

EXECUTIVE PROGRAMME

DECEMBER 2008

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) *Common seal of a company will have to be affixed on all the letters and documents of the company.*
- (ii) *Private companies can commence business immediately after receipt of 'certificate of incorporation'.*
- (iii) *Bonus issue may be viewed as a 'rights issue' except that money is paid by the company on behalf of the investing shareholders from its reserves.*
- (iv) *A resolution was passed by the shareholders in an annual general meeting approving final dividend @ 20% for the financial year 2007-08 and one month later the Board of directors decided to pay further dividend @ 5% for the financial year 2007-08.*
- (v) *All the shareholders of a company are members and all the members of a company are shareholders.* (5 marks each)

Answer 1(i)

This statement is not correct. Common seal need not be affixed on the letters, Annual Report etc. Resolution of Board is required for affixing common seal of the company on deeds and contracts. Common seal is affixed only in presence of two directors and company secretary or such other person as the Board may appoint for the purpose in accordance with the articles of association. They will put their signatures on the documents. The documents are:

- Power of Attorney of the company
- Share certificate, Debenture/Bond Certificate.
- Share warrant
- Any other deed as may be required by the articles.

The common seal will have to be kept under safe custody.

Answer 1(ii)

A private company can commence business immediately after its incorporation. Certificate of commencement is not required for a private company.

A private company or a company having no share capital may commence business and exercise its various powers immediately after it is incorporated. Once it has received its Certificate of Incorporation, nothing further is required.

Answer 1(iii)

Section 81 of the Companies Act, 1956 provides for **issue of right shares** to the existing shareholders in proportion to the capital paid-up on their shares at the time of issue. The shareholders may accept the offer or renounce it fully or partly. Price of each share in rights issue, number of shares offered etc. is mentioned in the application form. The application duly filled in along with cheque/Bank draft will have to be submitted, as directed, on or before the last date.

Bonus shares are allotted by the company to the existing shareholders in proportion to the number of shares they have been holding. The existing shareholders are neither required to make any application nor have to pay anything. Accumulated profits of the company transferred to reserve are converted into capital and the company divides the capital amongst the existing shareholders in the form of bonus share.

Answer 1(iv)

It has been considered by the Company Law Board (CLB) that whether a company is prohibited from declaring a further dividend at a general meeting of a company other than the annual general meeting after a dividend had already been declared at an annual general meeting. CLB is of the opinion that it is beyond the powers of a company to declare a further dividend after the declaration of dividend at the annual general meeting. In this connection attention is invited of all concerned, to the decision of the Calcutta High Court in the matter of *Biswa Nath Pd. Khaitan v. New Central Jute Mills Ltd.* [1961] 31 Comp. Cas. 125. Thus, a company which could not declare a dividend at an annual general meeting may do so at a subsequent general meeting. On the other hand, where a company has declared a dividend at a general meeting neither the company nor its directors can declare a further dividend for the same year. (As per Circular No. 22 [7/9/74-CL-II], dated 25-9-1975 issued by the Department of Company Affairs).

Answer 1(v)

Normally, all the shareholders are members and all the members are shareholders. However, members are those whose names have been entered in the Register of Members of the company. Hence, situation may arise when a shareholder may not be member viz.:

- (a) A person is holding a share warrant.
- (b) A person has bought shares but his name is not been entered in the register of members.
- (c) Heir/legal representative of the deceased till the shares are transmitted in his/her name.

Similarly, in certain situations a member may not be a shareholder, for instance-

- (d) Person has transferred/sold shares but his name has been appearing in the Register.
- (e) Name of a person has been included in the Register by mistake.

Question 2

(a) Choose the most appropriate answer from the given options in respect of the following :

(i) The number of debentureholders in a private company should not exceed—

- (a) Fifty
- (b) Twenty
- (c) One hundred
- (d) No such limit.

(ii) Which of the following is not an advantage/privilege enjoyed by a private company over a public company —

- (a) Business can be commenced immediately on incorporation
- (b) No need to have more than two directors
- (c) The number of members is limited to fifty
- (d) There is no restriction on remuneration payable to directors.

(iii) In a government company, the government shareholding must not be less than —

- (a) 25% of the paid-up share capital
- (b) 50% of the paid-up share capital
- (c) 51% of the paid-up share capital
- (d) 100% of the paid-up share capital.

(iv) Which of the following is not a characteristic of a statutory corporation in India —

- (a) It is owned by the State
- (b) Its employees are civil servants and are governed by government regulations in respect of conditions of service
- (c) It is created by a special law of the Parliament or State legislature
- (d) It is a body corporate and therefore it can sue and be sued.

(v) Under section 146, every registered company should have a registered office —

- (a) From the date on which it begins to carry on business
- (b) From the date on which it obtains certificate of incorporation
- (c) From the 30th day after the date of its incorporation
- (d) From the date on which it begins to carry on business or from the 30th day after the date of its incorporation, whichever is earlier.

(vi) The quantum of registration fees payable by companies to be incorporated in India depends on —

- (a) The issued capital of the company
- (b) The nominal capital of the company

- (c) *The paid-up capital of the company*
 - (d) *The called-up capital of the company.*
 - (vii) *When bonus shares are allotted to members, they are required to pay —*
 - (a) *The market price of the shares*
 - (b) *The book value of the shares*
 - (c) *The face value of the shares*
 - (d) *None of the above.*
 - (viii) *Forfeited shares can be re-issued by a company by way of passing —*
 - (a) *An ordinary resolution at the general meeting*
 - (b) *A special resolution at the general meeting*
 - (c) *A Board resolution*
 - (d) *None of the above.*
- (1 mark each)
- (b) *Re-write the following sentences after filling-up the blank spaces with appropriate word(s)/figure(s) :*
- (i) _____ *acts as the official signature of a company.*
 - (ii) *A private company, which is subsidiary of a company not being a private company, is a _____ company.*
 - (iii) _____ *is an Act enacted to prevent the improper use of certain emblems and names for professional and commercial purposes in India.*
 - (iv) *The issue of ESOPs or ESOS shall be subject to approval of shareholders through a _____ resolution.*
 - (v) *When a company makes buy-back of shares or securities, the buy-back operations shall be completed within _____ from the date of filing of draft letter of offer.*
 - (vi) *Working capital of a company may be defined as the excess of current and liquid assets over _____.*
 - (vii) *The register and index of debentureholders of a company should be preserved for _____ till after the redemption of the debentures.*
 - (viii) *The directors appointed under the principle of proportional representation shall hold office for a period of _____.*
- (1 mark each)

Answer 2(a)

- (i) (d) No such limit
- (ii) (c) The number of members is limited to fifty
- (iii) (c) 51% of the paid-up share capital
- (iv) (b) Its employees are civil servants and are governed by government regulations in respect of conditions of service

- (v) (d) From the date on which it begins to carry on business or from the 30th day after the date of its incorporation, whichever is earlier
- (vi) (b) The nominal capital of the company
- (vii) (d) None of the above
- (viii) (c) A Board resolution

Answer 2(b)

- (i) **Common seal** acts as the official signature of a company.
- (ii) A private company, which is subsidiary of a company not being a private company, is a **public** company.
- (iii) **The Emblems and Names (Prevention of Improper Use) Act, 1950** is an Act enacted to prevent the improper use of certain emblems and names for professional and commercial purposes in India.
- (iv) The issue of ESOPs or ESOS shall be subject to approval of shareholders through a **special** resolution.
- (v) When a company makes buy-back of shares or securities, the buy-back operations shall be completed within **12 months** from the date of filing of draft letter of offer.
- (vi) Working capital of a company may be defined as the excess of current and liquid assets over **current liabilities**.
- (vii) The register and index of debentureholders of a company should be preserved for **15 years** till after the redemption of the debentures.
- (viii) The directors appointed under the principle of proportional representation shall hold office for a period of **three years**.

Question 3

- (a) *What is 'capital profit' ? Can dividend be declared out of capital profit ? If so, under what circumstances ?* (6 marks)
- (b) *Under section 205, depreciation will have to be provided for working out distributable profit. Though, the present value of land of a company, dealing with land, is much less than the book value, the difference between the book value and market value was not amortised before declaring dividend. Discuss.* (4 marks)
- (c) *Can the dividend be declared out of previous years' profits transferred to reserve? Discuss.* (6 marks)

Answer 3(a)

The term 'capital profits' may be defined to mean those profits which arise otherwise than in the normal course of the business and earned out of capital transactions. The usual sources of capital profits are:

- (1) Profits on sale of fixed assets.
- (2) Profits on revaluation of fixed assets.

- (3) Premium on issue of shares/debentures/bonds.
- (4) Profits on reissue of forfeited shares.
- (5) Capital redemption reserve account.
- (6) Profit prior to incorporation i.e. profits which accrues to a company till the date of incorporation.

The Companies Act does not mention specifically whether capital profits i.e. profits which arise where a company sells part of its fixed assets at a price higher than the original cost of such asset, can be distributed as dividend.

However, in the two important cases of *Lubbock v. British Bank of South America* (1892) 2 Ch. 198 and *Foster v. The New Trinidad Co. Ltd.* (1901) 1 Ch. 208, the courts have held that capital profits cannot be considered as available for distribution as dividend unless:

- (a) the articles of association authorise such a distribution; and
- (b) the surplus is realised and remains after a valuation of the whole of the assets and liabilities.

Answer 3(b)

A loss of capital need not be made good before declaring or payment of dividend out of capital profits [*Botton v. Natal Land & Colonisation Co. Ltd.* (1892) 124 Ch.]

In this case, the plaintiff sought to restrain the payment of dividend by a company dealing with land on the ground that the book value of the land was much higher than the true value and must be written down before profit can be distributed. Held that a loss of capital need not be made good before declaring a payment of dividend out of current profits.

Answer 3(c)

In case of absence or inadequacy of profits, dividend can be declared under Section 205A(3) of the Companies Act out of the accumulated profits earned by the company in the previous years and transferred by it to reserves. Such declaration should be in accordance with the rules prescribed in this regard by the Government. If such a declaration does not conform to the rules, the declaration of dividend will require the previous approval of the Central Government. In exercise of its powers under this subsection, the Central Government has framed rules known as Companies (Declaration of Dividend Out of Reserves) Rules, 1975.

Under these rules dividend can be declared from amounts drawn from reserves (i.e. free reserves only and not from any specific reserves) in case of absence or inadequacy of profits subject to the following conditions:

- (a) the rate of dividend declared shall not exceed the average of the rates of dividend declared by it during the immediately preceding last five years or 10% of the paid-up capital, whichever is less;
- (b) the amount to be drawn shall not exceed 10% of its paid-up capital and free reserves and the amount so drawn should be first utilised to set off the

losses incurred in the financial years before any dividend in respect of preference and equity shares is declared; and

- (c) the balance of reserves after such drawal shall not fall below 15% of the paid-up share capital.

Question 4

- (a) *What are the provisions regarding disclosure in the directors' report of the events of great importance to the business developed after closure of accounts of the company ?* (4 marks)
- (b) *Enumerate the differences between 'statutory books' and 'statistical books' of a company.* (4 marks)
- (c) *What is the procedure regarding authentication of annual accounts of a private company when only one director is available in India ?* (4 marks)
- (d) *Is it mandatory for all the directors to obtain DIN ? Discuss.* (4 marks)

Answer 4(a)

The annual report will have to include indication of company's likely future developments and of any important events occurring after balance sheet date.

Guidelines in this connection have been published by the Institute of Chartered Accountants of India. According to the guidelines, significant events occurring after the balance sheet date and the date on which the financial statements are approved, both favourable and unfavourable, which have significant effects on the financial result may require adjustment to asset and liabilities or may require disclosure. Those significant events which occur during that period i.e. balance sheet date and their approval date, which do not have material effect on the financial results as on balance sheet date may be disclosed through Directors' Report or Chairman's statement/speech.

Two types of events have been identified –

- (i) those that provide further evidence of conditions that existed at the balance sheet date, and
- (ii) those that are indicative of conditions that arose subsequent to the balance sheet date.

Answer 4(b)

Statutory Books

In addition to the books of account, the Companies Act, 1956, specifically requires certain other books to be kept by a company for maintaining a record of its different activities in order to safeguard the interests of the shareholders and creditors. These books are known as Statutory Books. Some of such books are laid down as below:

1. Register of investments in securities made by the company but not held by it in its own name [Section 49(7)].
2. Register of fixed deposits.
3. Register of Securities bought back [Section 77A(9)].

4. Register of charges [Section 143(1)].
5. Register of Members [Section 150(1)].
6. Index of Members where the number is more than fifty unless the Register of Members itself affords an index [Section 151(1)].
7. Register of Debentureholders [Section 152(1)].
8. Index of Debentureholders where the number is more than fifty unless the Register of Debentureholders itself affords an index [Section 152(2)].
9. Register and Index of Beneficial Owners [Section 152A].
10. Foreign Registers of Members and Debentures holders and their duplicates [Sections 157(1) and 158(4)].

Statistical Books

In addition to the books of account and statutory books mentioned earlier, a company usually maintains a number of statistical books in order to keep complete records of the numerous details connected with the business operations. The keeping of such books has become a necessity although there is no legal compulsion for the same. The following is the list of some of such important books:

1. Share Application and Allotment Book
2. Share Call Book
3. Share Certificate Book
4. Share Transfer Book
5. Debenture Interest Book
6. Director's Attendance Book
7. Agenda Book
8. Dividend Mandate Register
9. Share Warrants Register
10. Register of certified transfers

Answer 4(c)

According to section 215 of the Companies Act, 1956, the balance sheet and the profit and loss account shall be signed on behalf of the Board by (a) the manager or secretary if any and by (b) two directors one of whom shall be a managing director where there is one. If there is no managing director, then by (a) the manager or secretary, if any and (b) any two directors shall sign the same. If only one director or managing director is, for the time being in India, he can sign the balance sheet and the profit and loss account. However, in such a case he is required to file with the Registrar of Companies, along with the balance sheet and the profit and loss account, a signed statement explaining the reason as to why compliance with the provisions of Sub-section (1) of Section 215 was not possible.

Answer 4(d)

Sections 266A to 266G of the Companies Act, 1956 contain the provisions for DIN. As such, all the existing directors and individuals intending to become directors have to

obtain DIN within the prescribed time frame and in the manner as prescribed. Central Govt. has prescribed Director Identification Number Rules, 2006, governing Director Identification Number.

DIN is allotted by the Central Government within one month from the receipt of application for allotment of DIN.

No one can obtain more than one DIN.

DIN number will have to be quoted while furnishing any return, information etc. relate to the Director or contain information/reference of any director.

Intimation of DIN will have to be given to the Registrar or any other officer or other specified authority within a week of obtaining the number.

Question 5

(a) *State, with reasons in brief, whether the following statements are correct or incorrect:*

- (i) *The property of a company is not the property of the individual members.*
- (ii) *The separate personality of a company is a statutory privilege and it must be used for legitimate business purposes only.*
- (iii) *Every company shall have the words 'Limited', if the company is registered with a limited liability.*
- (iv) *The members of an unlimited company are liable directly to the creditors of the company.* (2 marks each)

(b) *Write short notes on the following :*

- (i) *The golden rule or golden legacy; and*
- (ii) *Corporation sole.* (4 marks each)

Answer 5 (a)

- (i) **Correct.** A company being a legal person and entirely distinct from its members, is capable of owning, enjoying and disposing of property in its own name. The company is the legal person in which all its property is vested, and by which it is controlled, managed and disposed of. Their Lordships of the Madras High Court in *R.F. Perumal v. H. John Deavin*, A.I.R. 1960 Mad. 43 held that "no member can claim himself to be the owner of the company's property during its existence or in its winding-up".
- (ii) **Correct.** As separate personality of the company is a statutory privilege, it must be used for legitimate business purposes only. Where a fraudulent and dishonest use is made of the legal entity, the individuals concerned will not be allowed to take shelter behind the corporate personality. The Court will breakthrough the corporate shell and applies the principle of what is known as "lifting of or piercing through the corporate veil".
- (iii) **Correct.** Every company shall have the words 'Limited', if the company is registered with a limited liability. Moreover, if a company is registered with a limited liability, the words 'Private Limited' must be added at the end of its name

by a private limited company. On the other hand, the words 'limited' must be added at the end of its name by a public limited company. However, section 25 company is an exception in this regard.

- (iv) **Incorrect.** The members of an unlimited company are not liable directly to the creditors of the company, as in the case of partners of a firm. The liability of the members is only towards the company and in the event of its being wound up only the Liquidator can ask the members to contribute to the assets of the company which will be used in the discharge of the debts of the company.

Answer 5(b)(i)

The Golden Rule or Golden Legacy

It is the duty of those who issue the prospectus to be truthful in all respects. This Golden Rule was enunciated by Kinderseley, V.C. in *New Brunswick, etc., Co. v. Muggeridge*, (1860) 3 LT 651, and has come to be known as the "golden legacy". "Those who issue a prospectus hold out to the public great advantages which will accrue to the persons who will take shares in the proposed undertaking. Public is invited to take shares on the faith of the representation contained in the prospectus. The public is at the mercy of company promoters. Everything must, therefore, be stated with strict and scrupulous accuracy. Nothing should be stated as a fact which is not so and no fact should be omitted, the existence of which might in any degree affect the nature or quality of the privileges and advantages which the prospectus holds out as inducement to take shares. In short, the true nature of the company's venture should be 'disclosed'. If concealment of any material fact has prevented an adequate appreciation of what was stated, it would amount to misrepresentation. Thus, even if every specific statement is literally true, the prospectus may be false if by reason of the suppression of other material facts, it conveys a false impression".

Answer 5(b)(ii)

Corporation Sole

A corporation sole is a single individual constituted as a corporation in respect of some office held by him or function performed by him. The Crown or a Bishop under the English law is an example of this type of corporation. It may be noted that though a corporation sole is excluded from the definition for the purposes of the Companies Act, it continues to be a legal person capable of holding property and becoming a member of a company.

The classic examples for 'corporation sole' in India are the President of India and the Governors of the Indian States. Under Article 299 of the Constitution of India, all contracts for and on behalf of the Governments in India are required to be in the name of the President of India [in case of Government of India] and the Governors of the States [in case of State Governments].

Question 6

- (a) *Jolly is one of the preference shareholders of Jack & Jill Ltd., a company registered under the Companies Act, 1956. The annual general meeting of the said company is scheduled to be held on 8th January, 2009. In this context, Jolly wants to*

exercise his voting rights at the scheduled general meeting. Can he do so ? If so, state whether he can vote on every resolution placed before the meeting.

(8 marks)

(b) What is 'class meeting' ? What are the purposes, provisions and procedure for holding class meeting ?

(8 marks)

Answer 6(a)

Under section 87(2) of Companies Act, 1956 a preference shareholder has the right to vote only on a resolution which directly affects the rights attached to his preference shares.

For this purpose, any resolution for winding up of the company or for the repayment or reduction of its share capital shall be 'deemed' directly to affect the rights attached to preference shares.

However, a preference shareholder shall be entitled to vote on every resolution placed before the company at any meeting, if the dividend has remained unpaid for specified period, viz.,

- (i) in the case of cumulative preference shares, in respect of an aggregate period of not less than two years preceding the date of the commencement of the meeting; and
- (ii) in the case of non-cumulative preference shares, either in respect of a period of not less than two years ending with the expiry of the financial year immediately preceding the commencement of the meeting or in respect of an aggregate period of not less than three years, comprised in the six years ending with the expiry of the financial year aforesaid.

Therefore, Jolly can exercise his voting rights at any general meeting only on matters as discussed above.

Answer 6(b)

Class meetings are those meetings which are held by holders of a particular class of shares, e. g. preference shares. Need for such meetings arise when it is proposed to vary the rights of a particular class of shares. Thus, for effecting such changes, it is necessary that a separate meeting of the holders of that class of shares is held and the proposed variation is approved at the meeting. For example, for deciding not to pay the arrears of dividends on cumulative preference shares, for which it is necessary to call a meeting of such shareholders and pass the resolution as prescribed by Section 106 of the Act.

According to section 106 of the Companies Act, 1956, where the share capital of a 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 with the sanction of a special resolution passed at a separate meeting of the holders of the issued shares of that class—

- (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.

Procedure for Class Meetings

Regulation 3 of the Table A of Schedule I of the Act provides as under:

- (1) If, at any time, the share capital is divided into different classes of shares, the rights attached to any class (unless otherwise provided by the terms of issue of the shares of that class) may, subject to the provisions of Sections 106 and 107, and whether or not the company is being wound up, be varied with the consent in writing of the holders of three-fourths of the issued shares of that class or with the sanction of special resolution passed at the separate meeting of the holders of the shares of that class.
- (2) To every such separate meeting, the provisions of these regulations relating to general meeting shall mutatis-mutandis apply, but so that the necessary quorum shall be two persons at least holding or representing by proxy one-third of the issued shares of the class in question.

The articles of companies will have to be suitably modified or incorporated depending on the needs of each case on the above lines.

The other procedures/provisions relating to service of notice, persons to whom notice should be given, chairman, voting, proxy, minutes, poll etc. are similar to those provided in case of general meetings.

Question 7

(a) *Discuss the following :*

- (i) *Front office represents the interface of the corporate and public users with the MCA-21 system.*
- (ii) *For MCA-21, four types of users which are identified as users of digital signature.*
- (iii) *SMART governance.* (3 marks each)

(b) *What relief are available to the minority shareholders against wrongful conduct of the majority ?* (7 marks)

Answer 7(a)(i)

Front office represents the interface of the corporate and public users with the MCA21 system. This comprises of Virtual Front Office and Registrar's Front Office.

Virtual Front Office (VFO) – VFO merely represents a computer facility for filing of digitally signed e-forms by accessing the MCA portal through internet.

Registrar's Front Office (RFO) – When a company or user does not have the computer facilities required for e-filing, it can avail of these facilities at the designated facilitation centres, known as Registrar's Front Office (RFO) or Physical Front Office (PFO).

Answer 7(a)(ii)

For MCA-21, the following four types of users are identified as users of Digital Signatures and are required to obtain digital signature certificate:

1. MCA (Government) Employees.
2. Professionals (Company Secretaries, Chartered Accountants, Cost Accountants and Lawyers) who interact with MCA and companies in the context of Companies Act, 1956.
3. Authorized signatories of the company including Managing Director, Directors, Manager or Secretary.
4. Representatives of Banks and Financial Institutions.

Answer 7(a)(iii)**SMART Governance**

E-governance or Electronic governance is the application of information technology to the Government functioning in order to bring about simple, moral, accountable, responsive and transparent (SMART) Governance. The system aims at moving from paper based to nearly paperless environment. It is based on the Government's vision of National e-governance in the country.

Answer 7(b)

The management of companies is based on majority rule. Board of Directors exercise their powers vested on them by the Articles of Association of the company, Companies Act and powers given to them by the shareholders in general meetings and passed by a simple majority or by a Special Resolution, Majority rule prevails. However, the rule of majority's supremacy does not hold good in all situation.

The company law provides for adequate protection for the minority shareholders when their rights are oppressed/abused by the majority. However, the Court will not usually intervene at the instance of shareholders. The basic principles of non-interference with the internal management of the company has been laid down in *Foss vs. Harbottle*. The supremacy of the majority, does not prevail in all situations, as over a period of time, certain exceptions have developed. For instance –

Under common law

- ultra vires acts.
- fraud on minority.
- wrong doers in control.
- breach of duties etc.
- resolution requiring special majority passed with simple majority.
- Individual membership rights invaded by the majority of shareholders.

Remedies under the Companies Act –

- (i) variation of class rights

- (ii) in the scheme of reconstruction and amalgamation, the minority shareholders are given protection
- (iii) in cases of oppression and mismanagement, the provisions under section 397 and 398 come to the rescue of the minority shareholders
- (iv) aggrieved shareholder can make winding up petition
- (v) at the instance of shareholders Central Government can order for investigation.

Question 8

- (a) *What do you understand by the term 'illegal association' ? What are the rights and liabilities of a member of illegal association ?* (8 marks)
- (b) *An association of 15 members (not being HUF) started banking business without being registered. After one year, six members retired. Thereafter, three members instituted a suit for partition of assets of the association. Discuss the fate of such a suit.* (8 marks)

Answer 8(a)

Meaning of Illegal Association

By virtue of Section 11 of the Companies Act, no company, association or partnership consisting of more than 20 persons (10 in the case of banking business) can be formed for the purpose of carrying on any business for gain, unless it is registered as a company under the Companies Act, or is formed in pursuance of some other Indian Law, or is a Joint Hindu Family carrying on business for gain. If it is formed without complying with the above provisions, it is called an illegal association.

Section 11 of the Act does not apply to the case of a single joint family carrying on any business whatever may be the number of its members. But if two or more joint hindu family firms carry on business together and the combined number of members exceed 20, then their association will become illegal. In computing the number, minor members of joint families are to be ignored. If by reason of minor members of such joint families on attaining majority, the number of persons exceeds the statutory limit, it will ipso facto become an illegal association. In this case the question arises as to whether the penal provision of this section may be applied to that illegal association. The liberal view under such circumstances seems to be exemption from the penal provision since illegality supervenes at a subsequent stage. [*Niraban v. Lalit*, I.L.R. (1938) 2 Cal. 368]. But by strict interpretation of the provisions of the said section one may hold such illegal association liable.

Rights and liabilities of a member of illegal association

The members of an illegal association are individually liable in respect of all acts or contracts made on behalf of the association; they cannot either individually or collectively, bring an action to enforce any contract so made, or to recover any debt due to the association [*Wilkinson v. Levison* (1925) 42 T.L.R. 97].

Under Sub-sections (4) and (5) of Section 11, every member of an illegal association is:

- (i) personally liable for all liabilities incurred in carrying on the business of, or by, the illegal association, and

- (ii) punishable with fine up to Rs. 10,000.

Answer 8(b)

Under Section 11 of the Companies Act, an association consisting of more than 10 persons carrying on banking business (not being a Hindu Undivided family business) should be registered. If it is not registered, it would be an illegal association, and the effect would be that it has no legal existence. Law does not recognize such an association. An illegal association cannot become a legal association even if later on the number of members falls below the required numbers, e.g. 10 in this case.

It was held in the case of *MST Kumarswami Chettiar v. MSM Chinnathambi Chettiar*, 1950, that an association contravening section 11 of the Companies Act is an illegal association and while it cannot sue on a contract made by it, its members will be individually liable on such contract. There can be no cause of action on the basis of an illegal association.

Thus, in the present question, the association will remain illegal notwithstanding the fact that its number has fallen below 10. Therefore the suit will not be tenable.
