

INTERMEDIATE EXAMINATION

JUNE 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) A company cannot ratify its pre-incorporation contracts.*
- (ii) Registered office of a company can be shifted from one State to another without the approval of the State Government.*
- (iii) A company can accept deposits by issuing advertisement.*
- (iv) Statutory meeting is held only once in the lifetime of a company.*
- (v) Buy-back of shares does not amount to reduction of share capital.*

(5 marks each)

Answer 1(i)

Contracts entered into by the promoters on behalf of the company before its incorporation is known as preliminary contracts. Since a company comes into existence only after it is incorporated, the relationship of principle and agent does not exist. A principle who is not in existence cannot appoint an agent. Since at the time of contract, the company was not in existence, a contract by a promoter purporting to act on behalf of the company prior to its incorporation does not bind the company. The promoters alone, therefore, remain personally liable for any contract they purport to make on behalf of the company, unless the company enters into afresh contract in terms of such agreement after incorporation adopting the contract entered into by the promoter.

In *Kelner v. Baxter*, (1866) LR 2CP 174, it was held that the company could not ratify pre-incorporation contracts. Even if the company has received some benefit under the contract, the company cannot ratify and there is no viability of the company for such contracts. A company cannot ratify a pre-incorporation contract, but it is open to it to enter into a new contract after its incorporation to give effect to a contract made before its formation [*Howard v. Patent Ivory Co.* (1888) 38 Ch.D]. Since the pre-incorporation contract is a nullity, even the company cannot sue the vendor of property if he fails to carry out such a contract.

Answer 1(ii)

A special resolution shall be passed at a general meeting so as to change the place of registered office from one State to another. The alteration shall not take effect until it is confirmed by the Company Law Board on petition. The Company Law Board shall cause notice of the petition for confirmation of the change to be served on the Registrar for objections and suggestions, if any.

Approval of State Government not required

At one time, the shifting of the registered offices of certain companies to places outside a State was opposed by the State on the grounds of loss of revenue and employment opportunities and the Courts (now the Central Government) were hesitant in giving confirmation. In *Orient Paper Mills Ltd. v. The State*, A.I.R. (1957) Ori. 232, the Orissa High Court declined confirmation of change of registered office from Orissa to another State on the ground that in a federal Constitution every State has got the right to protect its revenue and, therefore, the interests of the State must be taken into account.

In *Rank Film Distributors of India Ltd. v. Registrar of Companies*, West Bengal, A.I.R. (1969) Cal. 32, a Division Bench of the Calcutta High Court observed that State has no statutory right under Section 17 to oppose the shifting of the registered office from one State to another.

Under the Act, it is for the members of a company and not for the State to decide whether the registered office of the company should be transferred from one State to another in the interest of the company for the reasons specified in Section 17.

Answer 1(iii)

No company can accept deposits except after publication of an advertisement specifying therein the financial condition, management structure and other specified particulars. The advertisement shall be made not later than 6 months of the close of the financial year based on which financial details are given therein, in a leading English newspaper and in one vernacular language newspaper circulating in the State in which the registered office of the company is situated.

The Board meeting should also approve and adopt the text of the advertisement inviting deposits from the public. The advertisement must contain the particulars as per Rule 4(2) of the Companies (Acceptance of Deposits) Rules. These include (among others):

- (a) name of the company;
- (b) the date of incorporation of the company;
- (c) business carried on by the company and its subsidiaries;
- (d) brief particulars of the management of the company;
- (e) names, addresses and occupations of the directors;
- (f) profits before and after providing for tax, for the 3 financial years, immediately preceding the date of advertisement;
- (g) dividends declared in respect of the said 3 financial years;
- (h) a summarized financial position as in 2 immediately preceding audited balance sheets prior to the date of advertisement;
- (i) the amount which the company can raise by way of deposits under the rules and the aggregate of deposits actually held on the last day of the immediately preceding financial year; and
- (j) a statement to the effect that on the date of the advertisement, the company has no overdue deposits other than unclaimed deposits or a statement showing the amount of such overdue deposits, as the case may be.

The advertisement shall remain valid for a period of 6 months from the date of closure of the financial year in which it is issued or until the date the balance sheet is laid before the company in general meeting or where the annual general meeting is not held, the latest date on which the meeting should have been held, whichever is earlier. A fresh advertisement has to be made in each succeeding financial year for inviting deposits thereafter.

Answer 1(iv)

As per Section 165 of the Companies Act, 1956 every company limited by shares/ limited by guarantee and having a share capital shall within a period of not less than one month and not more than six months from the date on which the company is entitled to commence business hold a statutory meeting. It is clear that such statutory meeting is required to be held only once in the life time of a company. The purpose of holding the statutory meeting is to apprise the shareholders about

- (1) shares allotted and amount paid thereon and the consideration received;
- (2) receipt and payment of cash;
- (3) preliminary expenses of the company;
- (4) names, addresses and occupation of directors, auditors, manager and secretary;
- (5) particulars of contracts of modification thereof if any proposed to the meeting for approval;
- (6) underwriting contracts;
- (7) unpaid calls;
- (8) commission/brokerage paid or payable.

The above shall be in the form of a report called as the statutory report, copy of which is required to be circulated amongst the members' at least 21 days in advance of the meeting.

Answer 1(v)

As per Section 77(A) of the Companies Act, 1956, a company is authorized to buy back its own shares from the shareholders. By this process only the paid up share capital of the company gets reduced and the amount of shares bought back is transferred to Capital Reserves. This does not result into reduction of capital. In the following cases, the diminution of share capital is not to be treated as reduction of the capital.

- (1) Cancellation of shares agreed to be taken but not taken by any person.
- (2) Redemption of preference shares.
- (3) Shares forfeited for non payment of calls.
- (4) Where the company buys back its own shares under Section 77A.

Question 2

- (a) *Discuss the provisions relating to 'registration of charges'.* (6 marks)
- (b) *Discuss the majority rule and minority rights.* (10 marks)

Answer 2(a)

Company organizations raise finance from banks and financial institutions for the purpose of the business against the security of company's assets including book debts. The Companies Act, 1956 requires under Section 125 that charge created on the assets of the company should be filed in e-form 8 with Registrar of Companies, within 30 days of creation of charge. On payment of additional fee, further 30 days time is allowed to file the charge. After repayment of the loan, the company has to file the form for satisfaction of charge in e-form 17.

The charges which must be registered are:

- (a) a charge for the purpose of securing any issue of debentures;
- (b) a charge on uncalled share capital of the company;
- (c) a charge on any immovable property, wherever situate or any interest therein;
- (d) a charge on any book debts of the company;
- (e) a charge, not being a pledge, on any movable property of the company;
- (f) a floating charge on the undertaking or any property of the company including stock-in-trade;
- (g) a charge on calls made but not paid;
- (h) a charge on a ship or any share in a ship; and
- (i) a charge on goodwill or a patent or a licence under a patent, or on a trade mark, or on a copyright or a licence under a copyright.

Failure to register a charge shall render the same inoperative against the liquidator in the event of winding up of the company.

Answer 2(b)**Powers of Majority**

As a company is an artificial person with no physical existence, it functions through the instrumentality of the Board of directors who is guided by the wishes of the majority, subject, of course, to the welfare of the company as a whole. It is, therefore, a cardinal rule of company law that prima facie a majority of members of a company are entitled to exercise the powers of the company and generally to control its affairs.

The Principle of Non-interference (Rule in Foss v. Harbottle)

The court will not usually intervene at the instance of shareholders in matters of internal administration, and will not interfere with the management of a company by its directors so long they are acting within the powers conferred on them under the articles of the company. The basic principle of non-interference with the internal management of company by the court is laid down in a celebrated case of *Foss v. Harbottle* 67 E.R. 189; (1843) 2 Hare 461. No action can be brought by a member against the directors in respect of a wrong alleged to be committed to a company. The company itself is the proper party of such an action.

Justification of the Rule in Foss v. Harbottle

The justification for the rule laid down in *Foss v. Harbottle* is that the will of the majority prevails. On becoming a member of a company, a shareholder agrees to submit to the will of the majority. The rule really preserves the right of the majority to decide how the company's affairs shall be conducted. If any wrong is done to the company, it is only the company itself, acting, as it must always act, through its majority, that can seek to redress and not an individual shareholder.

Exceptions to the Rule in *Foss v. Harbottle* — Protection of Minority Rights and shareholders remedies

The rule in *Foss v. Harbottle* is not absolute but is subject to certain exceptions. In other words, the rule of supremacy of the majority is subject to certain exceptions and thus, minority shareholders are not left helpless, but they are protected by:

- (a) the common law; and
- (b) the provisions of the Companies Act, 1956.

Actions by Shareholders in Common Law

The cases in which the majority rule does not prevail are commonly known as exceptions to the rule in *Foss v. Harbottle* and are available to the minority. In all these cases an individual member may sue for declaration that the resolution complained of is void, or for an injunction to restrain the company from passing it. The said rule will not apply in the following cases;

(1) *Ultra Vires Acts*

Where the directors representing the majority of shareholders perform an illegal or ultra vires act for the company, an individual shareholder has right to bring an action.

(2) *Fraud on Minority*

Where an act done by the majority amounts to a fraud on the minority, an action can be brought by an individual shareholder.

(3) *Wrongdoers in Control*

If the wrongdoers are in control of the company, the minority shareholders' representative action for fraud on the minority will be entertained by the court [Cf. *Birch v. Sullivan*, (1957) 1 W.L.R. 1274].

(4) *Resolution requiring Special Majority*

A shareholder can sue if an act requires a special majority but is passed by a simple majority.

(5) *Personal Actions*

Individual membership rights cannot be invaded by the majority of shareholders.

(6) *Breach of Duty*

The minority shareholder may bring an action against the company, where although there is no fraud, there is a breach of duty by directors and majority shareholders to the detriment of the company. [*Daniels v. Daniels*, (1978) 2 W.L.R. 73]

(7) *Prevention of Oppression and Mismanagement*

The minority shareholders are empowered to bring action with a view to preventing the majority from oppression and mismanagement.

Statutory Remedies (under the Companies Act) with reference to Prevention of Oppression and Mismanagement

Prevention of Oppression (Section 397)

The first remedy in the hands of an oppressed minority is to move the Company Law Board. Section 397 provides that any member of a company who complain that the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member(s) (including any one or more of themselves) may make an application to the Company Law Board by way of petition for relief.

On being satisfied about the above requirements, the Company Law Board may make the necessary orders for ending the matters complained of.

Prevention of Mismanagement (Section 398)

Section 398 provides for relief in cases of mismanagement. For a petition under this section to succeed, it must be established that the affairs of the company are being conducted in a manner prejudicial to the interest of the company or public interest, [(Section 398 (1) (A)] or that, by reason of any change in the management or control of the company, it is likely that the affairs of the company will be conducted in that manner [(Section 398 (1) (b)]. If the court is so convinced, it may, with a view to bringing to an end or preventing the matter complained of or apprehended, make such order as it thinks fit [Section 398 (2)].

Question 3

- (a) *When is a trust said to be extinguished and when revoked ?* (8 marks)
- (b) *An existing company wants to commence a new business. Elucidate the procedure laid down therefor.* (8 marks)

Answer 3(a)

Indian Trust Act, 1882 defines trust as an obligation annexed to the ownership of property and arising out of confidence reposed in and accepted by the owner or declared and accepted by him for the benefit of audit or of another and the owner. Trust connotes a legal relationship created for lawful purposes only.

A Trust is extinguished:

- (i) when its purpose is completely fulfilled or
- (ii) when the purpose of the trust becomes unlawful or
- (iii) when the fulfillment of the purpose of the trust becomes impossible by destruction of the trust property or otherwise or
- (iv) when the trust being revocable is revoked.

When a trust is revoked:

- I. If a trust is created by a will it may be revoked by the revocation of the trust.
- II. If the trust has been created otherwise than by a will or orally, it can be revoked only
 - (a) with the consent of all the beneficiaries competent to contract;
 - (b) by the exercise of power of revocation expressly reserved by the author of the trust in case of trusts declared orally or by non-testamentary instruments or
 - (c) where the trust is created for the payment of debts of the author of the trust and has not been communicated to the creditors, at the pleasure of the author of the trust. However, if the creditors are parties to the agreement creating the trust, the trust cannot be revoked without their consent.

A trust is generally irrevocable unless a power of revocation is expressly reserved.

Answer 3(b)

According to the clarification given by the Department of Company Affairs (Now, Ministry of Corporate Affairs), new business means a business which is not germane to the existing business carried on by the company. The guiding criterion is, therefore, whether the new activity is germane to the original business or not. In case the reply is 'yes', no special resolution is necessary and vice versa.

Section 13 requires that every company formed on or after October 15, 1965 must state in its memorandum (i) the main objects to be pursued by the company on its incorporation and objects incidental or ancillary to the attainment of the main objects; (ii) other objects not included in (i) above, separately.

Procedure in case an existing company wants to commence a new business.

1. Call a board meeting after giving notice to all the directors of the company and approve the commencement of new business.
2. Convene the general meeting by passing a special resolution by three-fourth majority.
3. Forward three copies of the notices and a copy of the proceedings of the General Meeting to the Stock Exchange with which the shares of the company are listed. This is required in case of a listed company.
4. File the special resolution with the concerned ROC in e-form 23 within thirty days of the passing thereof.
5. The Central Government, may, however, on application by the Board of directors allow the company to commence new business, even if the special resolution is not passed by the company in general meeting, but passed by a simple majority.
6. It also requires the filing with the Registrar a declaration in e-Form No. 20A verified by one of the directors or the secretary or where the company has not appointed a secretary, a secretary in whole-time practice, that the approval by special resolution has been given by the company in general meeting.

However, the above procedure does not apply to a private company which can commence any new business permitted by the Memorandum of Association after passing a board resolution.

Question 4

Write short notes on any four of the following :

- (i) Government company*
- (ii) Doctrine of ultra vires*
- (iii) Multi-State co-operative societies*
- (iv) Investor Education and Protection Fund*
- (v) Audit committee.*

(4 marks each)

Answer 4(i)**Government company**

Government Company is defined as any company in which not less than fifty one percent of the paid up share capital is held by

- (1) Central Government or
- (2) Any state Government or
- (3) State Governments or
- (4) Partly by Central and partly by State Govt.

A subsidiary of a Government company is also treated as Government Company.

The provisions of Companies Act, 1956 also apply to Government companies but with exemptions which can be summarized as under:

- 1. Sections 255, 256 & 257 regarding appointment and retirement of directors.
- 2. Section 297 -contracts entered into with any other Government company.
- 3. Section 205A regarding transfer of unpaid dividend to special dividend account.
- 4. Provisions regarding managerial remuneration.
- 5. Section 187C - disclosure of beneficial interest.
- 6. Section 295 regarding loans to directors.
- 7. Sections 165, 187D, 294, Section 294AA.
- 8. Section 43A, 149(2A) 205B, 263 to 266, 307, 308,316,317 & 356.
- 9. Section 108.

Answer 4(ii)**Doctrine of ultra vires**

The word 'ultra' means beyond and the word 'vires' means the powers. In the case of a company whatever is not stated in the memorandum as the objects or powers is

prohibited by the doctrine of ultra vires. As a result, an act which is *ultra vires* is void, and does not bind the company. Neither the company nor the other contracting party can sue on it. Also, as stated earlier, the company cannot make it valid, even if every member assents to it.

The general rule is that an act which is ultra vires the company is incapable of ratification. An act which is intra vires the company but outside the authority of the directors may be ratified by the company [*Rajendra Nath Dutta v. Shilendra Nath Mukherjee*, (1982) 52 Comp. Cas. 293 (Cal.)].

The rule is meant to protect shareholders and the creditors of the company. But if the act is ultra vires (beyond the powers of) the directors only, the shareholders can ratify it. Or if it is ultra vires the articles of association, the company can alter its articles in the proper way.

The doctrine of ultra vires was first enunciated by the House of Lords in a classic case, *Ashbury Railway Carriage and Iron Co. Ltd. v. Riche*, (1878) L.R. 7 H.L. 653.

Answer 4(iii)

Multi-State co-operative societies

A co-operative society which operates in more than one state is called Multi State Co-operative society. Such societies are registered under Multi State Co-operative Act to serve the interest of members in more than one state with the object to promote the economic and social betterment of its members, mutual aid and in accordance with the co-operative principles. Multi state co-operative society is required to be registered with the Central Registrar of Co-operative societies, New-Delhi. Membership of multi state co-operative societies is open to:

- (1) An individual competent to contract under Section 11 of the Indian Contract Act (which means the individual should be a major and of sound mind and is not disqualified for contracting according to the law to which he is subject).
- (2) Any Multi-State Co-operative Society or any Co-operative Society.
- (3) The Central Government.
- (4) The State Government.
- (5) The National Co-operative Development Corporation.
- (6) Any other Corporation owned or controlled by the Government.
- (7) Any Government company as defined in Section 617 of the Companies Act, 1956.
- (8) Such class or classes of persons or association of persons as may be permitted by the Central Registrar having regard to the nature and activities of a multi-state co-operative society.

Answer 4(iv)

Investor Education and Protection Fund

As per Section 205 C inserted w.e.f. 31.10.1988 in the Companies Act, 1956 the Central Government has established a fund called the Investor Education and Protection Fund.

Following amounts shall be credited to the said fund:

- (a) amounts in the unpaid dividend accounts of companies;
- (b) the application moneys received by companies for allotment of any securities and due for refund;
- (c) matured deposits with companies;
- (d) matured debentures with companies;
- (e) the interest accrued on the account referred to in clauses (a) to (d);
- (f) grants and donations given to the Fund by the Central Government, State Government, companies or any other institutions for the purposes of the Fund; and
- (g) the interest or other income received out of the investments made from the Fund.

The amounts at points (a) to (d) above shall not form part of fund unless such amounts have remained unclaimed or unpaid for a period of 7 years from the date they become due for payment.

The company when effecting a credit to the account of the fund, is required to separately furnish to the Registrar of Companies a statement in e-form 1.

Answer 4(v)

Audit Committee

Section 292A of the Companies Act, 1956 contains provisions for constitution of Audit Committee. According to it, Audit Committee must have a minimum of three members. Two-thirds of the total number of members should be non-executive directors. The remaining one-third members may be executive directors (managing and/or whole-time directors). There is no limit on the maximum number. This is a "committee of the Board"; hence it must consist only of directors. A person who is not a director of the company cannot be appointed as a member of the Audit Committee although such person can be invited by the Board at its discretion.

Unlike clause 49 of the Listing Agreement, Section 292A does not spell out functions and duties of Audit Committee. It has left that to the Board to decide. The power of electing a chairman of Audit Committee is vested in the Committee. The composition of Audit Committee must be disclosed by the company in every Annual report.

According to Sub-section (5), the auditors, the internal auditor, if any, and the director-in-charge of finance shall attend and participate at meetings of the Audit Committee but shall not have the right to vote. This Sub-section enjoins on Audit Committee to interact with the statutory auditors concerning the matters specified in it. Secondly, it enjoins to review the half-yearly and annual financial statements before submission to the Board. Thirdly, it enjoins to ensure compliance of internal control systems. Audit Committee has been given power to have "full access to information contained in the records of the company" and also external professional advice, if necessary.

The recommendations of the Audit Committee on any matter relating to financial management, including the audit report, shall be binding on the Board. In case the Board

wants to disregard the recommendations, the Board shall record its reasons for denying the same. The chairman of the Audit Committee is required to attend the annual general meetings of the company to provide any clarification on matters relating to audit.

Question 5

- (a) Choose the most appropriate answer from the given options in respect of the following :
- (i) Promoter is a person who is :
 - (a) Elected as director
 - (b) Appointed as chairman
 - (c) Appointed as managing director
 - (d) Engaged in promoting a company.
 - (ii) Minimum number of directors which every public limited company should have is :
 - (a) 5
 - (b) 10
 - (c) 3
 - (d) 7.
 - (iii) Maximum number of companies in which an individual can become director is :
 - (a) 20
 - (b) 50
 - (c) 15
 - (d) 5.
 - (iv) Maximum value of shares an investor must hold to become a 'small shareholder' is :
 - (a) Rs. 10,000
 - (b) Rs. 5,000
 - (c) Rs. 25,000
 - (d) Rs. 20,000.
 - (v) Percentage of deposits maturing in a year that is to be placed in a bank account is :
 - (a) 20%
 - (b) 15%
 - (c) 30%
 - (d) 5%.
 - (vi) A private limited company can commence its business after obtaining :
 - (a) Certificate of commencement of business
 - (b) Certificate of incorporation

(c) Approval from Central Government

(d) Approval from Registrar of Companies.

(1 mark each)

(b) Following information has been extracted from the balance sheet of Richy Rich Ltd. :

(i) Paid-up share capital	Rs. 20 crore
(ii) Reserves and surplus	Rs. 80 crore
(iii) Capital reserve	Rs. 5 crore
(iv) Investment in securities	Rs. 10 crore
(v) Loan to companies	Rs. 30 crore

DEF Ltd. has requested Richy Rich Ltd. for a loan of Rs. 50 crore which the Board of directors will consider at its ensuing meeting. Explain the legal position and advise the Board. (10 marks)

Answer 5(a)(i)

(d) Engaged in promoting a company.

Answer 5(a)(ii)

(c) 3.

Answer 5(a)(iii)

(c) 15.

Answer 5(a)(iv)

(d) Rs. 20,000.

Answer 5(a)(v)

(b) 15%.

Answer 5(a)(vi)

(b) Certification of Incorporation.

Answer 5(b)

As per Section 372A of the Companies Act, 1956 a company can give loan/give guarantee etc. to companies to the extent of 60% of its paid up capital and free reserves or 100% of free reserves, whichever is higher, with the prior approval of the Board. Any investment, or loan or, guarantee beyond this limit can be made with the previous approval of the members in general meeting by way of special resolution.

In case of Richy Rich Ltd. the limit upto which the company can give loans/give guarantee is as follows:

Paid up capital	Rs. 20 crores
Free Reserves	Rs. 80 crores
Total	Rs. 100 crores

60% of Rs.100 crores	Rs. 60 crores
100% of free reserves	Rs. 80 crores

As 100% of free reserves i.e. Rs. 80 crores is more than 60% of paid up share capital and free reserve i.e. Rs. 60 crores, therefore, the overall limit for release of loan is Rs. 80 crores.

The company can give loan/give guarantee upto Rs. 80 crores without obtaining approval of members.

Existing Loans	:	Rs. 30 crores
Investment in securities	:	Rs. 10 crores
Total		Rs. 40 crores
Proposed loan to DEF Ltd.		Rs. 50 crores
Total loan and Investments		Rs. 90 crores

It can be seen that the total loan/investment exceeds the limit of 60% of paidup capital and free reserves and 100% of free reserves. Thus, a loan of Rs. 50 crores can be given to DEF Ltd. with the previous approval of the members by passing a special resolution in a general meeting as required under Section 372A of the Companies Act, 1956.

However, in case of a listed company, the special resolution required must be passed through postal ballot in accordance with rule 4 of the Companies (Passing of the Resolution by Postal Ballot) Rules, 2001.

Question 6

- (a) *Ajay sold his shares and executed a transfer deed in favour of Vijay. The documents were lodged for transfer with the company. However, before effecting and registering the transfer by the company, Ajay, the transferor passed away. What is the impact of the death of Ajay on the registration of transfer of shares in favour of Vijay, if the death of Ajay is – (i) intimated to the company before the registration; and (ii) intimated to the company after registration of the transfer of the shares in favour of Vijay ?*
- If Vijay dies before registration of the transfer of shares, what will be the consequences — (i) if the death of Vijay is intimated to the company before registration of transfer; and (ii) if the death of Vijay is not intimated to the company before the registration of transfer ? (8 marks)*
- (b) *Two companies are incorporated with the same set of shareholders. Are they same or distinct under the Companies Act, 1956 ? Discuss. (4 marks)*
- (c) *The entire assets of a company are acquired by another company. Will it constitute taking over the management of the company ? Why ? (4 marks)*

Answer 6(a)

In accordance with Section 108(1) of the Companies Act, 1956 a company shall register the transfer of shares when a proper instrument of transfer duly stamped and

executed by or on behalf of the transferor, and transferee has been delivered to the company along with the share certificates.

In the given case Ajay sold his shares by executing a transfer deed in favour of Vijay and such documents were lodged for transfer. Therefore, if Ajay, the transferor dies, the company would register the transfer in both cases i.e. where the death of Ajay is intimated to company before registration of transfer and where death is intimated after registration of transfer.

If Vijay, the transferee dies before registration, and company has notice of his death, transfer of shares cannot be registered in the name of the Vijay who has already deceased. With the consent of the transferor and the legal representatives of the transferee, the transfer may be registered in the name of the legal heirs of the Vijay (who has already died) or his nominee, if any. But if there is a dispute, an order of the Court will be insisted by the company before effecting the transfer.

In case, the death of Vijay is not notified to the company, the company can register the transfer in the name of the deceased transferee, in as much as the company is not aware of the death of the transferee and the transfer is done bonafide by the company, as per the information available with it.

Answer 6(b)

On incorporation, a company becomes a separate legal person in the eyes of law. The company is vested with a corporate personality quite distinct from individuals who are its members. Being a separate legal entity it bears its own name and acts under a corporate name. It has a seal of its own. Its assets are separate and distinct from those of its members. It is also a different 'person' from the members who compose it. As such it is capable of owning property, incurring debts, borrowing money, having a bank account, employing people, entering into contracts and suing or being sued in the same manner as an individual. As such two companies which are incorporated with the same set of shareholders are nevertheless distinct and separate entities [*Patinson v. Bindya Debi* AIR 1933 Pat 196]. [*Theory of Corporate Veil; Saloman v. Saloman & Co. Ltd.*]

Answer 6(c)

The company has an identity and existence independent of the estate and undertaking owned by it. As such, even if the entire estate or assets are taken over by the govt. by an order such action does not constitute a taking over of the management of the company.

In the case of [*Gopalpur Tea Company v. Peshok Tea Company Ltd.* (1982) 52 Com Cases 239, 241 (Cal)], a similar issue was encountered. It was held that what had been taken over was only the estate of the company and not the company itself. There can be no doubt that in law the company, as constituted under the Indian Companies Act, has an identity and existence independent of the estate owned by it so that even if the estate is taken over by the Central Govt., that does not constitute a taking over of the management of the company.

Question 7

- (a) Explain 'independent director' and 'inside director'. Does inside director and interested director connote the same meaning ? (5 marks)

- (b) *Companies are required to obtain Secretarial Compliance Certificate in certain cases. What are these ? Who is competent to issue the said certificate ?*
(5 marks)
- (c) *When is dividend payable ? When may dividend be payable out of capital profits ?*
(6 marks)

Answer 7(a)

Independent Director

In clause 49 of the Listing Agreement, independent director is defined as a non-executive director of the company who

- (a) apart from receiving director's remuneration does not have any material pecuniary relationships or transactions with the company, its promoters, its senior management or its holding company, its subsidiaries and associated companies;
- (b) is not related to promoters or management at the Board level or at one level below the Board;
- (c) has not been an executive of the company in the immediately preceding three financial years;
- (d) is not a partner or executive of the statutory audit firm or the internal audit firm that is associated with the company and has not been a partner or an executive of any such firm for the last three years. Similar provisions are applicable for legal firms and consulting firm that have material association with the company;
- (e) is not a supplier, service provider or customer of the company. This should include also include the relationship of lesser and lessee;
- (f) is not a substantial shareholder of the company holding two or more percent of the block of voting shares.

However, independent directors on the Board of Companies shall be considered as independent director whether the institution is an investing institution or a lending institution.

Inside directors are those who are in the whole-time employment of a company which includes the Managing Director, Executive Director, whole-time Director, Technical Director etc.

Interested director means any director whose presence cannot by reason of Section 300, count for the purpose of forming quorum at a meeting of the Board at the time of discussion or vote on any matter in which such director is interested or interested. The interest should be specifically indicated at the meeting before the related matter is taken up.

In view of the above, it can be concluded that inside director and interested director connote two different aspects and generally do not mean the same thing.

Answer 7(b)

Instances where a company is required to obtain Secretarial Compliance Certificate

Every company which is not required to employ a whole-time secretary under Section 383A(1) and having a paid-up capital of rupees ten lakhs and more are required

to obtain Secretarial Compliance 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 file the same with the Registrar of Companies as also attach the same with the Directors' Report referred to in Section 217 of the Act. The certificate is required to be filed along with e-form 66 as an attachment within 30 days from the date of the Annual General Meeting.

Person competent to issue the secretarial compliance certificate

Only a secretary in whole-time practice is competent to issue the Secretarial Compliance Certificate as provided under Section 383A(1).

Obtaining Secretarial Compliance Certificate and submission of the same by a company which required to appoint a whole-time Secretary cannot be treated as a substitute for such appointment.

Answer 7(c)

When Dividend is payable

Under Section 207 of the Companies Act, 1956, dividend has to be distributed within 30 days of the declaration. Posting of dividend warrants within 30 days will be deemed to be payment irrespective of the fact whether the warrant has been encashed or not under [Regulation 91 of Table A of Schedule I to the Act]. In the case of joint holders, the warrant has to be sent to the registered address of the first named joint holder or to such person and to such address as the joint holders may in writing direct.

Exceptions

In the following circumstances dividend need not be paid within 30 days of declaration:

- (i) Where dividend could not be paid by reason of the operation of any law e.g. in the case of non-residents, dividend need not be paid within 30 days if permission for remittance where required has not been received therefor from the Reserve Bank of India within 30 days;
- (ii) Where a shareholder has given directions to the company regarding the payment of dividend and these directions cannot be complied with;
- (iii) Where there is a dispute regarding the right to receive dividend;
- (iv) Where the dividend has been lawfully adjusted by the company against any sum due to it from the shareholder; or
- (v) Where for any other reason for failure to pay the dividend or to post the warrant was not due to any default on the part of the company.

When Dividend is payable out of capital profits

Capital profits means those profits which arise otherwise than in the normal course of the business and earned out of capital transactions such as profit on sale of fixed assets, re-issue of forfeited shares, share/debenture premium etc.

The Companies Act does not mention specifically whether capital profits can be

distributed as dividend. However, the Courts have held that capital profits cannot be considered as available for distribution as dividend unless –

- (i) the Articles of Association authorize such a distribution; and
- (ii) the surplus is realized and remain after a valuation of the whole of the assets and liabilities.

Question 8

Distinguish between the following :

- (i) 'Company' and 'co-operative society'.
- (ii) 'Shares in physical form' and 'shares in dematerialised form'.
- (iii) 'Certificate of incorporation' and 'certificate of commencement of business'.
- (iv) 'Mortgage' and 'charge'. (4 marks each)

Answer 8(i)

'Company' and 'Co-operative society'

<i>Company</i>	<i>Co-operative society</i>
1. Registered under the Companies Act,	1. Registered under the Co-operative societies act.
2. Functioning of companies is regulated by Companies Act and rules framed thereunder.	2. Functioning of Co-operative societies is governed and regulated by Co-operative societies act and rules framed thereunder.
3. Voting rights of members in case of poll at general meeting is as per number of shares held by a shareholder i.e. One share - one vote.	3. Voting right at general meeting is one man-one vote.
4. Aim of Companies is to earn profit.	4. Principle of co-operation is to provide service to the members rather than making profits.
5. There are no concessions from the Govt. in respect of taxes, excise etc.	5. There are number of concessions available to co-operative societies in respect of taxes, stamp duty etc.

Answer 8(ii)

'Shares in physical form' and 'shares in dematerialized form'

<i>Shares in physical form</i>	<i>Shares in dematerialized form</i>
1. Share certificates are issued in physical form.	1. Shares are issued in electronic form.
2. For share transfer form 7B has to be executed.	2. No form is necessary for transfer. Only delivery instructions of depository participant are essential.

<i>Shares in physical form</i>	<i>Shares in dematerialized form</i>
3. No necessity of opening account with any body.	3. It is necessary to open a demat account with depository participant.
4. Transfer of shares takes longer time due to physical transit of documents.	4. It does not take time for transfer.
5. Stamp duty is to be paid on transfer deed.	5. No stamp duty is to be paid on transfer.
6. There are chances of thefts, forgery etc.	6. The chances of theft, forgery are remote.
7. Chances of bad delivery are there.	7. There are no chances of bad delivery.

Answer 8(iii)**‘Certificate of incorporation’ and ‘certificate of commencement of business’**

<i>Certificate of incorporation</i>	<i>Certificate of commencement of Business</i>
1. A certificate of incorporation is issued whereby the Registrar certifies under his hand that the company is incorporated and, in the case of a limited company, that the company is limited. [Section 34(1)].	1. When the company fulfils the conditions stated under Section 149(1) and (2), the Registrar certifies that it is entitled to commence business and that the certificate shall be conclusive evidence that the company is so entitled. [Section 149(3)].
2. From the date of incorporation mentioned in the certificate of incorporation, such of the subscribers of the memorandum and other persons, as may from time to time be members of the company, shall be a body corporate by the name contained in the memorandum. It becomes capable of exercising all the functions of an incorporated company having perpetual succession and a common seal. [Section 34(2)].	2. A certificate of commencement of business empowers a public company having a share capital to commence business and exercise its borrowing powers.
3. Certificate of incorporation is must for each company.	3. A private company can commence business immediately after obtaining certificate of incorporation.
4. The certificate of incorporation is the birth certificate of a company.	4. The certificate of commencement of business is a certificate that the company is entitled to commence business.

<i>Certificate of incorporation</i>	<i>Certificate of commencement of Business</i>
5. The documents to be filed with ROC for getting Certificate of Incorporation are Memorandum of Association, Articles of Association, e-form 18, e-form 32 and e-form 1.	5. The documents to be filed with ROC for getting Certificate of Commencement of Business are either e-form 19 alongwith copy of prospectus as an attachment or e-form 20 alongwith copy of statement in lieu of prospectus as an attachment.

Answer 8(iv)**'Mortgage' and 'Charge'**

<i>Mortgage</i>	<i>Charge</i>
(a) Mortgage is created by act of parties.	(a) Charge may be created by act of parties or by operation of law.
(b) Mortgage requires registration prescribed under Transfer of Property Act.	(b) Charge created by act of parties required registration.
(c) A mortgage is for a fixed term.	(c) A charge may be in perpetuity.
(d) Simple mortgage carries personal liability unless excluded by express contract.	(d) In case of charge, no personal liability is generally created.
(e) Mortgage is transfer of an interest in a specific immovable property.	(e) A charge only gives a right to receive payment out of charged property.
(f) A mortgage is good against subsequent transferees.	(f) Charge is good against subsequent transferees with notice.