

INTERMEDIATE EXAMINATION

JUNE 2007

COMPANY LAW

Time allowed : 3 hours

Maximum marks : 100

- NOTE :** 1. Answer **SIX** questions including Question No. 1 which is **COMPULSORY**.
2. All references to sections relate to the Companies Act, 1956 unless stated otherwise.

Question 1

Comment on any four of the following :

- (i) "A promoter is not a trustee or agent for the company, but he stands in a fiduciary position towards it."
- (ii) "Members of a limited company may nevertheless have unlimited liability."
- (iii) "A company does not have unlimited powers to alter its articles of association."
- (iv) "The directors have uncontrolled and unfettered powers to refuse registration of transfer of shares."
- (v) "Every company must have a whole-time Secretary."
- (vi) "A company can accept deposits without issuing advertisement."

(5 marks each)

Answer 1(i)

A promoter is neither an agent of, nor a trustee for, the company because it is not in existence. But he occupies a fiduciary position in relation to the company and therefore requires full disclosure of the relevant facts, including any profit made as held by Lord Cairns in *Erlanger v. New Sombrero Phosphate Co.* (39 LT 269).

They have in their hands the creation and moulding 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 begin to act as a trading corporation [As per Lord Cairns in *Erlanger v. New Sombrero Phosphate Co.*, (1873) 3 App. Case 1218-1236]. In a series of similar cases under the English Law it has been held that the promoters, being in a fiduciary position, may not make, either directly or indirectly, any profit at the expense of the company and that if he does make a profit in disregard of this rule, the company can compel him to account for it. The promoters can be compelled to surrender the secret profits [*Emma Silver Mining Co. v. Grant*, (1879) 11 Ch. D. and *Erlanger v. New Sombrero Phosphate Co.*, (1878) 3 A.C. 1218-1236 (supra)].

There are two fiduciary duties of a promoter, namely:

1. A promoter cannot make either directly or indirectly, any profit at the expense of the company he promotes, without the knowledge and consent of the company and that if he does so, in disregard of this rule, the company can compel him to account for it. [*Emma Silver Mining Co. v. Grant*, (1879) 11 Ch. D. and *Erlanger v. New Sombrero Phosphate Co.* (1878) 3 AC. 1218-1236 (supra)]. A promoter is not forbidden to make profit but to make secret profit.

2. A promoter is not allowed to derive a profit from the sale of his own property to the company unless all material facts are disclosed.

It is not the profit made by the promoters which the law forbids, but the nondisclosure of it. If full disclosure is made, as was done in *Salomon v. Salomon & Co. Ltd.*, the profit is admissible.

In case, therefore, the promoter wishes to sell his own property to the company, he should either disclose the fact:

- (a) to an independent Board of directors; or
- (b) in the articles of association of the company; or
- (c) in the prospectus; or
- (d) to the existing and intended shareholders directly.

In addition to disclosing secret profits, a promoter has the duty to disclose to the company any interest he has in a transaction entered into by him.

Answer 1(ii)

As provided by Section 45 of the Companies Act, 1956, the members become personally liable if the membership falls below the statutory limits i.e., seven in a public company and two in a private company and the business is carried on for more than six months thereafter. It is also provided in Section 323 of the Act that a limited company may, if so authorized by its articles, alter its memorandum by special resolution so as to render the liability of its directors or of any of its directors or manager as unlimited.

Answer 1(iii)

The Articles of association of a company are its byelaws or rules and regulations that govern the management of its internal affairs and the conduct of its business. The articles can be altered by passing a special resolution in general meeting subject to the following:

- (a) Alteration in the Articles must not exceed the powers given by the Memorandum of Association. In the event of conflict, Memorandum of Association prevails.
- (b) It must not be inconsistent with any of the provisions of the Companies Act or any other statute or order of court under Section 397 and Section 398.
- (c) Altered articles must not contain anything illegal or against public policy and should be for the benefit of the company as a whole.
- (d) Alteration must not constitute fraud on minority nor inflict hardship on it without any corresponding benefit to the company as a whole.
- (e) An alteration tending to increase the liability of its members to contribute to the share capital is not binding on them unless they consent in writing to such increased liability.
- (f) A company cannot justify breach of contract with other parties by altering its Articles.
- (g) No alteration in Articles can be made to convert a public company into private company or in clauses relating to MD/whole-time director etc. without approval of Central Government.
- (h) Alteration to Articles cannot have retrospective effects.

Answer 1(iv)

The directors have uncontrolled and unfettered powers to refuse registration of transfer of shares. The given statement is not true.

The provisions with regard to power of the Board to refuse registration and appeal against refusal are contained in Section 111 of the Companies Act, 1956. It may be noted that though the inherent power of the Board to refuse registration of transfer of shares, if so, authorised by the articles and intimation thereof to the transferor and the transferee has been retained, this right has been sheltered with sufficient safeguards by the Amendment Act of 1988 by requiring companies to categorically state the reasons therefor. According to Sub-section (1) of Section 111, if a company refuses, whether in pursuance of any power of the company under its articles or otherwise, to register the transfer of or the transmission by operation of law of the right to any shares or interest of a member in, or debentures of the company, it shall within two months from the date on which the instrument of transfer, or the intimation of such transmission, as the case may be, was delivered to the company, send notice of the refusal to the transferee and the transferor or to the person giving intimation of such transmission, as the case may be, by giving reasons for such refusal.

Where the articles give power to the Board of directors to refuse to register a transfer of shares, such power must be exercised actively by the directors, and unless they do so, the transfer must be registered. This means that there must be a refusal to register a transfer by a resolution of the Board of directors passed either unanimously or by majority.

Where the articles give the directors absolute and uncontrolled power to refuse registration of a transfer, they can do so without giving any reason and such refusal can be attacked only if the directors have not exercised their discretion honestly in the interest of the company.

If their refusal is exercised mala fide, i.e. if they act oppressively, capriciously, or corruptly, the Company Law Board will interfere and order registration of the transfer of shares (*B. Choukhani v. Western India Theatres Ltd.*, A.I.R. 1957 Cal. 709). Unless the contrary is proved, the power is deemed to have been exercised properly (*Berry & Stewart v. Tottenham Hotspur Football and Athletic Co. Ltd.*, 1936, 3 A11 E.R. 554).

Answer 1(v)

Section 383A of the Companies Act, 1956 as amended by the Companies (Amendment) Act, 1988 introduced the statutory requirement for certain companies to have a company secretary. Sub-section (1) of the Section provides that every company having a paid-up share capital of such sum as may be prescribed shall have a whole-time secretary and where the Board of directors of any such company comprises of only two directors, neither of them shall be the secretary of the company. The Government has in exercise of its powers under this section and Section 2(45), framed the Companies (Appointment and Qualifications of Secretary) Rules, 1988 and provided that every company having a paid-up share capital of not less than rupees two crore must have a whole-time secretary who should be a member of the Institute. Further, the rules provide

that in the case of a company with a lesser paid-up share capital, where the paid-up share capital of such company is increased to rupees two crore or more, the company shall within a period of one year from the date of such increase appoint a person as a whole-time secretary who should be a member of the Institute.

Every company, which is not required to employ a whole-time secretary under Sub-section (1) and having a paid-up share capital of ten lakh rupees or more, shall file with the Registrar a certificate from a secretary in whole-time practice in such form and within such time and subject to such conditions, as may be prescribed as to whether the company has complied with all the provisions of the Act and a copy of such certificate shall be attached with Board's report referred to in Section 217 of the Act.

Where a company fails to comply with the above provisions, the company and every officer of the company, who is in default, shall be punishable with fine which may extend to five hundred rupees for every day during which the default continues.

Answer 1(vi)

Every company intending to invite, allowing or causing any other person to invite deposits, shall issue an advertisement. This is implied by the provisions of Section 58A(2) of the Act. However, a company can accept public deposits without publishing any text of advertisement in the newspaper.

As per Rule 4A of the Companies (Acceptance of Deposits) Rules, 1975 –

- (1) Where a company intends to accept deposits without inviting, or allowing or causing any other person to invite, such deposits, it shall, before accepting deposits, deliver to the Registrar for registration a statement in lieu of advertisement containing all the particulars required to be included in the advertisement by virtue of sub-rule (2) of rule 4 and duly signed in the manner provided in sub-rule (4) of that rule.
- (2) A statement delivered under sub-rule (1) shall be valid until the expiry of six months from the date of closure of the financial year in which it is so delivered or until the date on which the balance sheet is laid before the company in general meeting or, where the annual general meeting for any year has not been held, the latest day on which that meeting should have been held in accordance with the provisions of the Act, whichever is earlier.

Question 2

- (a) *State with reasons and relevant legal provisions/case law, if any, whether the following statements are correct or incorrect. Attempt any five :*
 - (i) *A public limited company can commence business immediately on incorporation.*
 - (ii) *Hire-purchase and leasing transactions lead to 'borrowing'.*
 - (iii) *Share certificate is an official publication.*
 - (iv) *The place from which a representative of a foreign company in India conducts meetings of shareholders or even directors, and procures orders from customers is a 'place of business' of the foreign company.*

(v) *Modification of charge in the event of change in law requires registration.*

(vi) *Raja, a director of Empire Ltd., resigned his directorship. He is liable to file Form No. 32 with the Registrar of Companies.* (2 marks each)

(b) *Write short notes on any two of the following :*

(i) *Shelf prospectus*

(ii) *Modes of acquiring membership*

(iii) *Director's identity number (DIN).* (3 marks each)

Answer 2(a)(i)

Incorrect, a public company, after incorporation, must obtain a certificate to commence business from the Registrar before it can commence business or exercise its borrowing powers. In order to obtain this certificate, the company must comply with Section 149 of the Companies Act. If the company has issued a prospectus then Section 149(1) applies and if it has not issued a prospectus, Section 149(2) applies.

"Commence any business" does not mean merely the business for which the company was started, but it also includes the power to borrow and make any transaction including sale, and purchase of property, etc. [*Kishangarh Electric Supply Co. Ltd. v. United State of Rajasthan*, AIR 1960 Raj. 49].

Answer 2(a)(ii)

Incorrect. Borrowing implies receipt of money. In hire purchase and leasing transactions, assets are taken for use and the owner is compensated for the use of the asset by paying cash. Hire Purchases and leasing transactions are not covered by Clause (d) of Section 293(1) of the Companies Act, 1956 which deals with borrowing, as they do not amount to borrowing.

Answer 2(a)(iii)

Incorrect. Share certificate is not an official publication under section 147(1)(c) of the Companies Act. Under Section 82, shares are moveable property transferable in the manner provided in the articles of the company. The share certificates are certificate of title and are moveable property but are not official publication in the nature of prospectus, balance sheet, advertisement etc.

Answer 2(a)(iv)

Incorrect. It was held in the case of [*P J Johnson v. Astrofiel Armadom* (1989) 3 Comp L J 1] that mere presence of a representative of a foreign company is not sufficient if his only authority is to elicit orders from customers and therefore, it was not a "place of business."

Answer 2(a)(v)

Correct. So long as the terms or conditions or the extent of operation of any charge is modified for whatever reason, the provisions of Section 135 would become applicable. Therefore, even in case of modification of charges without any mutual agreement between

the parties thereto, namely, as a result of a change in law, the provisions of Section 135 are attracted. (Letter: No. 8/42 (135)/66-CL-V dated 25.11.1966).

Answer 2(a)(vi)

Incorrect. The director is not liable but the Company Secretary of the Company, as one of the officers in default is liable to file form No. 32 and give notice to ROC. [*Soumil Dilip Mehta v. State of Maharashtra* (2003) 113 Comp. Cas.443(Guj)]

Answer 2(b)(i)**Shelf Prospectus**

A new section 60A has been inserted by the Companies (Amendment) Act, 2000. “Shelf Prospectus” means a prospectus issued by any financial institution or bank for one or more issues of securities or class of securities specified in the shelf prospectus. The financial institutions/banks are not required to issue prospectus every time they offer shares to the public within the period of validity of such shelf prospectus which is one year from the date of opening of the first issue of securities. A company filing a shelf prospectus shall be required to file an information memorandum along with shelf prospectus. This concept will save expenditure and time of the companies in issuing a prospectus every time they wish to issue securities.

Answer 2(b)(ii)**Modes of Acquiring Membership**

As per Section 41 of the Companies Act, 1956, membership of a company can be acquired by any of the following modes:

1. By subscribing to the Memorandum of Association of the Company;
2. By agreeing in writing to become a member :
 - (a) by making an application to the company for allotment of shares; or
 - (b) by executing an instrument of transfer of shares as transferee; or
 - (c) by consenting to the transfer of share of a deceased member in his name;or
 - (d) by acquiescence or estoppel;
3. By holding equity shares in the company by purchase of shares in the secondary market either in physical form or through depository participant account

and on his name being entered in the register of members of company.

Answer 2(b)(iii)**Director’s Identity Number (DIN)**

In the current scenario of e-filing, all existing directors and every other person, before becoming a director are required to obtain the Director Identification Number (DIN). DIN is a unique identification number for an existing director or a person intending to become the director of a company. DIN is also mandatory for directors of Indian Companies who are not citizens of India. However, DIN is not mandatory for directors of foreign company having branches in India. Only a single DIN is required for an individual,

irrespective of number of directorships held by him. An existing Director / person intending to become a Director is required to make an application to Ministry of Corporate Affairs (MCA) for this unique identification number in the application form (Form DIN).

Question 3

- (a) *What are the consequences of non-registration of a charge ?*
 - (b) *Whether a member of a company can be expelled ? Discuss with reference to a case law.*
 - (c) *A listed company is having an executive chairman. Explain the provisions regarding composition of the Board of directors in terms of the listing agreement.*
 - (d) *Define 'small depositors' and state how their interest is safeguarded.*
- (4 marks each)

Answer 3(a)

Non registration of charge

The consequences of non-registration of a charge will be as follows :-

1. The charge will be void as against the liquidator and against creditors.
2. The company may give a subsequent valid mortgage to secure the same debt. But if a subsequent creditor, even with notice of the first charge, takes a registered charge before the first charge is registered, he obtains priority.
3. During liquidating process, the creditor becomes unsecured creditor.
4. The creditor who holds equitable charge on the security of the company will lose his lien on the title deeds of documents because of non-registration of the charge.
5. Due to non-registration of the charge, the loan becomes repayable immediately and the company cannot repudiate the loan on the ground of non-registration.
6. Omission to register particulars of charges is punishable with fine which may extend to Rs. 5,000 for every day during which the default continues. A further fine of Rs. 10,000 may be imposed under Section 142.

Answer 3(b)

Expulsion of member

For a long time there has been a controversy about right of the company to expel a member if it is found that his conduct is detrimental to the interest of the company.

The Ministry of Corporate Affairs (MCA) is of the view that providing for expulsion of members is opposed to the fundamental principles of the company's jurisprudence and is ultra vires the company. Referring to the case of *Bajaj Auto Ltd. v. N.K. Firodia*, (1971) 41 Com Cases in the circular, the MCA's view is that authorizing the Board of Directors to expel a member is illegal and void.

Even if the company provides in the articles of association a right to expel a member, this right is not legal because any such provision contained in the articles of association is repugnant to the provisions of the Companies Act, 1956.

Answer 3(c)

Clause 49 of the listing agreement has given the following provisions for composition of the board of directors :

1. Not less than 50 per cent of the board of directors should be non-executive directors.
2. The number of independent directors depends on whether the Chairman is executive chairman or non-executive chairman.
3. In case of non-executive chairman, at least one third of the board should comprise of independent directors.
4. Where the chairman is executive chairman, at least fifty per cent of the board should comprise of independent directors.

Independent directors are those directors who apart from receiving director's remuneration do not have any other material pecuniary relationship or transactions with the company, its promoters, its management, or its subsidiaries, which may affect their independence of judgement.

Answer 3(d)**Small Depositors**

To safeguard the interest of depositors, a provision has been inserted in the Companies Act, 1956 by inserting Section 58AA by the Companies (Amendment) Act, 2000.

A small depositor has been defined to mean a deposit holder who has deposited in a financial year, a sum not exceeding Rs. 20,000/- in a company and includes his successors, nominees and legal representatives. (Section 58AA).

1. It is obligatory on the part of company to inform the Company Law Board / Company Law Tribunal (CLB/CLT) within 60 days of any default in non-payment of deposit on due date or non-payment of interest.
2. The provision further prohibits companies from accepting deposits from small depositors till they repay the matured deposits of each small deposit holder including interest accrued thereon.
3. The company is required to disclose about the default in non-repayment to small depositors on due date, in all their advertisements / application forms for inviting deposits.
4. The new provision also provides for penal action in case of failure to comply with any order of CLB / CLT, of punishment with imprisonment which may extend to three years and also be liable to fine of Rs. 5000 for every day of default.

Section 58AAA was also inserted by the Companies (Amendment) Act, 2000. This section makes every offence connected with or arising out of acceptance of deposits, a cognizable offence under the Code of Criminal Procedure, 1973.

Question 4

- (a) *What is 'forfeiture of shares' ? State the procedure for forfeiture of shares.*
(10 marks)

(b) *Re-write the following sentences after filling-up the blank space with appropriate word(s) so as to convey the correct meaning :*

- (i) *An incorporated company has _____ succession.*
- (ii) *The statutory report shall be forwarded to every member of the company at least _____ days before the day on which the meeting is to be held.*
- (iii) *The maximum amount of fine under section 193 for not recording the minutes of the Board of directors and general meetings is Rs. _____.*
- (iv) *An explanatory statement must be annexed to the notice for the general meeting according to section 173 for consideration of _____ business at a general meeting.*
- (v) *A dividend once declared cannot be revoked except with the consent of the _____.*
- (vi) *In terms of Clause 47 of the listing agreement, Compliance Officer shall be _____ of the company. (1 mark each)*

Answer 4(a)

Forfeiture of Shares

While raising share capital, the companies may call the money due on the shares at intervals as and when the funds are required by the company. While making the calls, the Board of Directors must comply with the provisions of articles of association in this regard. After passing of resolution by the Board to make a call on the shares, call notices are issued to the shareholders requiring them to make payment of call money within a time frame. In case shareholders do not pay the call money inspite of repeated requests, then the Board of Directors is empowered to forfeit the shares. The provisions contained in the articles regarding forfeiture of shares must be strictly complied with.

The following rules may be noted in connection with forfeiture of shares :

1. *Articles to Authorise* — Shares can be forfeited for non-payment of any call, if the articles authorize. As per Regulation 29 of Table A, shares can be forfeited only against non-payment of any call, or instalments of a call.
2. *Resolution for forfeiture* – Article 31 of the Table A provides that if the defaulting shareholder does not pay the amount within the specified time as required by the notice, the directors may pass a resolution forfeiting the shares.
3. *Proper Notice* – Before the shares of a member are forfeited, a proper notice to that effect must have been served. Regulation 30 of Table A provides that a notice requiring payment of the amount due along with any interest accrued must be served, mentioning a further day (not less than 14 days from the date of service of the notice) on or before which the payment is to be made. A proper notice is a condition precedent to the forfeiture and even the slightest defect in the notice will invalidate the forfeiture [*Public passenger Services Ltd. v. M.A. Khader* (1966) 1 Comp. LJ1].
4. *Bona fide exercise* – power of forfeiture must be exercised bona fide and for the benefit of the company. The power must be used in order to coerce reluctant shareholders into paying their calls.

Reissue of Forfeited Shares

Company can either cancel the forfeited shares or reissue the same to another person at the discretion of the Board. Such forfeited shares can be issued at discount also if the Board so decides. No return of allotment is required to be filed in respect of re-issue of forfeited shares.

Answer 4(b)

- (i) An incorporated company has **Perpetual** succession.
- (ii) The statutory report shall be forwarded to every member of the company at least **21** days before the day on which the meeting is to be held.
- (iii) The maximum amount of fine under section 193 for not recording the minutes of the Board of directors and general meetings is **Rs. 500**.
- (iv) An explanatory statement must be annexed to the notice for the general meeting according to section 173 for consideration of **Special** business at a general meeting.
- (v) A dividend once declared cannot be revoked except with the consent of the **Shareholders**.
- (vi) In terms of Clause 47 of the listing agreement, Compliance Officer shall be **the Company Secretary** of the company.

Question 5

Distinguish between any four of the following :

- (i) *'Reserve capital' and 'capital reserve'.*
 - (ii) *'Interim dividend' and 'final dividend'.*
 - (iii) *'Motion' and 'resolution'.*
 - (iv) *'Revocable trust' and 'irrevocable trust'.*
 - (v) *'Debenture' and 'loan'.*
- (4 marks each)

Answer 5(i)

<i>Reserve Capital</i>	<i>Capital Reserve</i>
(1) It is a part of uncalled capital of the company as decided by passing a special resolution under section 99.	(1) It is the accumulation of profits created out of capital profits or earnings.
(2) It is receivable only at the time of winding up of the company.	(2) It is the amount already received by the company.
(3) It is applied only at the time of winding up of a company.	(3) It can be applied at any time to write off the losses of capital nature or issue of bonus shares.
(4) It is not mandatory to create Reserve Capital.	(4) It is mandatory to create Capital Reserve in case of Capital Profit.

Answer 5(ii)

With the enactment of the Companies (Amendment) Act, 2000, interim dividend stands on the same footing as that of the final dividend. Both interim and final dividend when declared, become debt and are payable within 30 days of declaration. However, the following differences should be noted:

<i>Interim Dividend</i>	<i>Final Dividend</i>
(1) It is declared in between two annual general meetings.	(1) It is declared at the end of financial year.
(2) No sanction of shareholders in the general meeting is required.	(2) Sanction of shareholders at the general meeting is required.

Answer 5(iii)

'Motions' and 'Resolutions' are used synonymously but in legal sense there is difference between the two. Motion is a proposal submitted for a discussion and a decision is adopted by means of a resolution.

A Motion is a proposal and a resolution is the adoption of a motion duly made and seconded. But every motion need not be followed by a resolution, as in case of a motion being made for adjournment of meeting.

A Motion becomes a resolution only after the requisite majority of members have adopted it. A motion should be in writing and signed by the mover and put to the vote at the meeting by the Chairman. In case of company meetings, only such motions are proposed as are covered by the agenda.

Answer 5(iv)**Revocable and Irrevocable Trusts**

A revocable trust is one which is revocable when it is created by a non-testamentary instrument or orally and a power of revocation has been expressly reserved by the settler. A trust may be revoked by the consent of all the beneficiaries who are competent to contract (Section 78).

All other trusts are irrevocable. Besides if a trust is created for charitable or religious purposes, such a trust cannot be revoked.

Answer 5(v)

Debenture - A debenture is a document given by a company under its seal as an evidence of a debt to the holder usually arising out of a loan. Most commonly, but not necessarily, it is secured by a charge. A document which either creates a debt or acknowledges it, is a debenture.

The following need to be noted for issuance of debentures:

- (1) Under section 117B of the Companies Act, no company shall issue a prospectus or a letter of offer to the public for subscription of its debentures, unless the

company has, before such issue, appointed one or more debenture trustees for such debenture. Thereby, debenture trust deed has to be executed for this purpose.

- (2) Every company issuing debentures is required to create a Debenture Redemption Reserve under section 117C, to which adequate amount shall be credited out of its profits until such debentures are redeemed, to be utilized for redemption of debentures only.
- (3) Credit rating of not less than investment grade is to be obtained from not less than two credit rating agencies registered with SEBI as per clause 2.5.1A of SEBI (DIP) Guidelines, 2000.
- (4) As per the definition of debentures under section 2(12) of Companies Act, debentures include bonds.
- (5) Debentures need not be classified as long term and short term under Schedule VI.

Loans— A loan creates a right in the creditor to demand repayment, and the substance of a debt is a liability upon the debtor to repay the money. [Ram Ratan Karmarkar v. Amulya Charan Karmarkar, 56 CWN 728].

The following need to be noted in respect of loans:

- (1) Section 295 of the Companies Act relating to loans to directors and section 370 of the Companies Act, relating to loans etc. to companies under the same management apply in respect of loans.
- (2) Loans are required to be classified as secured and unsecured; and long term and short term under Schedule VI to Companies Act.
- (3) Unsecured loans are treated as deposits under section 58A of the Companies Act.
- (4) Credit rating is not required for giving loans.
- (5) Loans do not include bonds.
- (6) Unlike debenture, loans can be given by individuals and partnership firms.
- (7) In the international market, loans can be taken in the nature of External Commercial Borrowings.

Question 6

- (a) *State the provisions of the Companies Act, 1956 regarding issue of shares at a premium. For what purpose the share premium may be applied ? (5 marks)*
- (b) *Gomez, the chairman of a company, borrowed Rs. 5 lakh from the State Bank of India, Patna under a promissory note. A suit was filed for the recovery of debts on the basis of the pronote executed by the chairman. The company refused to accept the liability on the plea that the chairman had borrowed funds without authorisation from the company. Will the company succeed ? Explain. (5 marks)*
- (c) *Garima Ltd., a public company in which 32% of the subscribed capital is held by the Central Government, wishes to reappoint Lal Pal & Co. as its auditors in the*

annual general meeting proposed to be held on 30th June, 2007. Advise Garima Ltd. about the procedure to be followed in this regard. (6 marks)

Answer 6(a)

Issue of shares at a premium

A company may issue shares at a premium i.e. at a price above the face value of shares, as provided for under Section 78 of the Companies Act, 1956. For e.g. Rs.100 shares issued at a price of Rs. 110 thereby earning a premium of Rs.10 per share irrespective of the fact whether the shares are listed on Stock Exchange or not. If shares are issued at a premium, whether for cash or other consideration, the amount of premium on shares is required to be transferred to an account called the "Securities Premium Account. The premium cannot be treated as profit and as such it is not available for distribution as dividend.

Purposes for which share premium can be applied:

- (1) Issuing fully paid bonus shares.
- (2) Writing off the preliminary expenses of the company.
- (3) Writing off the expenses of any issue of shares or debentures.
- (4) Writing off the commission paid or discount allowed on the issue of any shares or debentures.
- (5) Providing for premium, if any, payable on the redemption of redeemable preference shares or debentures of the company.

A private company and an unlisted company not making a public issue is at liberty to issue capital at a premium as may be decided by the board of directors.

Answer 6(b)

In *Kumar Krishna Rohatgi and others v. State Bank of India and others* (1980) 50 Comp. Case 722, the Company borrowed an amount of Rs.5 lakhs from the State Bank of India under a promissory note guaranteeing the repayment by executing a guarantee in favour of the company. The pronote was renewed from time to time. In the suit for recovery, the Company contended that the pronote was executed by the chairman without Board resolution authorizing him to execute as required under Section 292(1)(c) of the Companies Act, 1956. The Patna High Court held that in cases where the directors borrowed funds without proper authorization from the company and the amount borrowed was utilized for the benefit of the company, the company cannot then repudiate its liability to repay, since general law implied a promise to be paid by the principal when the money so borrowed by an agent had gone into the coffins of the principal. Hence, the principal had taken the benefit of the amount borrowed. Hence, the company's contention was rejected by the Patna High Court. If the same fact of benefit been taken is assumed here, the decision shall apply to the case in question mutates mutandis.

Answer 6(c)

A special resolution is required for the reappointment of M/s. Lal & Co. as Auditors under Section 224A.

The appointment of auditors is made by an ordinary resolution passed at the annual general meeting of the company. But where twenty five percent or more of the subscribed share capital of the company is held jointly or singly by a public financial institution, a Government company, Central Government, any State Government, a nationalized bank or an Insurance company carrying on general insurance business, the appointment or reappointment of an auditor shall be made by a special resolution at each annual general meeting.

Question 7

- (a) *The name of Piyush is found entered in the register of members of a company. But, Piyush contends that he is not a member of the company. The company maintains that Piyush had orally agreed to become a member of the company, and hence, his name was entered in the register and so he is a member. Is the contention of Piyush valid ?* (5 marks)
- (b) *An annual general meeting of Hum Log Ltd. called on 30th December, 2004 was adjourned to 31st March, 2005, and was held on that date. The next meeting was held in February, 2006. Can the company be held liable for not holding any meeting in 2005 ?* (5 marks)
- (c) *A proxy was appointed by a member on an instrument duly executed. Will the vote cast by the proxy be valid in the following cases :*
 - (i) *When the member himself attended and cast his vote at the meeting without revoking the authority of the proxy; and*
 - (ii) *When the member died in the meantime ?* (3 marks each)

Answer 7(a)

Yes, the contention of 'P' is valid. Person other than subscriber to memorandum should agree in writing to become a member of a company under Section 41.

Thus in this situation, P is neither a person who has subscribed to the memorandum nor he had agreed in writing to become a member. So his contention is valid. [*H.H. Manabendra Shah v. Official Liquidator, Indian Electric Tools Corporation Ltd.*]

Answer 7(b)

Yes, the Company is liable for not holding the meeting in the year 2005, because the meeting held on 31st March, 2005 was not a different meeting from the one which was scheduled on 30th December, 2004. It was the same meeting. Accordingly, the Company can be prosecuted for not holding any meeting of the company in 2005 [*Meenakshi Mills Co. Ltd. v. Asst. Registrar of Joint Stock Companies* (1938) 8.Comp. Case 175 Madras]. As regards the gap between two Annual General Meetings, it is spelt out in Section 166 read along with Section 210 of the Companies Act.

Answer 7(c)

- (i) **Proxy :** The vote given by the proxy will not be valid, because where a shareholder who having appointed a proxy, personally attends and votes at the meeting, the proxy is revoked thereby and his right to vote is terminated [*Cousins v. International Bricks Co. Ltd., 2 Ch PO (CA) at 101: (1932) 2 Com Cases 108*]. But the revocation should be communicated before the meeting. Revocation

will be too late if communicated after the meeting has commenced. In such a case, the votes cast by the proxy will be valid in a poll [*Spiller v. Mayo (Rhodestina) Development Co. (1908) Ltd.*, (1926) WN 78].

- (ii) The vote cast by the proxy shall be invalid if the member appointing the proxy dies and company comes to know of the death of the member before the commencement of the meeting. However, if the company has no notice of such death, the vote cast by the proxy shall be valid.

Question 8

- (a) *Explain the provisions relating to 'no compensation to sole-selling agent for loss of office' under section 294A.* (5 marks)
- (b) *A company was in dire need of further capital. The majority representing 98% of the shares were willing to provide the capital if they could buy-up the 2% minority shares. The majority passed a resolution altering the articles and enabling them to purchase the minority shares. The minority shareholders refused to surrender their shares and challenged the validity of the majority resolution. Decide.* (5 marks)
- (c) *40 out of 100 members of a company submitted a requisition for holding of an extraordinary general meeting in order to remove the managing director from the office. On the failure of the company to call the meeting, the requisitionists themselves called the meeting at the registered office of the company. On the appointed date, they could not hold the meeting at the registered office, as it was kept under lock and key by the managing director himself. The members held the meeting elsewhere and adopted a resolution removing the managing director from office. Is the resolution valid? Give reason.* (6 marks)

Answer 8(a)

Compensation to Sole Selling Agent for loss of office

According to Section 294A, no company shall pay or be liable to pay any compensation to its sole selling agent for the loss of his office in the following cases:

- (a) Where the appointment of the sole selling agent ceases to be valid by virtue of Sub section 2A of Section 294;
- (b) Where the sole selling agent resigns his office in view of the reconstruction of the company or its amalgamation with any other body corporate or bodies corporate and is appointed as the sole selling agent of the reconstructed company or of the body corporate resulting from the amalgamation;
- (c) Where the sole selling agent resigns his office, otherwise than on the reconstruction of the company or its amalgamation as aforesaid;
- (d) Where the Sole-Selling agent has been guilty of fraud or breach of trust in relation to, or of gross negligence in the conduct of his duty as the sole selling agent;
- (e) Where the sole selling agent has instigated or has taken part directly or indirectly in bringing about the termination of the sole selling agency.

Answer 8(b)

The majority resolution is void as it is neither just nor equitable for the benefit of the company as a whole to purchase the shares of minority compulsorily.

As in the decided case, *Brown v. British Abrasive Wheel Co. (1919)*¹ Ch. 290, the majority shareholders holding ninety-eight (98%) of the shares were willing to subscribe further capital which the company badly needed, but only if they were able to acquire the shareholdings of the minority. They passed a special resolution to alter the articles to enable them to purchase the minority shares compulsorily on certain terms. The plaintiff refused to sell his shares and challenged the validity of the majority resolution. It was decided that the alteration was not for the benefit of the company but for the benefit of the majority and accordingly, an injunction was granted against the company prohibiting it from carrying out the resolution.

Answer 8(c)

Yes, the resolution is valid. However, this is subject to the condition that the meeting was held by them within three months from the date of deposit of the requisition. The requisitionist may hold the meeting at any suitable place if the registered office is not made available to them under section 169 of the Companies Act, 1956, as it amounts to impracticability of conducting a meeting which includes impracticability of holding a meeting. Holding of a meeting is impracticable where registered office of a company is locked and is not available. [*Mr. S. Rathnavelusamichettiar v. M. R. S. Manickavelu Chettiar* (1951) 21 Comp. Cas.93 (Mad)].
