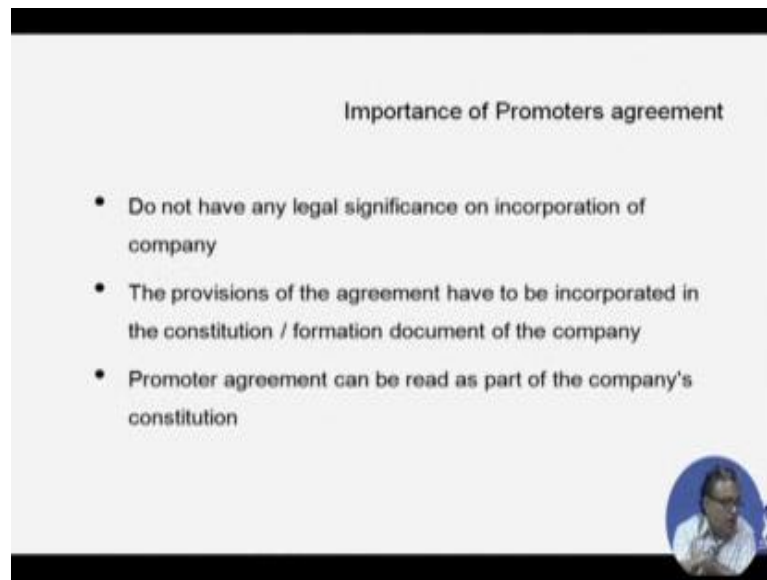
you are in a very small beginning, but I thought to talk with you that you might need to have a promoter's agreement. Because it might so happen that you know you are bringing the technology or the innovation which you have done, but you thought that well if you want to carry forward this particular, you know innovations into a product, or to manufacturing the product based on that particular innovation you need to have kind of capital or you need to have some backup infrastructure backup and so on and so forth.

Then in that case it is always advisable that you should have a promoter's agreement, or you have a number of people who are participated in that particular innovation, and some of your friend has brought a kind of a capital into the venture which you want to incorporate, then also it is suggested that you have a promoter's agreement. Because promoter's agreement gives lot of clarity about the incorporation which you want to incorporate and many other issues. So, promoter's agreement generally provide the provision relating to the capital contributions relating to the management what should be the management in the startup and how that particular management should be functioned, what should be the layer of management, and who is going to handle which aspect of the management in the startup.

Then it might you might talk about the entry and exit; that means, if new person or new venturer want to join you in this particular startup then what is the procedure by which he can enter into this particular venture, and if somebody want to dilute the stake or exit from this startup then how he or she can do. That many of the time you might find the venturer is going to join you; that means, the venture capitals or the angel fund is join you. Then also the promoter agreement play a significant role relating to the increase in the stake of the venturers, or gradually decreasing the stake of the venturers, and when the venturers are exiting this particular venture to whom they are going to sell their stake and can they sell the stake to the third person instead of existing, you know the promoters or the starters or venturer.

Now if there is a technological collaboration then in that case, what should be the cooling period; that means, if any person is going out of this particular venture or your startup, then what are the non disclosure agreement will operate and how many years it will operate, and what are the non compete agreement also operate against that particular person.

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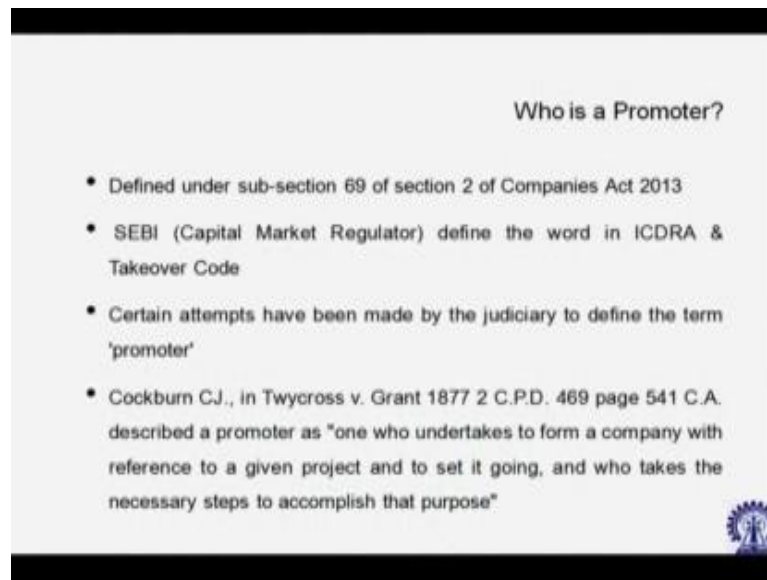


So, all these particular detail it is suggested that you should you should incorporate into the promoter's agreement document. Then the importance of the promoter's agreement is that even though it does not have a legal significance much once, this company is become incorporated.

But nevertheless the promoter's agreements are binding legally binding in nature. So, if there is any dispute arise in the future between the promoters, it can be legally enforced in the court of law, but it might not have a impact over the company, or startup which you have incorporated, or if you have incorporated your startup as a company.


Now, the provisions of the agreement can be incorporated or whatever you have been agreed upon in the promoter's agreement, can be again incorporated in the formation document or the constitution of the company. To be more specific it can be incorporated in MOA or AOA of the company. And lastly the promoter's agreement can be read as a part of company's constitution too; that means, you can create an adequate provision in the AOA of the company and wherein you can say that if something which is not clear or not mentioned away and is provided in promoter's agreement then that case it can be taken help for the interpretation of the AOA of the company. So, it can also act as the extension of the AOA of the company. Now you might be you know wondering who is a promoter. Promoters are those people who generally do everything for the company to start or to incorporate.

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Who is a Promoter?

- Defined under sub-section 69 of section 2 of Companies Act 2013
- SEBI (Capital Market Regulator) define the word in ICDRA & Takeover Code
- Certain attempts have been made by the judiciary to define the term 'promoter'
- Cockburn CJ., in Twycross v. Grant 1877 2 C.P.D. 469 page 541 C.A. described a promoter as "one who undertakes to form a company with reference to a given project and to set it going, and who takes the necessary steps to accomplish that purpose"



So, promoter is now defined under the company's act and you will find sub-section 69 of section 2. It is bit technical or legal, but still for your information I put these particular sections you might ignore this particular section therein it has been defined.

Now if you look in this particular definition, it has basically defined for some other purposes to understand the control which you can have or the promoter can have on the company. So, the promoter can continue throughout the life of the company, and promoter can hold a critical mass or critical shares or critical control over that particular company, through the shares or some other means. Similarly you will find that SEBI also defined the word promoters under ICDRA and takeover code, and therein it is also provided that who can be the promoter, but in both the cases as it is defined in company's act or ICDRA, or takeover code in all these particular cases this is from the perspective of the control over the company.

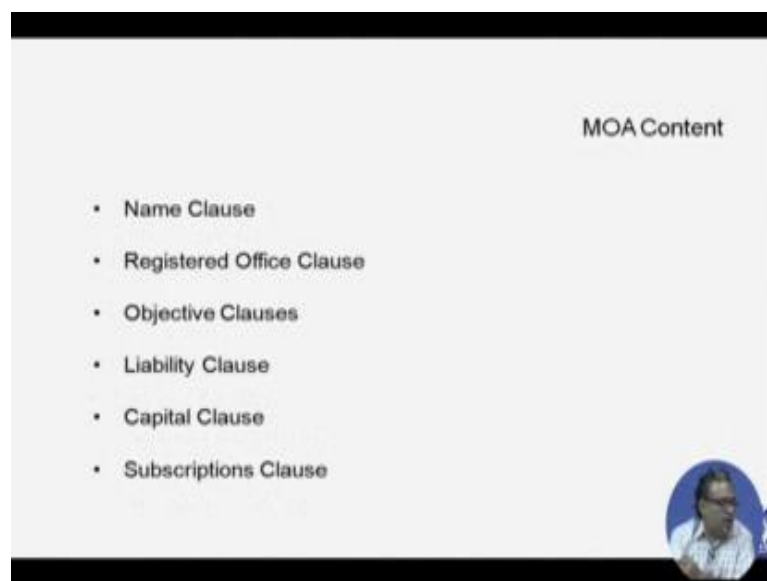
So, it might not be very significant for you when you are doing when you are incorporating the startup, but once your startup has grown up or it has become a large company then, the promoter might be a significant word for you. Then you know there is a certain attempt judiciary also made to define the term promoters, and they have defines the term promoter in a different word, but 1 of the good case which I have mentioned here is that Twycroos versus Grant it is a British case, but it is commonly referred in referred by the Indian judiciary too. While they are defining the promoter and therein they said that one who undertakes to form a company with reference to give a project

and to set it going and who takes the necessary steps to accomplish that particular purpose.

So, that means, promoter is a person who basically take all the pain to up the project; that means, if you have the startup you are taking all the pain in incorporating the startup. What are the pains you are trying to bring in the capital for the production, you are trying to forming organization, you are trying to bring in the manpower, you are trying to setting up the factory, or the establishment where you will run this particular. So, for that matter you will be the promoter of your organization or may be some of you who are participating into formation of startup, but please do not if you are taking kind of a professional service like somebody is sitting and drafting the AOA and MOA of you and you are paying the professional fees for that that particular person will not be called as the promoter of the company.

So, promoter has kind of a legal significance in the eye of law. And promoter has some kind of rights and liabilities against the company. Or under the law and you know as people say that promoter need to discharge their duty with the good faith against that particular company. So, being a promoter you cannot take the advantage against the company or you cannot use the position of yours for your own advantage.

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Now, let me take you to the next issue is relating what should be the content of memorandum of association. And I believe by now you are quite habituated with the

word MOA, because we have used this particular word MOA for all 4 type of companies, which I have discussed with you that is in case. Of the one person companies then I have talked with you the private limited company, then I had talked with you a public limited company, then I have talked with you non-profit companies. So, all the cases you need to have MOA. So, you should know what are the things you need to specify or need to incorporate in MOA. And you know this is a significant strategic decision which you need to take because, whatever you are going to incorporate, that is going to affect your business in the future. So, if you are mistakenly incorporate some of the provision and that particular provision are not aligned with your objective of the business then it might affect your business. So, it is advisable that while you are drafting memorandum of association you should be very, very careful.

Now, the first clause in the MOA, first clause means first matter in the MOA, Memorandum of association is a name clause. So, I have discussed with you that how you can you know find the names. May be in the next slide also I am going to talk with you relating to how to find the names and what are the law is relating to that. So, there is a process which I have talked with you, which is now widely or easily available in MCA 21 website. And there you can put the name and to find out the name with which you wanted to incorporate the startup is available or not. Then you need to have a register office I have discussed with you a lot of this, and I do not wanted to go further on the discussion, but you have to provide the address of the register office. Now you have to have the objective clause. Objective clause indicates that what is the business or what is the thing which you wanted to do with your organization.

Please remember you should clearly define what is business which you wanted to carry forward. Now if you want to have kind of you know objective to do some business which is ancillary to your main business, then in that case you should mention there that into your objective clause. Now if you want to have you know raising the capital from the public or you wanted to access the primary market then you should write it in the objective clause. If you want to go for the merger in the future and acquisition for a new company then that case you should write it in the objective clause. If you want to have if you want a subsidiary company in the future or if you want to promote different group company, then that also you should need to mention in the objective clause.

If you are going for giving the lending, or if you are borrowing the money, then also you

need to put in objective clause. So, what I am trying to drawing your attention that objective clause should be very comprehensive, and it should cover all the aspect which you are going to do as a company itself.

Because please remember, that if you are not putting anything in the objective clause and if you are carrying that particular work, then in that case it will be treated as ultra virus, and please remember my talk in the previous lecture, I have told whatever you are going to incorporate in the objective clause is the power of the company. And the board can exercise that particular power.

So, the defining the objective clause, or putting the matter in the objective clause, is a very very strategic decision you should not be too flexible in incorporating the objective clause, because in that case registrar might not pass or allow your company to be incorporated, but at the same time you should not be too close in framing your objective clause, you should have a space in the objective clause. So, that you can do or you can shift your business without amending the objective clause.

Now please remember you can amend this particular objective clause in MOA, but amending this objective clause is a quite cumbersome process, because you need to have a special majority of shareholders. So, many of the time you might not get the special majority once your business will start expanding, because there might be a number of people who have joined into the into your startup. Now then you have to have the liability clause. Liability clause specify that what kind of with kind of liability you are incorporating your company. So, are you incorporating your company with limited by shares which I have discussed with you? Or you are incorporating your company with limited by guarantee. Or if you incorporating your company limited by share and guarantee, or you are incorporating your company as unlimited company

So, whatever this liability is you need to specify in the memorandum of association. Then ultimately you need to have a subscription clause. Subscription clause means which are the people are subscribing this memorandum and article of association. Now when the meaning of the subscription is that these are the initial members of the company; that means, these people are proposing that company need to be incorporated, or you can say even they are the promoters.

So, in the subscription clause, it will record your name, number of shares you are

subscribing, how much capital you are contributing through the subscription of the shares everything will be recorded. So, initially one can understand that which are the people who are incorporating this particular company and this will be the permanent record kept in ROC or registrar of the company, and it will continue throughout the life of the company. So, if the company is continuing for hundred years, then this particular document will continue in ROC's office for hundred years, or even more than that if the company is existing.

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Now, I have talked about the name clause. So, let me take you through the legal provision section 42 of the company's act; that means, section 4 sub section 2 of the company's act 2013 provide the provision relating to the name clause how you should choose the name of the company.

Then you should also look into the names and emblems act where is it said that there is some of the name which you cannot use in the name of the company. Like you cannot use the word India, you cannot use the word president you cannot use the word Royal. I mean some of the names which are prohibited to use prime minister as a name within the name of the company, or even Mahatma Gandhi, or Ashoka Chakra, something, something, which has been prohibited to be used as a name of the company.

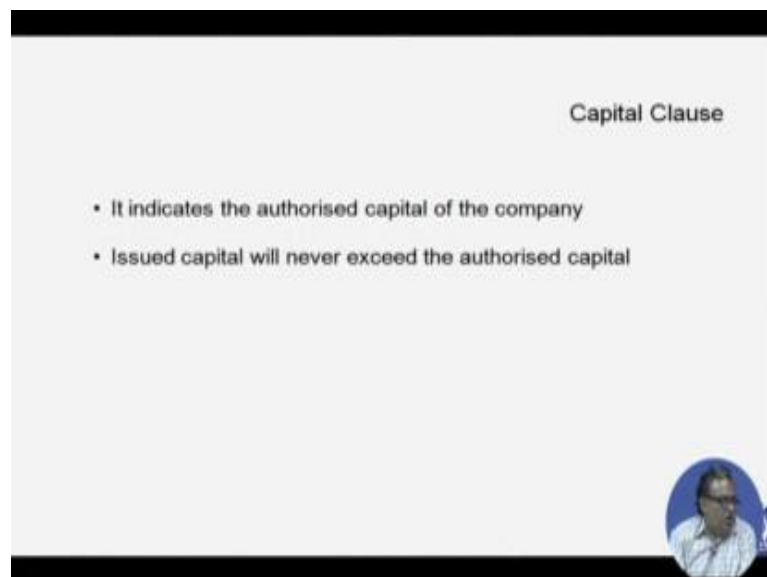
So, you have to find out this particular thing that whatever name you are proposing, is it prohibited under the emblems and names act. Then you have to look into the rules which



has been framed as company's name availability rules 2011, and you know, there is a long, you know, list of procedure has been provided. Like if you wanted to use the word Corporation in the name, in your name in the company's name, in that case too, you need to have a specific capital at the time of incorporation. And they generally specify what should be the specific capital at the time of incorporation. At the same time if you are wanted to do the business in a particular segment, they indicate that your business should be reflected by the name of the company.

Like if you wanted to do a startup in food delivery system. So, I mean, your name should indicate that you are doing something related to the food. It should not indicate that you are you should not put, you know, name which indicates that this particular company is like a travel company. So, there should be some kind of a relation between your objective, and the name of this particular company. And at the same time you need to apply before the ROC in form 18 relating to the availability of the name and while you applying. So, you have to you had to specify the number of names which you wanted to get.

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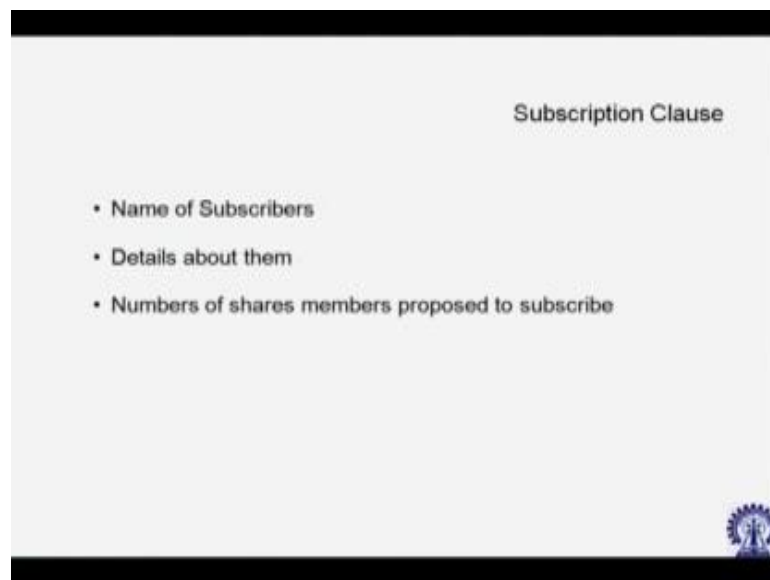


So, ROC might look into this and say which are the names available, and which you can choose for the purpose of incorporation. Now in the capital clause, it should indicate that what is the authorized capital of the company, and what are the issued capital of the company, and issued capital should not exceed the authorized capital. Now I have talked with you related to the authorized capital it means that whatever you have mentioned in

the capital clause of MOA. And issued capital means whatever actually issued by the company has been subscribed by its members. So, there is always a difference between the authorized capital and the issued capital. The issued capital much-much lesser than that of a authorized capital. But when you are framing the authorized capital, please do remember not make it a very big, then in that case you need to pay a lot of fees at the time of incorporation.

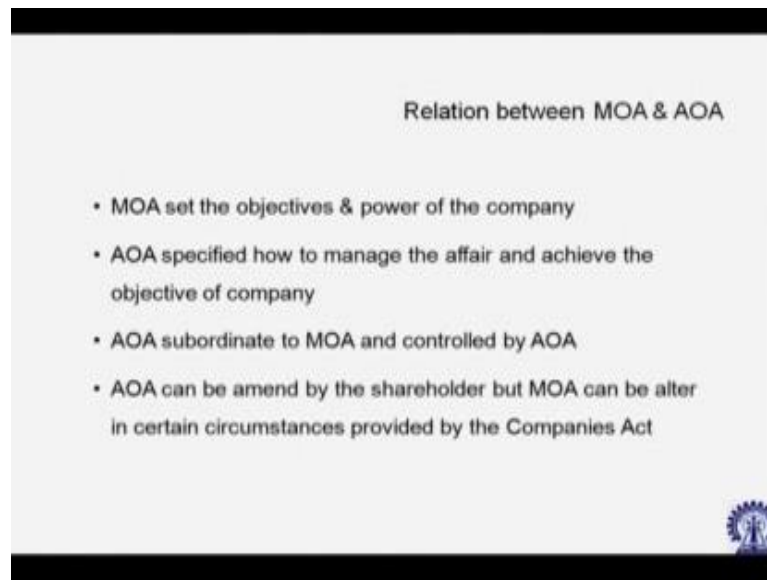
So, whatever you think, initially that you will have authorized capital you can you know choose that particular figure, but that particular authorized capital later you can amend it.

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Now, the subscription clause I have already talked with you.

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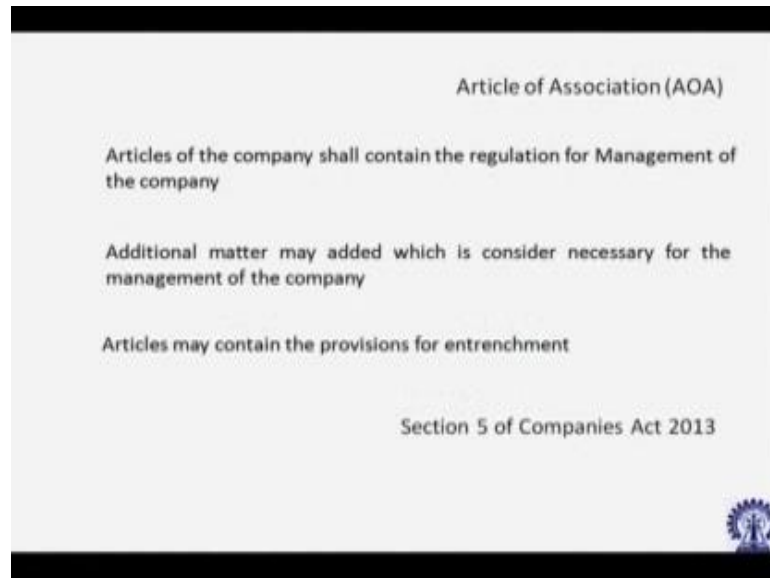


So, I am skipping this particular subscription clause. And now let me talk with you relation between this AOA and MOA. MOA is set objective and the powers of the company where as AOA specify how to manage the affair of the company and to achieve the objectives of the company.

So, AOA is more detailing of whatever you have specified in the objective of the company, objective clause of the MOA of the company. Now generally AOA is subordinate to MOA; that means, if there is a conflict between the provision of AOA and MOA then in that case MOA will prevail not AOA. So, whatever has been, I mean this is more of a legal issues, it is known as matter of interpretation. So, if there is a conflict you find tomorrow you know there is some litigation started related to this, then in that case whatever the provision is there in MOA, that will prevail not AOA. Because AOA is subordinate, and AOA can be amended by the shareholders, but MOA can be altered in certain circumstances, provided as it is provided in the company's act.

And you know in certain circumstances even you need to take a permission from the central government, like you know as I have talked with you if it is non-profit making company, then in that case if you want to make an amendment in MOA, you need to go back to the central government and or the government, respective government, and you have to take the permission before you make a change of that. Or in some cases also if there is a particular specification has been made, in some sector then also you need to take the central government permission for this matter.

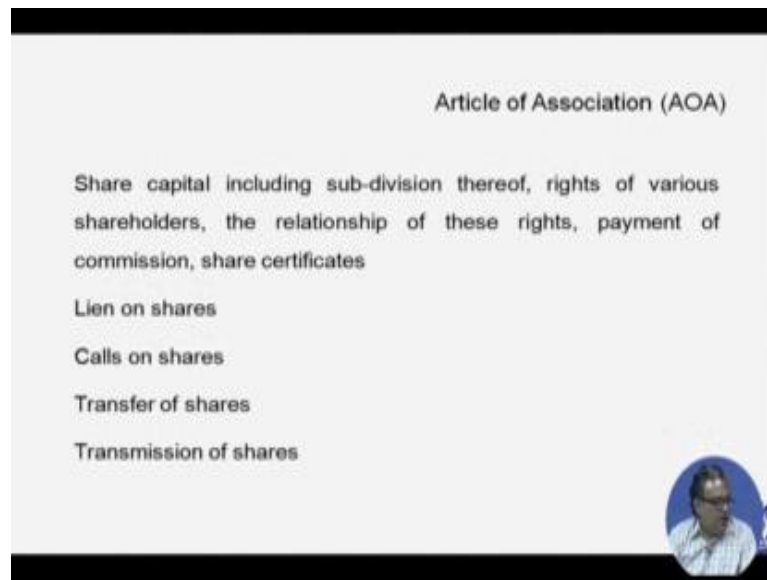
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Now let me take you to the article of the association and the detailing of that. Now in case of the article of the association it contained the regulation of the management of the company, and there is additional matter may be divided which is considered necessary for the management of the company.

So, in case of the article of the association you can detail out all the aspect, how the company can be managed, who are the people, what should be their qualification, you know, what should be the you know structure of the board then what should be the board committee how that particular people can be appointed you can also you know give the additional qualification, like you know, when I was talking with you a private company, I said you can also specify the additional criteria of disqualification a apart from that whatever has been prescribed in the company's act.

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An article may also contain the provision for entrenchment. So, you know in generally in the article you will find these are the provisions, like you know lien on the shares; that means, you know can the company exercise the lien on the shares; that means, if you are failed to pay the calls, I mean it is basically for the large company; that means, company can ask it is shareholders to pay the calls; that means, when the share has been subscribed in the beginning, they have not paid the whole face value. So, company can take this particular face value gradually. So, this is known as a call.

So, if you fail to pay these particular calls then company can exercise lien. Then you know there should be a detailing of provision of transferring and transmission of the shares and this is more important in case of a private limited company. Because if you remember I had talked with you that in case of private limited company you can have a restriction in the transfer and transmission of the share, but this is not possible in case of a public limited company.

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Now, you can about the forfeiture of the shares. These are possibly not much important for you as you know startup, but you can just simply incorporate the default provision because you will find this AOA, or you know provision what should be contained in the AOA is basically provided under the company's act. So, you can simply copy that particular provision to keep it within your AOA.

Then you can talk about the alteration of the capital then, what is the process that we have to follow for the alteration of the capital, which I have talked with you relating to the alteration of authorized capital. And while you are providing this particular provision please do not undermine the provision that is already provided in the company's act. Then you need to talk about the capitalization or the profit; that means, if you are interested to reinvest the profit which the company is making, then what are the processes you have to reinvest how much you can reinvest, how much you will keep it in your reserves, everything you can detail out there. Then further more if you are interested to do the buyback, then you can you can put the provision relating to that.

Now, again the buy back of the shares is not much relevant for you, because it basically require when your company has grown up, and they are doing a quite a good business, or if you have kind of a takeover threat or market acquisitions, then you go for a buyback. Or if you wanted to establish the good market capitalization you go for buyback. So, what simply you can do whatever the default provision is there in the company's act you just copy it and put it in your AOA.

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Then you can you need to talk about the general meeting and it is proceedings. Whatever the additional criteria you wanted to put in addition to provision in the company's act you can put it. Then you can talk about the voting right and the proxies, you can talk about the board of directors and board proceedings; that means how the meeting can be conducted. You can talk the additional qualification, or the appointment procedure which is suitable to you in addition to whatever has been prescribed in the law.

You can also talk about how the office can be vacated by the directors. What are the kinds of directors should be there in the board, what should be the composition of the directors in the board. In generally these particular provisions are little cumbersome. And I believe as a startup you know you do not require to think much about this particular composition of the board, because anyway you are going to incorporate your company as a private limited company, an in case of private limited company these are not. So, stringent, but if you think so, that you wanted to have some specific provision you can have them. And otherwise you simply incorporate whatever the default provision is there in AOA.

Then you can have a provision relating to your chief executive officer, manager company secretary, chief financial officers. And then you can you know detail out how they can be appointed these people are generally the employees of the company, but they have a right to sit in the board or they generally known as a executive director. So, you can provide you know the specific provision that how they can react in the board, and in

what are the matters they can you know take part in the board, or is there any restrictions in taking part or voting on some issues in the board, by these particular people you can provide this particular thing.

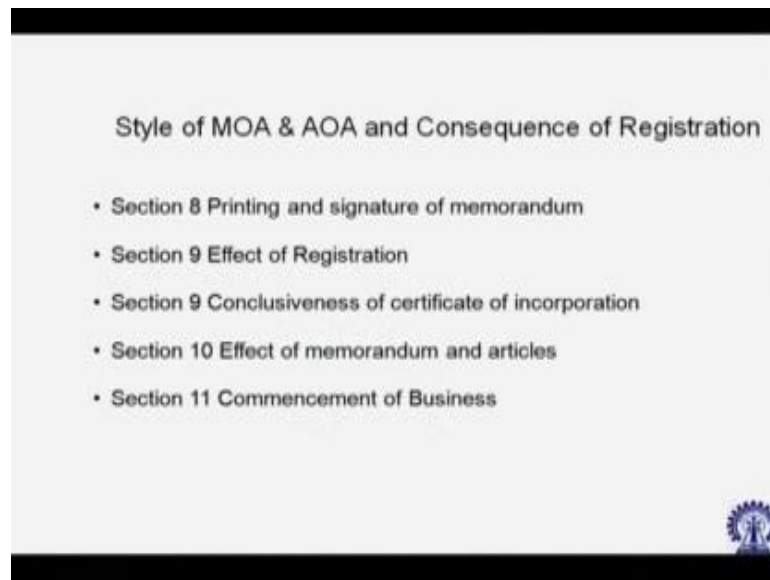
Then you need to talk about the dividend and the reserves; that means, how you are going to distribute the profit of the company, amongst the member of the company among yourself, or what are the reserves you are going to maintain. I believe you can put you know default provision what is there in AOA. But relating to the results you can if you want to a growth of your company you can start creating kind of reserves which is eliminating some of the portion of your profit and putting it into a general reserves or even you can earmark you know what kind of reserve you want to create.

But initially you might not require to think more about this you can also talk of the accounts, how you are going to maintain the accounts, and what are the matter in the accounts which you should, you know, take care or how you are going to appoint the auditor, how periodically you can bring this particular accounts in the public domain. Now as I have told you if you are again incorporating as a private limited company, then in that case this is not very stringent. So, you can just go with the default provision.

So, you can you can again follow the winding up, whatever has been provided in the winding up or indemnity whatever the provision has been provided within this AOA of this particular thing. Because you can you can have additional criteria, but you know I will suggest not to tinker this particular provision, but to go ahead as it is provided in the standard document.



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Now, these are the, you know, style of AOA and MOA and consequence. Which you need to do you need to do printing and signature of the MOA. And it has been prescribed in the section 8 of the company's act section 9 talks of the effect of registration. And I have discussed with you the effect of the registration, a, you will get a incorporation certificate. The moment you get incorporation certificate your company is become a legal person.

Once it is a legal person it can hold the property. It can you know have it is perpetual succession; that means, even if you leave the company or you if you have died, then also your company will continue, and some other person will come and continue your company until and unless it has been put into death through the legal process; that means, you have to do the winding up and you can sue and sued and all this thing, which you can do then, this certificate is conclusive; that means, nobody can challenge the incorporation of the company once it is issued, it is issued.

Now, if somebody you know says that there is a fraud at the time of incorporation, then also you cannot you know undo that incorporation. Then there is an affect of memorandum on articles; that means, you know whatever provisions you have incorporated in memorandum and article of the association that is binding. And company is need to be run according to these particular provisions. It is it is known as a constitution and I have I think referred it many of the time. And in case of public limited company previously this particular section was there. This commencement of the

business, but I think last year it has you know amended.

So, I believe wrongly I have kept these particular provisions still in my Power Point. So, this particular provision has been withdrawn, and it is no more there in the statute book. So, public it was commencement of the business certificate was required for the public limited company, but this is no more required now under this particular company's act. So, this is all about the process which you need to follow relating to incorporations. And you know now the incorporation is quite I mean there is a lot of efficiency has been incorporated relating to the company's incorporations. And in generally, to complete all the process; that means, to getting the name to complete the you know director identification number and to get all other documents prepared and then do the incorporation in generally now take between 1 and half months to 2 months time.

So, you should plan, it you know properly when you want to incorporate and accordingly you create you know complete your all the papers, and file it to the registrar of the company you can do it by yourself, but if you are doing that particular thing make it sure that you are taking the certificate from the advocate or a chartered accountant or a company secretary that all the required compliance you have done. Or I will advise you pay a small fees and get it done through professional, but what you should be you know careful while you are drafting these AOA and MOA. Because it should align to your business objective simply do not copy the existent format which is generally available with particular professional people and they always insist you just to copy the provision and just go ahead with that.

But that is not good thing because it might so, happen in the future, when you are progress when you are business startup you might find some provision which is been kept, which is been written in the constitution document, which is impediment to your business. So, please do check this particular document yourself and get yourself satisfied that whatever the objective with which you want to incorporate your startup, it has been taken care of, by this particular constitution document.

Thank you.