

DIVIDENDS AND MANNER AND TIME OF PAYMENT THERE OF (SECTIONS 205 – 207)

Manner and time of payment

Question 1

The shareholders at an annual general meeting unanimously passed a resolution for payment of dividend at a rate higher than that recommended by the directors. Discuss the validity of the resolution.

Answer

Articles of companies usually contain provisions with regards to declaration of dividend on the pattern of regulations 85 to 94 of Table A of the Companies Act, 1956. Under the regulation 85, the power to declare a dividend vests with the general meeting, but it has no power to declare a dividend exceeding the amount recommended by the Board of Directors.

Transfer of higher percentage of profits to reserves

Question 2

Advise on the following situations:

- (i) *A company wants to transfer more percentage of profits to reserves.*
- (ii) *A company wants to declare dividends out of past reserves instead of current year profits.*
- (iii) *A company wants to provide depreciation higher than the rates provided in Schedule XIV.*

Answer

- (i) A company can make a transfer of more than 10% to reserves provided it ensures the minimum distribution specified in Rule 3 of the Companies (Transfer of Profits to Reserves) Rules, 1975.
 - (a) The minimum distribution is the rate of dividend equal to the average of the rates of dividend for the last 3 financial years.
 - (b) Where bonus shares have been issued during the financial year, minimum distribution would be the average of the amount of dividend for the last three financial years.

- (c) Where, however, the net profits after tax for the financial year are lower by 20% or more than the average net profits after tax for the last two financial years, it will not be necessary to ensure the minimum distribution for making a higher transfer to reserve.
- (ii) Dividends may be declared out of the profits of the company for any previous financial year or years arrived at after providing for depreciation in accordance with Section 205 of the Companies Act, 1956. However, the Central Government may in the public interest relax the payment of the profits without providing for depreciation. The Companies (Declaration of Dividend out of reserves) Rules, 1975 provided that
- (iii) The rate of dividend declared does not exceed the average of the rates at which dividend was declared by it in the 5 years immediately preceding that year or 10% of its paid-up capital, whichever is less.
- (iv) The total amount to be drawn from the accumulated profits earned in previous years and transferred to the reserves does not exceed an amount equal to 1/10th of the sum of its paid-up capital and free reserves and the amount so drawn must first be utilized to set off losses incurred in the financial year before any dividend in respect of preference or equity shares is declared.
- (v) The balance of reserves after such drawal does not fall below 15% of its paid-up capital.
- (vi) The rates contained in Schedule XIV are the minimum rates below which companies are not permitted to charge for depreciation and therefore there is no bar in providing a higher rate of depreciation.

Declaration of Dividend out of Past Reserves

Question 3

A Public Company has been declaring dividend at the rate of 20% on equity shares during the last 5 years. The Company has not made adequate profits during the year ended 31st March, 2009, but it has got adequate reserves which can be utilized for maintaining the rate of dividend at 20%. Advise the Company as to how it should go about if it wants to declare dividend at the rate of 20% for the year 2008-2009. Would your answer be different if the company utilized only the profits made in the previous years and retained in the profit and loss account for the purpose of payment of dividend at the rate of 20% for the year 2008-2009?
(November 2009)

Answer

As per Rule 2 of the Companies (Declaration of Dividend out of Reserves) Rules, 1975 dividend may be declared by a company for any year out of the accumulated profits earned by it previous years and transferred by it to the reserves subject to certain conditions. One of the

conditions is that the rate of dividend declared shall not exceed the average of the rates at which dividend was declared by it in the 5 years immediately preceding that year or 10% of its paid-up capital which ever is less. As the proposed dividend exceeds 10%, it is necessary to seek the approval of the Central Government as required under section 205A(3) and only after obtaining the approval of the Central Government, the company may declare dividend at rate of 20% for year 2008-09, even if the other conditions relating to the amount that can be drawn from the reserves and minimum balance in the reserve are fulfilled. However, the credit balance, if any, carried in the profit and loss account will be available for declaration of dividend without any restriction. Hence in such a case dividend may be declared at the rate of 20% for 2008-09, without approval of the Central Government.

Declaration of interim dividend

Question 4

Board of Directors of M/s. RPP Ltd. in its meeting held on 29th May, 2009 declared an interim dividend payable on paid up Equity Share Capital of the Company. In the Board Meeting scheduled for 10th June, 2009, the Board wants to revoke the said declaration. You are required to state with reference to the provisions of the Companies Act, 1956 whether the Board of Directors can do so.
(May 2009)

Answer

Prior to the passing of Companies (Amendment) Act, 2000 only Regulation 86 of Table "A" to the Companies Act, 1956 dealt with the question of interim dividend. The said Regulation empowered the directors to declare interim dividend. i.e. dividend in between two annual general meetings. The said amending Act introduced sub-Section 14A in Section 2 of the Companies Act, 1956 whereby interim dividend is now part of dividend. Accordingly, all provisions of the Companies Act, 1956 relating to dividend have become applicable to interim dividend also.

Section 205 of the Companies Act, 1956 has also been amended by the said amending Act to provide as follows:

- (i) The Board of Directors may declare interim dividend and the amount of dividend including interim dividend shall have to be deposited in a separate bank account within five days from the date of declaration of such dividend. [Section 205(1A)]
- (ii) The amount of interim dividend so deposited as stated above shall be used for payment of interim dividend. [Section 205(1B)]
- (iii) The provisions of Sections 205, 205A, 205C, 206, 206A, and 207 of the Companies Act, 1956 have also become applicable to interim dividend to the extent possible. [Section 205(1C)]

In view of the above legal position, the Board of Directors of RPP Ltd. must have deposited the amount of interim dividend declared on 29th May, 2009 into a separate bank account on or before 3rd June, 2009 i.e. within five days from 29th May, 2009 when the interim dividend was declared. As stated above, the amount once deposited into a separate bank account, can be used only for payment of interim dividend.

As per provisions of the Companies Act, 1956, the Board of RPP Ltd. has no power to revoke the interim dividend declared on 29th May, 2009 and shall not have any power to use the interim dividend amount transferred to a separate bank account for any other purpose.

In case the amount of interim dividend has not been transferred to a separate bank account and is not paid within the time, the company and its directors have exposed themselves to the applicable penal provisions of the said Act.

Question 5

SKD an employee of M/s Moreh Ltd. met with an accident and died. The accident occurred when SKD was on Company's duty. He held one hundred S shares partly paid. Normally the Company has a first and paramount lien on the shares. The Board of Directors, however, relaxed the said provision with regard to the hundred shares held by SKD as a goodwill gesture on the part of the Company. Is the action of the Company valid? State the reasons. Also state whether the Company's lien can be extended to dividend payable on such shares.
(November 2009)

Answer

A Company cannot have lien on shares unless provided in the Articles of Association. Therefore provision to this effect should be in the articles. As per Regulation 9 of Table A of the Companies Act, 1956 the Company has first and paramount lien on every share (which has not been fully paid up for all monies (whether presently payable or not) called or payable at a fixed time in respect of that share and on all shares which are not fully paid up standing registered in the name of a single person, for all moneys presently payable by him or his estate to the Company.

The Board of Directors may, however, at any time declare any share to be wholly or in part exempt from the said provision. Hence the decision of the Board of Directors of M/s Moreh Ltd to relax the provisions of lien in respect of shares held by SKD is in order and valid (Vide Regulation 9 of Table A). Further the Company's lien is extended to all dividends payable on such shares as per regulation 9(2) of table A of the Companies Act, 1956.

EXERCISE

Question 1

The agenda for the meeting of the Board of Directors of M/s. Packsafe Enterprises Ltd. held on 20-3-2010 for adopting the annual accounts for the year ended 31-12- 2009 included an item relating to payment of dividend. At the meeting it became apparent that the profits made during the year ended 31-12-2009 were inadequate to declare dividend. The Board was keen to maintain the rate of 20% dividend on the equity shares as declared in the previous years so as to maintain the image of the company. The company has some accumulated profits earned in previous years, which were transferred to reserves. Advise the company as to how it should go about to achieve the objective to pay dividend at the rate of 20% on the equity shares.

Answer

Dividends out of past profits/reserves can be declared as per the Companies (Declaration of dividend out of Reserves) Rules, 1975. These Rules, inter alia, provide that the dividends to be declared out of reserves shall not exceed average of dividends declared during the last 5 years or 10% of its paid up capital whichever is less. Since, in the present case, it is proposed to declare dividend @ 20%, it shall not be possible without previous approval of the Central Government as per section 205A (3). The company is advised to make an application to the Central Government, seeking approval for payment of dividend at 20%. It is presumed that the paid-up capital of the company consists of only equity share capital.

ACCOUNTS (SECTIONS 209 – 223)

Books of Accounts to be kept by company (Section 209)

Question 1

The Board of Directors of M/s Bharat Ltd. has a practical problem. The registered office of the company is situated in a classified backward area of Maharashtra. The Board wants to keep the account books of the company at its corporate office in Mumbai which is conveniently located. The Board seeks your advice about the feasibility of maintaining the accounting records at a place other than the registered office of the company. Advice. (November, 2008)

Answer

According to Section 209 of the Companies Act, 1956 every company shall keep the books of accounts at its registered office. However, the books of accounts can be kept at such other places in India as the Board of directors may decide and when the Board of directors so decide, the company shall within 7 days of the decision file with the Registrar of Companies a notice in Form No. 23AA in writing giving full address of the other place. Thus in the present case, the company can follow the above procedure and keep its accounts book at Mumbai office.

Question 2

The Board of Directors of a company propose to charge the Chief Accountant of the company with the duty of ensuring compliance with the provisions of the Companies Act, 1956 relating to maintenance of proper Books of account and preparation of Balance Sheet and Profit & Loss Account in accordance with the law. Draft a Board Resolution for this purpose.

What are the consequences in case of default, when such a resolution is passed? Is it possible for the Board of Directors to pass such a resolution, when the company is managed by Managing Director? (November, 2003)

Answer

Draft Board Resolution for charging a person with the duty of Compliance with the requirements of Section 209 & 211 of the Companies Act.

Resolved that pursuant to section 209(7) and 211(8) of the Companies Act, 1956, Mr./Ms. _____ Chief Accountant of the company be and is hereby charged with the duty of

seeing that the requirements of Sections 209 and 211 of the Companies Act, 1956 are duly and fully complied with.

Resolved further that the said Mr./Ms. _____ is hereby entrusted with the authority to do such Acts, through and deeds as may be necessary or expedient for the purpose of compliance with the requirements of the said Sections 209 and 211.

Consequences in case of default: According to Section 209(6), the following persons are responsible to ensure that the company duly complies with the provisions of Section 209:

- (a) the managing director or managers of the company, if any;
- (b) all officers and other employees of the company; or
- (c) if the company has no managing director, every director of the company.

Penalty for default is imprisonment upto 6 months or fine upto Rs.10,000/- or both, if the persons mentioned above fail to take all reasonable steps to ensure that the provisions of Section 209 are duly complied with by the company or default has been committed by their own wilful Act. Further a person shall be sentenced to imprisonment only if the offence was committed wilfully [Section 205(5)].

In any penal proceedings, it shall be a defense to prove that a competent and reliable person was charged with the duty of seeing that these requirements are complied with and that he was in a position to discharge that duty [proviso to Section 205(5)]. The person so charged with responsibility of compliance with provisions of Section 209 is punishable with imprisonment upto 6 months or fine upto Rs.10, 000/- or both [Sections 205(7)]. Similar provisions are therein Section 211 [Section 211(7) and (8)]. Hence the above Board resolution makes the Chief Accountant responsible for compliance with the provisions of Section 209 and Section 211.

Even if the company is managed by Managing Director, it is possible for the Board of Directors to make the Chief Accountant responsible to ensure compliance with Sections 209 and 211 [Section 209(7) and Section 211(8)]. Managing Director may also charge the Chief Accountant with such duty by issuing a memo or office order.

Question 3

An allegation was leveled against PQR Ltd. that the funds of the company are misused. Mr. Z, one of the Directors of the company wants to inspect the books of account of the company in order to ascertain whether the allegation was true. But since Mr. Z does not have the knowledge of accounting, he appoints Mr. A, his friend and a practicing Chartered Accountant to go through the books of account of the company on his behalf. The company seeks your advice as to whether Mr. A may be allowed to inspect the books of account of the company on behalf of Mr. Z. You are required to give your advice to the company on behalf of Mr. Z. You

are required to give your advice to the company keeping in view the provisions of the Companies Act, 1956.

What would be your advice if Mr. Z would have been a shareholder only and not a Director of the company?
(May 2007)

Answer

Section 209 (4) of the Companies Act 1956 provides that the books of account and other books and papers shall be open to inspection by any director during the business hours.

The right of inspection given by this sub-section is not so restricted that it can only be exercised personally by the director *in Vakharia Vs Supreme General Film Exchange CO. Ltd* it was held that a director is entitled to take inspection of accounts personally or through an agent provided that there is no reasonable objection to the person chosen and the agent undertakes not to utilize the information obtained by him for any purpose other than the purpose of his principal.

As the right of inspection is a statutory right given under this sub-section, a director who is prevented from or refused inspection may enforce his right through court.

As such, Mr. Z being the director, can appoint Mr., A to inspect the Books of accounts of the company.

In case Mr. Z is the member of the company

As per the provisions of the Act the board shall from time to time determine whether and to what extent and at what times and places and under what conditions or regulation, the accounts and books of the company, or any of them, shall be open to inspection of members not being directors. No member (Not being a director) shall have any right to inspection any account or books or document of the company except as conferred by law or authorized by the board or by the company in general meeting.

In case Mr. Z is a member of the company, he shall be able to inspect the books of account only if he is given such a right by ordinary resolution of the members or if authorized by the board. But even in such case Mr. Z would have to exercise the right personally and not through a proxy i.e. he can himself inspect the books but cannot ask Mr. A to inspect the books in his behalf.

Question 4

A Public Company sought extension of time from the ROC for holding AGM upto a period of 3 months and it was granted. However, when the AGM was held and the accounts were presented, it was found that the annual accounts were upto a period beyond which it is permissible. The Company contended that since ROC granted extension of time for holding AGM up to a period of 3 months, the same would also be applicable for presentation of

accounts as well. Referring to the relevant provisions of the Companies Act, 1956, whether the contention of the company shall/may hold good?

Answer

While a company may hold its AGM in a year within the time limit of 15 months as provided by Section 166(1), it may still contravene Section 210. A company and its director may commit offences if it does not fulfil the three requirements and failure to comply with any of them constitute an offence unless an extension of time has been granted for holding the meeting by the ROC. However, the extension of time for holding the AGM is only with reference to the meeting and not to that of submission of accounts

Question 5

Advise:

- (a) XYZ Ltd. wants to maintain its books of account on cash basis;
- (b) It has a branch office outside India and wants to maintain accounts over there;
- (c) A shareholder of a company wants to inspect books of account. Would your answer be different if he is acting as an agent of the director of the company?

Answer

- a) In the absence of any express provision in the Act, hitherto it was open to a company to maintain its accounts on 'cash basis' or 'accrual basis' or on hybrid basis i.e. partly on cash and partly on accrual basis. Under the Income-tax Act, an assessee can, even now, maintain its books of account by adopting any of the aforesaid methods. The controversy in so far as maintenance of accounts pursuant to the provisions of Companies Act, 1956 has now been set at rest by the amendment of sub-section (3) of section 209. Every company is now required to keep its books of account on accrual basis and according to the double entry system of accounting, popularly known as mercantile system of accounting which alone discloses a true and fair view of the state of affairs of a company.' The responsibility for the preparation of accounts giving a true and fair view of the company's financial statement is placed fairly and squarely on the shoulders of the directors' (*Caparo Industries plc vs. Dickman*, (1990)).
- b) *Maintenance of books of account.* Books of account shall be maintained at the company's registered office unless the Board of directors decides to keep them at another place in India [Proviso to section 209(1)]. It will be the duty of the company to inform the Registrar of Companies within 7 days of the decision in case the Board decides to maintain books at a place other than the registered office. This has to be done by filing Form No. 23AA.

Where a company has a branch office whether in or outside India, it may maintain books of account with respect to the transactions effected at such branch, at that branch itself. However, in such a case, proper summarized return made up at an interval of not more than three months should be sent to the registered office or to the other place where the Board has decided to keep the books of account.

- c) The clear cut answer shall be 'no' except where he represents a director and the inspection is not malafide or for some ulterior motive or against the interest of the company. In *Sugrabai Alibhain v. Amtee Properties (P) Ltd.* [1984] 55 Comp Cas. 734 (Bom.), the Bombay High Court observed that a director is entitled to ask for inspection of books either personally or through an agent subject to the condition that the agent must give an undertaking to the company that he shall not pass on any information to any person other than the director who had appointed him to carry out the inspection.

Form and Contents of balance-sheet and profit and loss account (Section 211)

Question 6

- (i) Define the expression "Accounting Standards" within the meaning of Companies Act, 1956.
- (ii) XYZ Limited did not prepare its Balance Sheet as at 31st March, 2007 and the Profit and Loss Account for the year ended on that date in conformity with some of the mandatory Accounting Standards issued by the Institute of Chartered Accountants of India. You are required to stat with reference to the provisions of the companies Act, 1956, the responsibilities of directors and statutory auditor of the company in this regard. **(May 2007)**

Answer

- (i) As per sub-section (3c) of Section 211 of the Companies Act, 1956, the expression "accounting standards" means the standards of accounting recommended by the Institute of Chartered Accounts of India Constituted under the Chartered Accountants Act, 1949 as may be prescribed by the Central Government in consultation with the National Advisory Committee on Accounting Standards established under sub-section (1) of section 210 of the said Act.

Proviso to the above sub-section further the states that the standards of accounting specified by the Institute of Chartered Accountants of India shall be deemed to be the accounting standards until the according standards are prescribed by the Central Government under this sub-section.

- (ii) Sub-Section (3A) of the said section states that every profit and loss account and balance sheet of the company shall comply with the accounting standards.
- (a) the deviation from the accounting standards;

- (b) the reasons for such deviation; and
- (c) the financial effect, if any, arising due to such deviation.

Accordingly to sections 211 (7) and (8) read with section 209 (6) of the Companies Act, 1956 following persons are responsible for complying with the above requirements:

- (a) the managing director or manager of the company, if any,
- (b) all officers and employees of the company, and
- (c) if the company does not have a managing director or manager, then every director of the company.

In view of the above provisions of the Companies Act, 1956, the managing director/directors have a responsibility to ensure that in case of non-compliance of any mandatory Accounting Standard, proper disclosure is made in the profit & loss account and the balance sheet.

Moreover, the board of directors is also required under section 217 of the companies Act, 1956 to include a Directors Responsibility Statement indicating therein that in the preparation of the annual accounts the applicable accounting standards have been followed along with proper explanation relating to material departures.

Responsibilities of auditors:

As per section 227(3) (d) of the Companies Act, 1956, the statutory auditor's responsibility is to state in his report, whether, in his opinion, the profit and loss account and balance sheet comply with the accounting standards referred to in sub-section 211 of the Companies Act, 1956.

Financial year of holding company and subsidiary (Section 213)

Question 7

Sunrise Limited is a subsidiary company of Hotline Limited. The financial year of Sunrise Limited is 1st July to 30th June, whereas the financial year of Hotline Limited is from 1st April to 31st June, whereas the financial year of Hotline Limited is from 1st April to 31st March every year. To maintain uniformity and consolidation of annual accounts the Board of Directors of Hotline Limited decided that the accounting year of Sunrise Limited for the year 1st July, 2007 to 30th June, 2008 be extended from present 12 months to 21 months i.e. 1st July, 2007 to 31st March, 2009.

Mention, in the light of the provisions of the Companies Act, 1956, the steps to be taken by the Hotline Limited in this regard
(November 2003, May 2009)

Answer

EXTENSION OF FINANCIAL YEAR:

Where it appears to the Central Government that it is desirable for a holding company or a holding company's subsidiary to extend its financial year so that the subsidiary's financial year may end with that of the holding company, and for that purpose to postpone the submission of the relevant accounts to a general meeting, the Central Government may on the application or with the consent of the Board of Directors of the company whose financial year is to be extended, direct that in the case that company the submission of accounts to a general meeting, the holding of an annual general meeting or the making of an annual return, shall not be required to be submitted or made, earlier than the dates specified in the direction notwithstanding anything to the contrary in the Companies Act, 1956 or in any other Act for the time being in force.

Thus the management can extend the financial year of Sunrise Limited from 12 months to 21 months.

Following steps are required to be taken for this purpose.

1. To convene a meeting of the Board of Directors of Sunrise Limited whereat the resolution for extending the financial year is to be passed so that the year ending matches with the year ending of Hotline Ltd.
2. To make an application under Section 213 of the Companies Act, 1956 to the Central Government giving full details and specific reasons for seeking the extension in year ending.
3. To attach the following to the application:-
 - (a) A certified copy of the Last Balance Sheet and Profit & Loss Account of Hot Line Limited and Sunrise Limited.
 - (b) A certified copy of the Memorandum of Association and Articles of association of both the companies.
 - (c) A certified copy of the resolution of the Board of Directors proposing the extension of the financial year.
 - (d) Requisite fee payable to the Central Government under Rules.

Laying of Annual accounts and balance sheet

Question 8

State giving reasons whether the following are true or false? The Board of Directors of ABC Ltd. wants to circulate unaudited accounts before the Annual General Meeting of the shareholders of the Company.

Answer

False. The accounts must be audited. Section 218 of the Companies Act, 1956 clarifies that any copy of balance sheet cannot be issued, circulated or published without the annexures and attachments. The attachments and annexures are – Profit and Loss account, balance sheet of subsidiary, auditor's report and Report of Board of Directors. Thus, a balance sheet without auditor's report or without report of Board of Directors cannot be issued, circulated or published. It, therefore, follows that unaudited accounts cannot be sent to members or unaudited accounts cannot be filed with the Registrar of Companies.

Question 9

Sunshine Ltd., whose year ended on 31st March, held its annual general meeting on 30th September. The meeting transacted all other businesses except the accounts as they were not ready and adjourned the meeting to 20th December for consideration of accounts. The Registrar of Companies issued show cause notice for violation of section 210 of the Companies Act, 1956. Advice.

Answer

As per Section 166(1) of the Act, every company must hold its first annual general meeting within 18 months of its incorporation and subsequently one in each calendar year. Not more than 15 months shall elapse between the two annual general meetings. Powers are vested in the Registrar of Companies to grant extension of time up to 3 months for holding an annual general meeting for genuine reasons (Accounts not being ready is considered as a valid reason for this extension).

Section 210(3)(b) provides that every company should lay before every subsequent annual general meeting its annual accounts within six months or the extended period for holding annual general meeting, if any, granted by the Registrar of Companies, from the date of closure of the accounts.

In the given case, Sunshine Ltd. convened and held the annual general meeting within six months from date of closure of the accounts, but failed to lay the accounts within the six months and it had also not obtained permission for extension of time for holding annual general meeting under second proviso to sub-section (1) of Section 166 from the Registrar of Companies. Hence, it has violated the provisions of section 210 of the Act and Registrar of Companies was justified in issuing the show-cause notice.

Authentication of balance sheet and P/L a/c (Section 215)

Question 10

The Profit and Loss Account and Balance Sheet of Acre Limited has been signed by two directors A and B. The Board comprises of a third director C, who is also the Managing Director. The company has also employed a Full Time Secretary. Examine whether the authentication of the financial statements is in accordance with law.
(May 2000)

Answer

Except in the case of a banking company, the balance sheet and profit and loss account of a company must be signed on behalf of the Board of directors by two directors and the Manager or Secretary, if any. If the company has a Managing Director, he should be one of the signing directors, as per Section 215. In the instant case, the profit and loss accounting and balance sheet have been signed by A and B, the directors. In view of Section 215 of the Companies Act, 1956, C, the managing director should be one of the two signing directors. Since the company has also employed a secretary, he should also sign the profit and loss account and balance sheet in addition to the managing director C, and one of the directors, either A or B.

Directors' Responsibility Statement [Section 217 (2 AA)]

Question 11

The Companies (Amendment) Act, 2000 has prescribed an additional duty on the Board of Directors to include in the Board's Report a 'directors' Responsibility Statement'. Explain briefly the details to be furnished in the said statement. (November, 2001)

Answer

The Companies (Amendment) Act, 2000 has prescribed additional duty on the board of directors to include in the director's report the additional particulars by way of Directors' responsibility statement. The details are:-

- (i) That in the preparation of the annual accounts the applicable accounting standards had been followed along with proper explanation relating to material departures.
- (ii) That the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit or loss of the company for that period.
- (iii) That the directors had taken proper and sufficient care for the maintenance of adequate accounting standards in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities.
- (iv) That the directors had prepared the annual accounts on a going concern basis. [Section 217 (2AA)]

Filing of Balance-sheet etc with the Registrar (Section 220)

Question 12

The Annual General Meeting of M/s Robertson Ltd., for laying the Annual Accounts thereat for the year ended 31st March, 2010 was not held, as the accounts were not ready. In this context:

- (i) *Advise the company regarding compliance of the provisions of Section 220 of the Companies Act, 1956 for filing of copies of Annual Accounts with the Registrar of Companies.*
- (ii) *Will it make any difference in case the Annual Accounts were duly laid before the Annual General Meeting held on 27th September, 2010 but the same were not adopted by the shareholders?*
(May 2005)

Answer

Under section 220(1) of the Companies Act, 1956, after the balance sheet and profit and loss account have been laid before the annual general meeting, three copies thereof be filed with the Registrar of Companies, within 30 days from the date on which the Accounts were laid at the Annual General Meeting. Where the Annual General Meeting for any year has not been held, the accounts shall be filed with the Registrar of Companies within 30 days from the latest date when the Annual General Meeting ought to have been held in accordance with the provisions of the Act, namely, sections 166 and 210 of the Act. Under section 220(2), it is also provided that if annual general meeting does not adopt the annual accounts or if the Annual General Meeting for any year is not held, a statement of that fact and of the reasons shall be annexed to the accounts filed with the Registrar of Companies.

Accordingly,

- (i) In the present case though Annual General Meeting was not held, it ought to be held by 30th September 2010 under sections 166/210 of the Act. Thus, the balance sheet and profit and loss account for the year ended 31st March 2010 be filed with the Registrar of Companies by 29th October 2010 along with a statement that Annual General Meeting was not held by 30th September 2010 as the accounts were not ready.
- (ii) Since the Annual General Meeting has been held in time on 27th September 2010, the balance sheet and profit and loss account as at 31st March 2010 be filed with the Registrar of Companies by 26th October 2010. A statement be also annexed to the balance sheet that the accounts were not adopted at the Annual General Meeting held on 27th September 2010 giving reasons there for.

Question 13

The Comptroller and Auditor-General of India made certain adverse comments on the audited financial statements of a Government company. Explain with reference to the relevant provisions of the Companies Act, whether it is possible for the government company to revise the audited but unadopted financial statements in the light of the adverse comments made by the Comptroller and Auditor-General of India and also whether it is necessary for the board of directors to give explanations in the board's report in respect of such adverse comments.
(May, 2000)

Answer

Rectification of accounts after completion of audit: The Institute of Chartered Accountants (Compendium of Guidance Notes, September 1985) has opined that it is entirely within the competence of the Board of Directors to amend the accounts already audited. Hence the original accounting statements may be revised to remove reservations of Comptroller and Auditor General (C&AG). Such revised statements should be resubmitted to the auditors before placing them before the annual general meeting. The Institute has recommended that in such cases, the auditor should ensure that all copies of the original set are returned to him, and he should also make an adequate disclosure of the fact of revision of accounts in the amended set.

Explanation by Board of Directors: Section 217(3) imposes a duty on the Board of Directors of a company to submit give the fullest information and explanations in the Board's report regarding every reservation, qualification or adverse remark contained in the auditor's report. In the absence of any similar specific provision regarding the comments of C&AG on the audit report of a government company, the Board of directors of such a company is not bound to give information or explanation in respect of such comments.

Even the C & AG's comments would not have been required to be placed before the annual general meeting of a Government Company but for the express provisions contained in Section 619(5) of the Companies Act. Similar express provision would be necessary in the Act if it were intended that the provisions of Section 217(3) should also apply in the case of a Government Company. This is the view expressed by Department of Company Affairs in File No. 15/3/69 (G.C.). Hence the Board of Directors of a Government Company are not required to give explanations in the Board's Report.

EXERCISE

Question 1

Can Books of Accounts of a company be kept anywhere in India?

Answer

The books of account are required to be kept at the registered office of the company. However, the books can be kept at any other place in India as the Board of Directors may decide. In such a case, the company should file with Registrar of Companies a notice in writing giving the full address of the place where the books are kept. This notice should be filed within 7 days of the Boards' decision.

Question 2

(a) *Who are the persons who can inspect books of account?*

- (b) Can a director make inspection of the books of account through an agent?
- (c) Can a shareholder inspect books of account?

Answer

The following persons have the right to inspect the books of accounts.

- (a) Directors of the Company [Section 209(4)]
- (b) Registrar of Companies (Section 209 A)
- (c) Such officer of Government as may be authorized by the Central Government in this behalf (Section 209A).

The books of account and other books and papers shall be open to inspection by any director during business hours. Inspection shall be made by the SEBI in respect of matters covered under sections referred to in Section 55A. Shareholder has no statutory right of inspection of the books of account unless the articles specifically provides for.

Question 3

XYZ Limited did not prepare its Balance Sheet as at 31st March, 2009 and the Profit and Loss Account for the year ended on that date in conformity with some of the mandatory Accounting Standards issued by the Institute of Chartered Accountants of India. You are required to stat with reference to the provisions of the companies Act, 1956, the responsibilities of directors and statutory auditor of the company in this regard.

Answer

Sub-Section (3A) of the said section states that every profit and loss account and balance sheet of the company shall comply with the accounting standards.

- (a) the deviation from the accounting standards;
- (b) the reasons for such deviation; and
- (c) the financial effect, if any, arising due to such deviation.

Accordingly to sections 211 (7) and (8) read with section 209 (6) of the Companies Act, 1956 following persons are responsible for complying with the above requirements:

- (a) the managing director or manager of the company, if any,
- (b) all officers and employees of the company, and
- (c) if the company does not have a managing director or manager, then every director of the company.

In view of the above provisions of the Companies Act, 1956, the managing director/directors have a responsibility to ensure that in case of non-compliance of any mandatory Accounting

Standards, proper disclosure is made in the profit & loss account and the balance sheet. Moreover, the board of directors is also required under section 217 of the companies Act, 1956 to include a Directors Responsibility Statement indicating therein that in the preparation of the annual accounts the applicable accounting standards have been followed along with proper explanation relating to material departures.

Responsibilities of auditors:

As per section 227(3) (d) of the Companies Act, 1956, the statutory auditor's responsibility is to state in his report, whether; in his opinion, the profit and loss account and balance sheet comply with the accounting standards referred to in sub-section 211 of the Companies Act, 1956.

AUDIT (SECTIONS 224 – 233B)

Re-appointment of retiring auditor [Section 224(1)]

Question 1

Ram & Company was appointed as auditor of ABC Ltd. at the Annual General Meeting held on 30th September, 2004. Can Ram & Co. continue as auditor of the company in case the next annual general meeting has not been held in time? What would be the position in case the next annual general meeting was held on 30th September, 2005, but adjourned without considering the business of appointment or re-appointment of auditor? (November 2006)

Answer

Tenure of auditor

The tenure of an auditor is laid down in section 224(1) of the Companies Act, 1956. It is from the conclusion of the annual general meeting to the conclusion of the next annual general meeting. Therefore, the tenure of office of the auditor does not expire on the last date on which the annual general meeting was due to be held in terms of Section 166. Hence Ram & Co. can continue as auditor even if the AGM for the year 2005 has not been held in time.

In case AGM for 2005 was held on 30.9.05 that adjourned without considering the business of appointment or reappointment of auditor, the tenure of Ram and Co. will extend till the conclusion of the adjourned meeting.

Question 2

Ceiling on number of audits [Section 224(1B)]

Mr. Independent who is an individual auditor wants to compute the specified number of audits under the Companies Act, 1956 and for this purpose, he has drawn out a list of which identify, the company which shall be/not be taken into account for the purpose of calculating specified number of audits:

- (i) *Audit of Private Company*
- (ii) *Guarantee companies not having share capital*
- (iii) *Audit of non-profit companies*
- (iv) *Special Audits*
- (v) *Audits- of Foreign Companies*

(vi) *Branch Audits*

(vii) *Company audit where he is appointed as a joint auditor*

Further, he wants to know that as a member of the ICAI, whether there are any other restrictions on him as a member in the matter of inclusion/exclusion of audit of private companies for the purpose of calculating specified number of audit assignments. Advice.

Answer

As per Section 224(1B) of the Companies Act, 1956, private companies have been exempted from the provisions with respect to ceiling on number of audits.

Therefore, according to this section, only audit of public companies would be taken into consideration while computing the ceiling limit of number of audits. This, however, is subject to guidelines of the Institute of Chartered Accountants of India (ICAI) which provide restriction in respect of private companies as well. According to notification issued by ICAI, the specified number of audit assignments means-

- (a) in the case of a chartered accountant in practice or a proprietary firm of chartered accountant, thirty audit assignments whether in respect of private companies or other companies.
- (b) in the case of a firm of chartered accountants in practice, thirty audit assignments per partner in the firm, whether in respect of private companies or other companies. Provided that out of such specified number of audit assignments, the number of audit assignments of public companies each of which has a paid-up share capital of rupees twenty-five lakhs or more, shall not exceed ten.

Students may note that while the law excluded private companies from the specified limits but the ICAI has issued the above notification restricting the overall limit to 30 company audits including private limited companies. It may be noted that a member of ICAI who fails to comply with the notification shall be liable for professional misconduct

In computing the specified number of audits for the purpose of Section 224(1B), the following audit shall not be taken into account:

- (a) Audit of private company.
- (b) Audit of Guarantee Companies not having share capital.
- (c) Special Audits.
- (d) Audit of Foreign Companies.
- (e) Branch Audits.

Though the audit of private companies has been excluded for the purpose of calculating the specified number of audits, as a member of ICAI, the Audit of Private Companies will come under the purview of calculating the ceiling limit as a matter of self-regulation.

Question 3

An audit firm, comprising of two partners, holds office as auditor of 41 private companies out of which paid-up capital of 20 companies exceeds Rs. 50 Lakh. Decide whether this is in consonance with the applicable law.

Answer

As per Section 224(1B) of the Companies Act, 1956, private companies have been exempted from the provisions with respect to ceiling on number of audits. As per the section, an audit firm is entitled to 20 audits per partner (i.e. 40 audits in the given case) out of which not more than 10 companies per partner should be having paid-up capital of Rs. 25 Lakhs or more. The firm can do audit of any number of private companies. Thus, there is no problem in audit firm holding office of 41 private companies.

Appointment of First auditor [Section 224(5)]

Question 4

State the procedure for the following, explaining the relevant provisions of the Companies Act, 1956:

- (i) *Appointment of First Auditor, when the Board of Directors did not appoint the First Auditor within one month from the date of registration of the company.*
- (ii) *Removal of Statutory Auditor (appointed in last Annual General Meeting) before the expiry of his term.*

What difference it would make, if the Auditor was First Auditor appointed by the Board of Directors? **(November, 2004)**

Answer

- (i) Section 224(5) of the Companies Act, 1956 lays down that the first auditor of a company shall be appointed by the Board of Directors within one month of the date of registration of the company.

If the Board of Directors fails to exercise its power, the company in general meeting may appoint the first Auditor or Auditors.

Subsequently Auditor or Auditors of a company are appointed every year by the shareholders in annual general meeting by passing an ordinary resolution.

- (ii) Auditor appointed in an Annual General Meeting may be removed from office before the expiry of his term only by the company in general meeting, after obtaining the previous

approval from the Central Government in that behalf [Section 224 (7)].

Further the company has to follow the following procedure prescribed in Section 225 (2) and (3) as explained below:

No special notice under section 225 (1) is required for a resolution in the general meeting to remove the auditor, hold the general meeting etc.

The auditor shall be informed of the Board's decision immediately. [Section 225 (2)].

The auditor can make a representation. The copy of the representation should be sent to all the members to whom notice of meeting is sent. If the copy of the representation is not sent as it was received late or because of the company's fault, the auditor may insist that the representation may be read at the meeting. [Section 225 (3)].

If company does not wish to send the representation to the members or read at the general meeting, the company has to apply to Central Government/Company Law Board. If Central Government/Company Law Board is satisfied that the right of representation is being misused by auditor to secure needless publicity for defamatory matter, the Central Government/Company Law Board may order that the representation need not be sent and the representation need not be read at the meeting. (Proviso to Section 225(3)).

An ordinary resolution is to be passed at the general meeting for the removal of the auditor.

The first auditors appointed by Board can be removed by the company at a general meeting. (Proviso (a) to Section 224 (5)). The provisions in respect of removal as contained in Section 225 (2) & (3) are applicable for removal of first auditors also. (Section 225 (4)). However, in case of removal of first auditor appointed by the Board of Directors, only an ordinary resolution is sufficient to remove the auditor and Central Government's approval is not required.

Question 5

Explain how the auditor will be appointed in the following cases:

- (i) *A Government Company within the meaning of Section 617 of the Companies Act, 1956.*
- (ii) *The Auditor of the company has resigned on 31st December, 2003, while the Financial year of the company ends on 31st March, 2004.*
- (iii) *A company, whose shareholders include the following:*
 - (a) *Bank of Baroda (A Nationalized Bank) holding 12% of the subscribed capital in the company.*

- (b) *National Insurance Company Limited (carrying on General Insurance Business) holding 10% of the subscribed capital in the company.*
- (c) *Maharashtra State Financial Corporation (A Public Financial Institution) holding 8% of the subscribed capital in the company.* **(May, 2004)**

Answer

- (i) The appointment and re-appointment of auditor in the case of a Government Company is governed by the provisions of section 619 of the Companies Act, 1956. The said section states that the auditor of a Government Company shall be appointed or re-appointed by the Comptroller and Auditor General of India. Accordingly, the auditor of a Government Company shall be appointed by the Comptroller and Auditor General of India. The provision for appointment of auditor by Central Government on the advice of Comptroller and Auditor General of India has been amended by the Companies (Amendment) Act, 2000 with effect from 13.12.2000.
- (ii) The situation as stated in the question is covered by the provisions of section 224(6) of the Companies Act, 1956. Clause (a) of the said section states that the Board of Directors may fill any casual vacancy in the office of an auditor, but proviso thereto states that where such vacancy is caused by the resignation of an auditor, the vacancy shall only be filled by the company in general meeting. Hence, in the case of resignation by the auditor, the company is required to convene and hold a general meeting and appoint the auditor thereat.
- (iii) The case of appointment of auditor of a company whose 25% or more of the subscribed capital is held by Government, financial institutions, nationalised banks, General insurance companies is governed by the provisions of section 224A of the Companies Act, 1956. According to the provisions of the said section in the case of a company in which not less than twenty-five per cent of the subscribed share capital is held, whether singly or in any combination, by-
 - (a) a public financial institution or a Government company or Central Government or any State Government, or
 - (b) any financial or other institution established by any Provincial or State Act in which a State Government holds not less than fifty-one per cent of the subscribed share capital, or
 - (c) A nationalised bank or an insurance company carrying on general insurance business, the appointment or re-appointed at each annual general meeting of an auditor or auditors shall be made by a special resolution.

In view of the above provisions of the Companies Act, 1956, since the combined holding of the nationalised bank, general insurance company and the financial institution covered by the said provisions is 30% which exceeds the limit of 25% of the subscribed capital of

the company, the company has to appoint its auditor in the Annual General Meeting by passing a special resolution.

Question 6

Parkash Carriers Limited appointed Mr. Raman as its auditor in the Annual General Meeting held on 30th September, 2009. Initially, he accepted the appointment.. But he resigned from his office on 31st October, 2009 for personal reasons. The Board of Directors seeks your advice for filling up the vacancy by appointment of Mr. Albert as auditor. Advise.

Also suggest the procedure to be adopted in case Mr. Albert is proposed to be removed from his office before the expiry of his term. **(November 2009)**

Answer

Under section 224(6) of the Companies Act, 1956, the Board may fill any casual vacancy in the office of an auditor. However, where such vacancy is caused by resignation of an auditor, the vacancy shall be filled by the company in general meeting. Thus, in the present case, the company may convene an Extra Ordinary General Meeting to appoint Mr. Albert as its auditor consequent upon the resignation by Mr. Raman.

In term of section 224(7) of the Act, 1956, Mr. Albert may be removed from office before the expiry of his term only by the Company in General Meeting after obtaining previous approval of the Central Government.

Auditors not to be appointed except with the approval of the company by special resolution in certain cases. **(Section 224 A)**

Question 7

How would you deal with the following situations in the matter of appointment of Auditors?

- (i) *The shareholding of L.I.C. and U.T.I. increased from 23 per cent to 27 per cent of the subscribed share capital of the company after issue of notice of the Annual General Meeting, but before the date of the Annual General Meeting.*
- (ii) *Ordinary resolution is passed at the Annual General Meeting of a company when a special resolution is required to be passed for appointment of Auditor?*

(November, 2003)

Answer

- (i) Section 224A of the Companies Act, 1956 provides that in case of a company in which 25 per cent or more of the subscribed share capital is held whether simply or in any combination by: (i) a public financial institution or a Government Company or Central Government or any State Government; or (ii) Any financial or other institution established by any provincial or State Act in which a State Government holds not less

than 51 per cent of the subscribed share capital or (iii) a nationalised bank or an insurance company carrying on general insurance business, the appointment of an auditor shall be made by a special resolution only.

Section 224A does not specify the date on which 25 percent of the subscribed capital must be held by the specified institution(s). The Department of Company Affairs has clarified that the material date is the date of the annual general meeting at which the special resolution is required to be passed. Thus, even though, the shareholding of LIC and UTI increased beyond 25% only after issue of notice, Section 224A shall be required to be complied with. Fresh notice of the meeting shall become necessary.

- (ii) If the company fails to pass a Special Resolution where it is required to be so passed for appointment of auditor, it shall be deemed that no auditor(s) had been appointed by the company at its annual general meeting and the Central Government will be empowered to make the appointment [Section 224A(2)].

Question 8

Provisions as to resolutions for appointing or removing auditors (Section 225)

State the procedure for the following, explaining the relevant provisions of the Companies Act, 1956:

Removal of Statutory Auditor (appointed in last Annual General Meeting) before the expiry of his term.

What difference it would make, if the Auditor was First Auditor appointed by the Board of Directors?
(November 2004)

Answer

Auditor appointed in an Annual General Meeting may be removed from office before the expiry of his term only by the company in general meeting, after obtaining the previous approval from the Central Government in that behalf [Section 224 (7)]. Further the company has to follow the following procedure prescribed in Section 225 (2) and (3) as explained below:

No special notice under section 225 (1) is required for a resolution in the general meeting to remove the auditor.

The auditor shall be informed of the Board's decision immediately. [Section 225 (2)].

The auditor can make a representation. The copy of the representation should be sent to all the members to whom notice of meeting is sent. If the copy of the representation is not sent as it was received late or because of the company's fault, the auditor may insist that the representation may be read at the meeting. [Section 225(3)].

If company does not wish to send the representation to the members or read at the general meeting, the company has to apply to Central Government/Company Law Board. If Central Government/Company Law Board is satisfied that the right of representation is being misused by auditor to secure needless publicity for defamatory matter, the Central Government/Company Law Board may order that the representation need not be sent and the representation need not be read at the meeting. (Proviso to Section 225(3)).

An ordinary resolution is to be passed at the general meeting for the removal of the auditor.

The first auditors appointed by Board can be removed by the company at a general meeting. (Proviso (a) to Section 224 (5). The provisions in respect of removal as contained in Section 225 (2) & (3) are applicable for removal of first auditors also (Section 225 (4). However, in case of removal of first auditor appointed by the Board of Directors, only an ordinary resolution is sufficient to remove the auditor and Central Government's approval is not required.

Disqualifications of auditors (Section 226)

Question 9

- (i) *What is the liability of an auditor for failure to point out in his report that dividend is paid out of capital?*
- (ii) *Can an auditor be disqualified for indebtedness in the following cases?*
 - (a) *Where he is recovering his fees on a progressive basis even though the job is not complete.*
 - (b) *Where the auditor's firm has purchased goods from the auditee company and not paid for them for over six months.*

(May, 2003)

Answer

- (i) An auditor who is party to such payment of improper dividend to liable to proceedings by action or in case of winding up, to misfeasance summons and that the improperly paid dividend may be recovered from him with interest.
- (ii)
 - (a) The Auditor cannot be said to be indebted within the meaning of section 226 (3)(d) of the Companies Act, 1956.
 - (b) In this case the auditor of the company is said to be indebted if the amount outstanding from him regarding goods and services purchase form the company audited by him exceeds Rs.1000/- irrespective of the nature of purchase or period of credit allowed to other customer. The provisions regarding disqualification of auditor as contained in section 225 (3) (d) will be attracted. (Guidance Note on Independence of Auditors). Also when the firm is indebted to the company each and every partner of the firm also is deemed to have been indebted.

Powers and Duties of auditors (Section 227)

Question 10

The auditors of PQR Ltd. accepted the Certificate of the Manager, a person of acknowledge competence and high reputation, as to the value of the stock in trade. The stock was grossly overstated for several years in the balance sheets of the company. As a result of this over valuation dividends were paid out of capital. The Auditors did not examine the books of account very minutely. If they had done so and compared the amount of stock at the beginning of the year. With the purchases and sales during the year, they would have noticed the over valuation. The company subsequently went into liquidation and the auditors were sued to make good the loss caused by the wrongful payment of dividends relying on the balance sheets figures. Based on the above facts, you are required to decide. With reference to the provisions of the Companies Act, 1956 and the decided case laws, the following issues:

- (i) *Whether auditors of the company will be liable for the loss caused to the company by the wrongful payment of dividends based on the Balance Sheets duly audited by the Auditors.*
- (ii) *What are statutory duties of the Auditors in this regard?* **(November 2007)**

Answer

The answer of the problem given in question is mainly relates to the duties of the auditors. Section 227 of the Companies Act, 1956 provides that the main duty of the auditor is to make a report to the members of the company on the accounts examined by him and the balance sheet and the profit and loss account of the company and on every document which is annexed to the balance sheet or profit and loss account laid before the company in general meeting. The auditor owes a duty to the members to state whether the accounts give a true and fair view of the affairs of the company at the end of the financial year and of the profit and loss account of the year.

The duty of an auditor is to give information in direct and express terms (Crichton's Oil Co. Re (1902) 2 Ch 86) and not merely to arouse inquiry. If he discovers that any illegal or improper payment papers to have been made, his duty will be to state it public by reporting. The auditor occupies a fiduciary position in relation to the shareholders and in auditing the accounts maintained by the directors, he must act in the best interest of the shareholders who are in the position of beneficiaries.

But there is a limitation relating to perform the duties by the auditors. An auditor is not bound to be a detective, as loss laid to approach his work with suspicion or with a foregone conclusion that there is something wrong. He is a watchdog but not a bloodhound. He is justified in believing tried servants of the company in whom confidence is placed by the company. He is entitled to assume that they are honest and to rely upon their

representations, provided he takes reasonable care. If there is anything calculated to excite suspicion, he should probe it to the bottom, but in the absence of any thing of that kind he is only bound to be reasonable cautious and careful.

The above problem is related to case of Kingston Mill Co. Re (No 2) (1896) 2 ch 279. In this case it was held that, the auditors were not liable. It is not auditor's duty to take stock. There many matters in which he may rely on the honesty and accuracy of others. Further they (auditors) do not guarantee the discovery of all frauds.

Signature of audit report, etc. (Section 229)

Question 11

The auditors of a company refuse to make their report on the annual accounts of a company before it is signed on behalf of the board of directors. Advice the company.

Answer

The auditor is right. Theoretically, accounts are presented to auditors only after they are approved by the Board and signed by authorized persons. The auditor is only expected to submit his report on the accounts presented to him for audit. In practice, the checking of accounts is already completed before accounts are approved by the Board. Auditor informally approves the draft account with notes etc., before the accounts are approved by the Board. However, auditor signs the accounts only after these are approved by Board and signed by persons authorized by Board of the company.

Power of Central Government to direct special audit in certain cases (Section 233A)

Question 12

A group of shareholders approaches you for advice regarding the affairs of Fashion Apparels Ltd. According to the shareholders, the management of the company is not exercising its powers properly and that the statutory audit is being carried out in a routine manner. They want that a special audit should be conducted so that the real nature of transactions carried out by the management will come to light. Advice, with reference to the provisions of the Companies Act, 1956, as to when a special audit can be directed and by whom.

(May 2001, November 2005, November 2006, May 2008)

Answer

According to Section 233A of the Companies Act, 1956 the Central Government has the power to direct special audit in certain circumstances. They are:

- (i) if the Government is of the opinion that the affairs of the company are not being managed in accordance with sound business principles or prudent commercial practices; or
- (ii) that the company is being managed in a manner likely to cause serious injury or damage to the interests of the trade, industry or business to which it pertains or

- (iii) that the financial position of the company is such as to endanger its solvency.

Thus the group of shareholders can make a complaint about the affairs of Fashion Apparels Ltd., to the Central Government. If the Government is satisfied, it may order a special audit to be carried out either by the statutory auditors of the company or by any Chartered Accountant. The special auditor appointed under this section will have the same powers as an auditor of the company has under Section 227 of the Act.

Question 13

A group of shareholders has approached you for advice regarding the affairs of LPM Paper Mills Ltd. According to them, the management of the company is not carrying out its functions in accordance with the prudent commercial practice and if the affairs of the company are allowed to run in future in the same manner, the company's solvency would be in danger. They want that a Special Audit be conducted to find out the actual nature of the transactions.

- (i) *You are required to state with reference to the provisions of the Companies Act, 1956, as to when a special audit can be directed and by whom ?*
- (ii) *Draft an application to be submitted to the appropriate authority in this respect.*

(May 2008)

Answer

- (i) *Provision regarding Special Audit: Section 233A of the Companies Act, 1956 deals with the matter relating to Special Audit. The Special Audit can be ordered by Central government if it is of the opinion:*
- (i) that the affairs of the company are not being managed in accordance with sound business principles or prudent commercial practices, or
 - (ii) that the company is being managed in a manner likely to cause serious injury or damage to the interests of the trade, industry or business to which it pertains, or
 - (iii) that the financial position of the company is such as to endanger its solvency.

Thus, the dissatisfied group of shareholders may make a complaint to the Central Government requesting for conducting the special audit. If the Central Government is satisfied that there exist sufficient reasons, it may order a special audit to be carried out by a Chartered Accountant who may or may not be company's statutory auditor or who may or may not be in practice.

(ii) **DRAFT APPLICATION**

Dated

To
The Secretary,
Ministry of Corporate Affairs,
Government of India,
New Delhi.

Sir,

We, the undersigned, the shareholders of LPM Paper Mills Ltd. would like to bring to your kind notice that for a long time the affairs of the said company are not being managed in accordance with sound business principles and prudent commercial practices.

We are of the view that certain expenditures which are being incurred by the company are not related to the business of the company and the company is not getting any benefit out of such expenses. Moreover, we have the apprehension that there are certain business transactions which are being entered into by the directors with the concerns which are owned by the relatives of the Directors and the prices charged for such transactions are not comparable with the prices charged by the other parties for similar transactions.

If such state of affairs is allowed to be carried on for long, the financial position of the company will reach a stage where it will endanger its solvency.

We feel that the modus operandi of the transaction is such that it may be difficult for the regular statutory auditor to detect them in course of normal audit.

It is, therefore, prayed that the Central Government be pleased to appoint, pursuant to Section 233A of the Companies Act, 1956, a Special Auditor to properly audit the accounts of the Company and find the real nature of the transactions and determine the losses so far sustained and being sustained by the company on this account.

Yours faithfully

- 1.....
- 2.....
- 3.....
- 4.....
- 5.....

(Shareholders)

EXERCISE

Question 1

How is the first auditor of a company appointed?

Answer

The first auditor or auditors of a company shall be appointed by the Board of directors within one month of the date of registration of the company; and the auditor or auditors so appointed shall hold office until the conclusion of the first annual general meeting. However the company may, at a general meeting, remove any such auditor or all or any of such auditors and appoint in his or their places any other person or persons who have been nominated for appointment by any member of the company and of whose nomination notice has been given to the members of the company not less than fourteen days before the date of the meeting and if the Board fails to exercise its powers, the company in general meeting may appoint the first auditor or auditors.

Question 2

Who is empowered to sign auditor's report?

Answer

Only the person appointed as auditor of the company, or where a firm is so appointed in pursuance of the proviso to sub-section (1) of section 226, only a partner in the firm practicing in India, may sign the auditor's report, or sign or authenticate any other document of the company required by law to be signed or authenticated by the auditor.

POWER OF REGISTRAR TO CALL FOR INFORMATION, ETC. (SECTIONS 234 – 234A)

Power of Registrar to call for information or explanation (Section 234)

Question 1

A group of creditors of M/s XYZ Co. Ltd. makes a complaint to the Registrar of Companies, New Delhi, alleging that the management of the Company is indulging in destruction and falsification of the accounting records of the Company. The complainants request the Registrar to take immediate steps to seize the records of the Company, so that the management may not be allowed to tamper with the records. Examine the powers, if any, of the Registrar in such circumstances.

(November, 2001)

Answer

The power of Registrar of Companies to seize the records of a company is contained in Section 234 of the Companies Act, 1956. According to that section, if the Registrar has reasonable grounds to believe, upon information in his possession or otherwise, that the records of the company may be destroyed, mutilated, altered, falsified or secreted, he may make an application to the Magistrate of the first class or the Presidency Magistrate as the case may be having jurisdiction for an order for the seizure of the books and papers. After getting permission, the registrar has power to enter the place where the books and records of the company have been kept, and search and seize the books and papers as he considers necessary. The Registrar has to return back the books and papers within 30 days of seizure and he can place identification marks on the records and take copies or extracts from the records as he considers necessary. The Registrar has to follow the procedure laid down in Criminal Procedure Code relating to search and seizure of the records. [Section 234A (4)].

Seizure of Documents by Registrar (Section 234A)

Question 2

The Registrar of Companies, West Bengal has received a complaint from a group of creditors of a company. The complaint alleges that the Directors of the company, in order to prevent the unearthing of their embezzlement of company's funds, are engaged in falsification and

destruction of original accounting books and records. The complaints urged the Registrar to seize the accounting books and records of the company so that the Directors may not be able to tamper the same. You are required to state the powers, if any, of the Registrar in this respect.

(May, 2004)

Answer

The powers of the Registrar of Companies in respect of seizure of books and records of any company are governed by section 234A of the Companies Act, 1956. Sub-section (1) of the said section provides that if, pursuant to the information in his possession, the Registrar has reasonable ground to believe that books and papers of a company may be destroyed, mutilated, altered, falsified or secreted, the Registrar may make an application to the Magistrate of First Class or the Presidency Magistrate, as the case may be, having jurisdiction for an order for the seizure of such books and records.

According to Section 234(2), the Magistrate, after considering the application and hearing the Registrar, may authorize the Registrar to do the following:

- (i) To enter the place or places where such books and papers are kept.
- (ii) To search the place or places in the manner as provides in the Magistrate's order.
- (iii) To seize the books and papers as he considers necessary.

Section 234(3) authorises the Registrar to keep the seized books and papers for a period of thirty days, after which the same have to be returned to the person from whom the seizure was made. But the Registrar is empowered, before returning the said books and papers, to take copies of or extracts from them or place identification marks on them or deal with them in the manner he considers necessary.

Section 234(4) states that the Registrar, while conducting search and seizure, has to follow the provisions relating to search and seizure as prescribed in the Code of Criminal Procedure, 1898.

In view of the above provisions of section 234A of the Companies Act, 1956, the Registrar of Companies is empowered to seize the books and papers of the company against whom the complaint has been made by following the procedure laid down in the section.

INVESTIGATION (SECTIONS 235 – 251)

Investigation of company's affairs in other cases (Section 237)

Question 1

A majority of the Board of Directors of M/s High Value Infotech Ltd. have realised that some of the business activities carried out in the name of the company are not in the interest of either the company or its members. They want that the company should make an application to the Central Government to appoint an Inspector to carry out and so as to find out the whole truth. Explain the steps that should be taken to achieve the purpose and draft the application.

(November, 2001, May 2005, May 2007)

Answer

According to Section 237 of the Companies Act, 1956 the Central Government shall appoint one or more persons as inspectors to investigate the affairs of the company if the company by a special resolution or the court by an order declares that the affairs of the company should be investigated. The Central Government may also appoint an inspector if in the opinion of the Company Law Board, there are circumstances suggesting that:

- (i) the business of the company is being conducted with intent to defraud creditors, members or any other persons.
- (ii) the persons concerned in the formation of the company or the management of its affairs have been guilty of fraud, misfeasance or misconduct towards the company or its members.
- (iii) the members have not been given all information with respect to its affairs.

Thus the directors of High Value Infotech Ltd have three options before them to get the company's affairs investigated. Firstly, they can get a special resolution passed in a general meeting of the company. Secondly they can approach the court with a petition so that the court directs the Central Government to order investigation. The directors can also approach the Company Law Board with a petition. However, the Central Government may order an investigation on the recommendation of the Company Law Board. Thus the Central Government has a discretionary power in the last case; whereas in the first two instances the Central Government has no such discretion and it has to order the investigation.

Draft Application:

High Value InfoTech Ltd. (Address)

Dated 1st April, 2001

The Secretary,
Department of Company Law Affairs,
New Delhi
Sir,

At a meeting of the shareholders of the company, the members have passed the following special resolution unanimously:

“Resolved that the Central Government be approached to appoint an Inspector to carry out an investigation whether the following activities carried out in the name of the Company is or is not in the interest of either the company or its members.

“(Name a couple of activities)”

The said unanimous resolution was passed at an extraordinary general meeting of the Company held on 10th March, 2001.

It is, therefore, prayed that the Central Government be pleased to appoint as per Section 237 of the Companies Act an inspector to investigate the affairs of the company regarding the matters mentioned in the above resolution and communicate its decision to the company.

Yours respectfully,

For and on behalf of High Value InfoTech Ltd.

Secretary.

Proceedings for recovery of damages or property

(Section 244)

Question 2

The report submitted by the inspector appointed under Section 235/237 of the Companies Act, 1956 to investigate the affairs of a Company revealed that substantial funds of the Company have been misappropriated by the Managing Director of the Company. The Central Government is of the opinion that effective action may not be taken the company for recovery of the funds misappropriated by the Managing Director. Examine with reference to the provisions of the Companies Act, 1956 the action that can be taken by the Central Government for recovery of damages or funds misappropriated by the Managing Director.
(November 2009)

Answer

Section 244 of the Companies Act, 1956 provides that where from the inspectors' report it appears that a fraud or misappropriation of property has been committed and the Company is therefore, entitled to bring an action for damages for misconduct or for the recovery of any property, which has been misapplied or wrongfully retained, the Central Government may itself in public interest bring proceedings for that purpose in the name of the Company. Thus, the Central Government is empowered to bring civil proceedings in the name of the Company in any case where it appears that such proceedings ought in the public interest to be brought, even if the company does not take such action. In such a proceeding, the inspector's report shall be admissible as evidence of the opinion of the inspection in relation to any matter contained in the report (Section 246). The Central Government should indemnify the company against any cost or expenses incurred by it or in connection with any proceedings brought by it. [Section 244 (2)].

Imposition of restrictions upon shares and debentures and prohibition of transfer of shares or debentures in certain cases (Section 250)

Question 3

ABC Limited, over years, enjoys high reputation and its General Reserve is many times more than the paid up capital of the company. There is apprehension of cornering the shares of the company by some persons likely to result in change in the Board of Directors which may be prejudicial to the Public interest.

Advise, as to how can ABC Limited block the transfer of shares of the company under the provisions of the Companies Act, 1956. (May 2008, CA Final, New Course, May 2010)

Answer

Restrictions and Prohibition of transfer of shares or debentures: As per provisions of section 250(4) of the Companies Act, 1956, where the company Law Tribunal (Company Law Board till the Company Law Tribunal becomes operational, referred to as CLB hereinafter) has reasonable grounds to believe that a transfer of shares in a company is likely to take place whereby a change in the composition of the Board of Directors of a company is likely to take place and the CLB is of the opinion that any such change would be prejudicial to the public interest, the CLB may, by an order, direct that any transfer of shares in the concerned company during such period not exceeding three years, as may be specified in the order, shall be void.

As per section 250 (1) & (2) of the Companies Act, 1956, if the CLB is of the view that there are good reasons to find out the relevant facts about any shares and the CLB is of the opinion that such facts cannot be found out unless the restrictions are imposed, as an interim measure, it may, by an order, direct that transfer of any such shares shall be void and no voting rights shall be exercised in respect of such shares. However, the CLB is empowered to vary or rescind its order any time.

The facts given in the question squarely fall within the provisions of section 250 of the Companies Act, 1956. The management of ABC Ltd. may make a complaint to the CLB and convince it that the transfer of shares in favour of the group of unscrupulous persons would change the composition of the Board of Directors of the company which shall be prejudicial to the public interest and if the CLB is convinced with the plea of the company, it may pass an order as stated above which would block the transfer of shares as stated in the question.

DIRECTORS (SECTIONS 252 – 323)

Constitution of Board of Directors (252- 266)

Minimum Number of Directors (Section 252)

Question 1

The Board of Directors of M/s ABC Limited, an unlisted company having a paid-up capital of Rs.6 crores consisting of equity share capital of Rs.5 crores and preference share capital of Rs.1 crore and also 1,100 'Small Shareholders' holding equity shares seeks your advice on the following:

- (i) Is it necessary for the Company to appoint a Director to represent the 'Small Shareholders'?*
- (ii) In case the Company decides to appoint such a Director. The procedure to be followed by the company for such appointment and the period for which such appointment can be made.*
- (iii) Can such a director be removed by the Company before the expiry of his period of appointment without the consent of the 'Small Shareholders'?*

Advise explaining the relevant provisions of the Companies Act and the Rules.

(May, 2004, November 2008)

Answer

Director elected by small shareholders

- (1) A public company (i) having a paid up capital of Rs.5 crores or more; (ii) One thousand or more shareholders, may have a director elected by small shareholders in the manner prescribed by rules [proviso to Section 252(1)].
- (2) Paid-up capital includes both equity and preference share capital. In this case, the total paid up share capital including the preference share capital exceeds Rs.5 crores and the equity share capital is also Rs.5 crores. The company has also got more than 1000 small shareholders. Hence the provisions of Section 252(1) are applicable to this company.
- (3) Since the words used in proviso to Section 252(1) are "may have a director ", the appointment of small shareholders' director is voluntary Rule 4(1) of the Companies

(Appointment of the Small Shareholders' Director) Rules, 2001, a company can act suo motu to elect such director. It may also act upon notice of small shareholders and have proposed name of a person as director. However, if a notice is received from required number of shareholders, it will be mandatory to appoint small shareholders' director, otherwise it is discretionary.

- (4) The director in this case is the small shareholders' nominee and he is elected by the small shareholders only in the manner provided in Rule 4. The director so elected is appointed by the company. (Rule 4(5)). Small shareholders intending to propose to person shall give notice to company at least 14 days before meeting. The notice should be signed by at least 100 small shareholders and it must contain the prescribed particulars. The person whose name is proposed as director will sign and file with the company his consent in writing to act as a director (He must be a small shareholder). In case of unlisted company, appointment of small shareholder, director can be made at the general meeting, if may oath of small shareholders recommend his candidature for the post of director in the meeting.

A nominee director is normally removed by the person who has got authority to make such nomination [e.g. UTI, LIC nominee]. But in view of Rule 6(viii) relating to vacation of office, small shareholders director can be removed by the share holders at a general meeting under section 284 of the companies Act, 1956 before the expiry of his tenure.

He cannot be considered as a director appointed by the company in general meeting within the meaning of section 255. It can, therefore, be said that small shareholders' director is like and nominee director.

- (5) Small shareholders' director can be appointed for a maximum period of 3 years subject to meeting the requirements of provisions of Companies Act except that he is not required to retire by rotation (Rule 4(6)). But on expiry of his tenure, the same person, if so desired by small shareholders, may be elected for another period of 3 years [Rule 4(7)].
- (6) He cannot be considered as a director appointed by the company in general meeting within the meaning of Section 255. It can, therefore, be said that small shareholders' director is like and nominee director.

Question 2

Some small shareholders of TRG Ltd., a company listed with Mumbai Stock Exchange, want to appoint Mr. Raj, who is holding 1,000 Equity Shares of Rs.10 each in the Company as a Director as their representative on the Board of Directors of the said Company. You are required to state the relevant provisions of the Companies Act, 1956 in respect of such proposal to appoint Mr. Raj as a Small Shareholders' Director. **(November, 2004)**

Answer

The provisions of section 252 of the Companies Act, 1956, and the Companies (Appointment of Small Shareholders' Director) Rules, 2001 in respect of appointment of Small Shareholders' Director are as follows:

- (1) The provisions of appointment of Small Shareholders' Director are applicable to public companies having paid-up share capital of Rs.5.00 Crores or more and having 1000 or more small shareholders. In case, TRG Ltd. is fulfilling both these conditions, then only its shareholders shall be eligible to proceed in the direction of appointing Mr. Raj as a Small Shareholders' Director. [Proviso to section 252 (1)]
- (2) Small Shareholder for this purpose means a shareholder holding shares of nominal value of Rs. 20,000/- or less.[Explanation to section 252(1)].
- (3) Small Shareholders who intend to propose Mr. Raj as a Small Shareholders' Director have to leave a notice of their intention with TRG Ltd. at least 14 days before the meeting and such notice has to be signed by at least 100 small shareholders.
- (4) According to the rules, the person whose name is to be proposed for the post of Small Shareholders' Director should himself be a small shareholder. Since Mr. Raj is holding shares of nominal value of Rs.10,000/- only, which is less than Rs.20,000, he is eligible to be nominated as such.
- (5) The said notice shall contain the name, address, number of shares held, of Mr. Raj whose name is to be proposed as a Small Shareholders Director and also that of other shareholders proposing Mr Raj.
- (6) Before the meeting, Mr. Raj has to sign and file with TRG Ltd., his consent in writing to act as a director.
- (7) Since TRG Ltd. is a company, which is listed with Mumbai Stock Exchange, it shall elect small shareholders' nominee through the postal ballot.
- (8) On scrutinizing the postal ballot, if Mr. Raj secures the requisite number of votes, he will be elected as a director for a term of 3 years and on expiry of the term shall be eligible to be re-appointed if small shareholders so wish at that time. However, he need not have to retire by rotation.
- (9) Mr. Raj shall be treated as director for all other purposes except for appointment as whole time director or managing director.

Appointment of directors and proportion of those who are to retire by rotation (Section 255) &

Ascertainment of directors retiring by rotation and filing of vacancies (Section 256)

Question 3

A company has 11 directors on the Board consisting of the following:

- (a) Mr. Active, Mr. Archive as nominees from two Public Financial Institutions.*
- (b) Mr. First, Mr. Second, Mr. Third appointed at the 2nd AGM.*
- (c) Mr. Fourth, Mr. Fifth appointed at the 3rd AGM.*
- (d) Mr. Addition was appointed as additional director subsequent to 3rd AGM.*
- (e) Mr. Casual was appointed as director in place of Mr. Soul who died and was earlier appointed during the 3rd AGM.*
- (f) Mr. Excellent was appointed as Managing Director for 5 years w.e.f. 2nd AGM.*
- (g) Mr. One more was appointed as additional Director soon after Mr. Addition was appointed as Additional Director.*

List out in order, who shall be vacating the office at the 4th AGM of the company.

Answer

Section 255 of the Companies Act, 1956, provides that unless the Articles provide for retirement of all the directors at every general meeting, not less than two-thirds of the total number of directors of a public company, or of a private company which is a subsidiary of a public company, shall retire by rotation. In terms of section 256 of the Act, one-third of the directors liable to retire by rotation shall retire at the Annual General Meeting of the Company. If the number of directors liable to retire by rotation is not three or a multiple of three, then the number of nearest to one-third shall retire from the office of director.

In order to determine the directors who shall retire by rotation at every general meeting, it is provided that the persons who have been longest in office since their last appointment shall be liable to retire. As between the persons who became directors on the same day, the directors who shall retire may be determined by agreement among themselves. In the absence of any such agreement the persons liable to retire shall be chosen by lot.

Of the 11 directors mentioned in the question, Mr. Active and Mr. Archive, who are nominees of Public Financial Institutions respectively, are non-rotational directors and are not liable to retire. Mr. Excellent being the Managing Director, is also not liable to retire. The position in regard to the remaining 8 directors is as under:

- (i) Mr. Addition & Mr. One More who were appointed as Additional Directors in subsequent to 3rd Annual General Meeting respectively, shall vacate office on the date of 4th Annual General Meeting.*
- (ii) Mr. Casual was appointed in place of Mr. Soul who died and will, therefore, hold office till the date. Soul would have held office.*

- (iii) Of the 6 rotational directors, [viz., Mr. First, Mr. Second, Mr. Third, Mr. Fourth, Mr. Fifth and Mr. Casual, 2 directors who constitute one-third, and who have been longest in office are liable to vacate office. Accordingly, two amongst Mr. First, second and third who were appointed in 1st AGM and have been longest in office, shall vacate office. Amongst themselves, either they can decide by mutual consent or by draw of lots.

Question 4

ABC Ltd annual general meeting has been scheduled in compliance with the requirements of the Companies Act, 1956. In this connection, it has some directors who are rotational and out of which some have been appointed long back, some have been appointed on the same day.

Decide in this connection,

- (a) Which of the directors shall be retiring by rotation and be eligible for re-election?*
- (b) In case two directors were appointed on the same day, how would you decide their retirement by rotation?*
- (c) In case the meeting could not decide how the vacancies caused by retirement to be dealt with, what shall be consequences?*
- (d) What will be your answer, assuming that the matter could not be decided even at the adjourned meeting?*

Answer

According to Section 256, out of the 2/3rds rotational directors only 1/3rds must retire by rotation at one general meeting. If the number is not three or multiple of three, then the number nearest to 1/3 must retire from office. First those directors who are the longest in office must retire. If two directors have been appointed on the same day, their retirement will be determined either mutually or by lot. The vacancies caused by such retirement may be filled in the same annual general meeting by appointing either the retiring directors or some other person. But the meeting may also decide that the vacancies shall not be filled. Where, however, the meeting has not done either of two, and then the meeting is deemed to have been adjourned for a week. If at the adjourned meeting held after the said week, fresh appointment is not made and if no resolution against appointment is passed, then the retiring directors shall be deemed to have been appointed except in the following cases: (a) Where at the meeting or at the previous meeting the resolution for the reappointment of a particular director was put to vote but lost; (b) where the retiring director has expressed his unwillingness to be reappointed by a written notice addressed to the company or its Board of Directors; (c) Where he is unqualified or has been disqualified for appointment; and (d) where any special or ordinary resolution is required for his appointment or reappointment.

Question 5

The Articles of Association of M/s AB Ltd provides for five directors and all the five directors are in positions. How many directors are liable to retire at the ensuing annual general meeting? Will it make any difference if Mr. A, a Whole Time Director is not liable to retire by rotation. Explain.

Answer

Section 255 and 256 of the Companies Act, 1956 govern the retirement of directors. As per section 255, not less than two-thirds of the directors of a public company or of a private company which is a subsidiary company are liable to retirement by rotation. It would therefore, mean that one-third of the directors need not retire at the annual general meeting. In the question given, it is presumed that all the 5 directors are liable to retire by rotation.

As per section 256, one-third of such directors for the time being are liable to retire by rotation or if the number is not three or a multiple of three, then the number nearest to one-third shall retire from office. The directors who are longest in office shall retire first.

Keeping in view of the above provisions, where all the 5 directors are liable to retire by rotation, 2 directors i.e. $\frac{1}{3}$ rd of 5 (nearest) will retire by rotation, as this number is nearest to $\frac{1}{3}$ rd of 5.

As per second part of the problem, if Mr A is not liable to retire by rotation, then, those liable to retire by rotation $\frac{1}{3}$ rd of 4 (i.e. rotational directors) and this works out to 1. It means at the ensuing annual general meeting only one director will be liable to retire by rotation.

Earlier, it was presumed that all the 5 directors were liable to retire by rotation. If, however, the articles provided that one-third of the directors would not be liable to retire by rotation, then only $\frac{2}{3}$ rd of 5 would be liable to retire by rotation at the every annual general meeting. It means only 3 out of 5 are liable to retire and out of these 3, $\frac{1}{3}$ rd (one) directors will be liable to retire by rotation at every annual general meeting.

Question 6

ABC Company Ltd. in its First General Meeting appointed six Directors whose period of office is liable to be determined by rotation. Briefly explain the procedure and rules regarding retirement of these directors. Will it make any difference, if ABC Company Ltd. does not carry on business for Profit? **(November, 2002)**

Answer

According to section 255 of the Companies Act 1956, unless the articles provide for the retirement of all directors in every general meeting, at least $\frac{2}{3}$ rd of the total number of directors of the public limited company in question must, in the first place, be appointed,

save as otherwise expressly provided in the Act by the company in general meeting; Secondly, they must be persons whose period of office is liable to be determined by rotation.

According to section 256, out of 2/3rd rotational directors only 1/3rd must retire by rotation at one general meeting. If the number is not three or multiple of three, then the number nearest to 1/3 must retire from office.

Yes it will make a difference if ABC company does not carry on business for Profit. Provisions of Section 256 do not affect those companies which do not carry on business for profit or those which by their articles prohibit the payment of dividend to their members. Such companies are not affected by Section 255 also which provides that at least 2/3rd of the directors shall retire by rotation while section 256 provides that 1/3rd of the retiring directors shall retire every year.

Question 7

ADJ Company Limited has 10 directors on its board. Two of the directors have retired by rotation at an Annual General Meeting. The place of retiring directors is not so filled up and the meeting has also not expressly resolved 'not to fill the vacancy'. Since the AGM could not complete its business, it is adjourned to a later date. At this adjourned meeting also the place of retiring directors could not be filled up, and the meeting has also not expressly resolved 'not to fill the vacancy'.

Referring to the provisions of the Companies Act, 1956, decide:

- (i) *Whether in such a situation the retiring directors shall be deemed to have been re-appointed at the adjourned meeting?*
- (ii) *What will be your answer in case at the adjourned meeting, the resolutions for re-appointment of these directors were lost?*
- (iii) *Whether such directors can continue in case the directors do not call the Annual General Meeting?*

(May, 2010)

Answer

Retiring director – When to be deemed director?

In accordance with the provision of the Companies Act, 1956, as contained in Section 256(3) at the annual general meeting at which a director retires as aforesaid, the company may fill up the vacancy by re-appointing the retiring director or some other person thereto. If the place of retiring director is not so filled up and the meeting has not expressly resolved not to fill the vacancy, the meeting shall stand adjourned to same day in the next week, at the same time and place, or if that day is a public holiday, till the next succeeding day which is not a public holiday. If at the adjourned meeting also, the place of the retiring is not filled up and that

meeting also has not expressly resolved not to fill the vacancy, the retiring director shall be deemed to have been re-appointed at the adjourned meeting, unless at the adjourned meeting or at the previous meeting a resolution for the re-appointment of such directors was put and lost.

Therefore, in the given circumstances answer to the questions as asked shall be:

- (1) In the first case, applying the above provisions, the retiring directors shall be deemed to have been re-appointed.
- (2) In the second case, where the resolutions were lost, the retiring directors shall not be deemed to have been re-appointed.
- (3) In the third case the directors due to retire shall vacate their offices latest on the date on which AGM was to be held. (B.R. Kundra v. Motion Pictures Association, 1976, 46 Comp. Cas. 339)

Right of persons other than retiring directors to stand for directorship (Section 257)

Question 8

One of the members of ADB Ltd. has proposed the name of Mr. Fame for appointment as a Director of the Company in the Annual General Meeting and given a notice under Section 257 of the Companies Act, 1956. Mr. Fame is one of the partners of the Fame & Fame, Chartered Accountants, who are the retiring auditors of the company. But the audit of the company is being looked after by another partner of the firm. Examine whether Fame & Fame can be reappointed as auditors, if Mr. Fame is appointed as Director **(May 2006)**

Answer

Appointment of a partner of the company's auditors as a director: Problem as asked in the question is based on the provisions of Companies Act, 1956 as contained in Section 2(30) read with Section 226(3)(b) and (c). Accordingly, Mr. Fame is appointed as a director of the company 'Fame and Fame' cannot be reappointed as company's auditors. It is so because a director is an officer of the company within the meaning of section 2(30) of the Companies Act, 1956 and the audit firm becomes disqualified under section 226(3) (b) and (c) even if any of its partner is also an officer of the company. It is immaterial that the audit of the company is being looked after by another partner of the firm and not by Mr. Fame. Therefore, if Mr. Fame is appointed as a director of the company, 'Fame and Fame' cannot be reappointed as company's auditors.

Question 9

The management of ATP Ltd., a company listed with The Stock Exchange, Mumbai wants to appoint Mr. BDF as a Director of a Company at the Annual General Meeting of the Company to be held on 24th May, 2007. It may be noted that Mr. BDF is not a retiring Director. The

Management seeks your guidance regarding the procedure to be adopted for the purpose. You are required to state the procedure to be followed for giving effect to such proposal and formalities to be observed after appointment of Mr. BDF as Director, by the management of ATP Ltd., as per the provisions of the Companies Act, 1956. **(May 2007)**

Question 10

Mr. Wilson was appointed in ABC Ltd. as a director and he was to retire by rotation on 1st September, 2008. On account of some unavoidable reasons the annual general meeting of the company could not be held on the said date, nor the vacancy caused by retirement could be filled up at the adjourned meeting. State the relevant provisions of the Companies Act, 1956 and decide whether Mr. Wilson shall be deemed to be retired on 1st September, 2008 when the meeting was scheduled to be held or it will become a case of deemed reappointment. **(November 2008)**

Answer

DEEMED REAPPOINTMENT OF DIRECTOR: Section 256 of the Companies Act, 1956 deals with deemed re-appointment of a retiring director. The vacancies caused by retirement of a director by rotation should be filled up at the same meeting or at an adjourned meeting. If it is not so done, the retiring director shall be deemed to have been reappointed at such adjourned meeting except in the following cases-

- (i) at any previous meeting, a resolution for his reappointment was put to vote but was lost, or
- (ii) the retiring director has, in writing expressed his unwillingness to continue, or
- (iii) he is not qualified or is disqualified for the said appointment, or
- (iv) a special or ordinary resolution is necessary for his appointment or reappointment by virtue of any provisions of the Companies Act 1956, or
- (v) it is resolved to appoint two or more directors by a single resolution, or
- (vi) it is resolved not to fill the vacancy.

In the instant case the above mentioned exceptions are not applicable and hence Mr. Wilson cannot be deemed to be retired. He is deemed to be re-appointed as director.

The directors of a company are appointed by the shareholders at the general meeting. Though the retiring directors are normally re-appointed, it may sometimes become necessary to appoint a person other than the retiring director as director. The shareholders also have a right to propose the appointment of a person as a director. This power may be exercised in order to increase the strength of the Board or to permit the shareholders to exercise this important right available to them.

In the case of private company which is not a subsidiary of a public company, the producers given below are not applicable and the appointment shall be in accordance with the Articles of Association.

Procedure to be adopted:

1. A person, other than the retiring director, shall be eligible for appointment to the office of director only if he or some other member intending to propose him has, at least 14 days before the meeting, left at the office of the company a special notice in writing under his hand signifying his candidature for the office of director along with a deposit of Rs. 500 as required under section 257 of the Companies Act, 1956.
2. On receipt of the special notice, information should be sent to all the members of the company not less than 7 days before the meeting. Alternatively, an advertisement may be issued regarding the candidature or intention not less than 7 days before the meeting in at least in two newspapers circulating in the place where the registered office of the company is situated both in English and in the local language.
3. The resolution for the appointment should be move before the annual general meeting and an ordinary resolution should be passed for this purpose. If the resolution is not passed, no further action needs to be taken in this regard.
4. In case the resolution is passed, the deposit money is Rs. 500 should be refunded to the person who made the payment.
5. In the case of a listed company, copy of the minutes of the meeting and intimation regarding the appointment should be sent to each of the stock exchanges in which the securities are listed.
6. Within 30 days of the appointment, a return in Form No. 32 should be filed electronically, with the Registrar of Companies together with the prescribed filing fee.
7. The Company and the director has to complete the formalities as prescribed under Companies (Director Identification Number) Rules, 2006.
8. A genial notice of disclosure of interest in Form No. 24AA indicated the names of bodies corporate of which he is a director or member (holding more than 2% of paid-up capital) or firms in which eh is a partner should be obtained. The said disclosures should be placed before the Board and a resolution taking the notice on record should be passed. The notice shall expire at the end of the financial year but may be renewed by giving a fresh Form No. 24AA in the last month of the financial year in which it would otherwise expire.
9. Articles of Association should be check and in case it provides for acquiring of qualification shares, the same should be acquired within two months of appointment, if the new appointee does not hold the same.

10. Particulars regarding directors should be entered in the Register of Directors and the Register of Directors' Shareholdings.

Increase in the number of directors to require Government sanction (Section 259)

Question 11

The maximum number of Directors of each of the following Companies as per their Articles of Association is 11.

- (i) *ABS Company Ltd.*
- (ii) *DSP Trading Private Ltd.*
- (iii) *Traders Association (a Company registered under Section 25 of the Companies Act, 1956)*
- (IV) *Hindustan Paper Ltd. (a Government Company under Section 617 of the Companies Act, 1956)*

The Board of Directors of the Company wants to increase the number of Directors to 15.

State with reference to the provisions of the Companies Act, 1956 whether the Directors can do so.

(November, 2003)

Answer

According to the provisions of section 259 of the Companies Act, 1956, in the case of a company incorporated after 21st July, 1951, any increase in the number of its directors beyond the maximum fixed by its Articles of Association as originally adopted and registered and in the case of a company existing prior to that date, any increase in the number of directors shall not have any effect unless approved by the Central Government and it is to become void to the extent to which it is disapproved by the Central Government. However, such approval from the Central Government is not required if the number of directors is increased to 12 or less than that.

From the reading of the provisions of the said section 259 of the Companies Act, 1956, it can be concluded that these provisions are applicable to only public companies or private companies which are subsidiaries of public companies.

Based on the above provisions, following can be stated in respect of various types of Companies as mentioned in the question:

In the case of ABS Company Ltd., the Directors have to obtain the approval of the Central Government for increasing the number of Directors from 11 to 15.

In the case of DSP Trading Private Ltd., a private company; Traders Association, a section 25 company and Hindustan Paper Ltd. a Government Company, the provisions of section 259 of the Companies Act, 1956 are not applicable to them, hence the Directors of

these companies can increase the number of Directors from 11 to 15 without approval of the Central Government subject to fulfilment of other procedural requirement.

Question 12

As per their Articles of Association the maximum number of Directors of each of the following companies is 9:

- (i) *Goodheart Company Limited.*
- (ii) *Frontline Trading Private Limited.*
- (iii) *Hindustan Zink limited (a Government company under section 617 of the Companies Act, 1956).*

The Board of Directors of the aforesaid companies proposes to increase the number of Directors to 15. Advise, whether under the provisions of the Companies Act, 1956, the Board of Directors can do so?
(June 2009)

Answer

As per Section 259 of the Companies Act, 1956, in the case of a company incorporated after 21st July, 1951, any increase in the number of its directors beyond the maximum fixed by its Articles of Association as originally adopted and registered and in the case of a company existing prior to that date, any increase in the number of directors shall not have any effect unless approved by the Central Government, and it is to become void to the extent to which it is disapproved by the Central Government. However, such approval from the Central Government is not required if the number of directors is increased to 12 or less than that.

The above mentioned provision of the Companies Act, 1956 are applicable only to public companies or private companies which are subsidiaries of public companies. Based on the above mentioned provisions, following conclusion can be drawn in respect of companies as mentioned in the question.

In the case of Good heart company Limited the Directors have to obtain the approval of the Central Government for increasing the number of Directors from 9 to 15.

In the case of Front Line Trading Private Limited (Which is a Private company) and Hindustan Zink Limited (a Government company) the provisions of section 259 of the companies Act, 1956 are not applicable and hence the directors of these companies can increase the number of directors from 9 to 15 without the approval of the Central Government, subject to fulfilment of other procedural requirements

Question 13

The Articles of Association of Rajasthan Toys Private Limited provide that the maximum number of Directors in the company shall be 10. Presently, the company is having 8 Directors.

The Board of Directors of the said company desire to increase the number of Directors to 15. Advise whether under the provisions of the Companies Act, 1956 the Board of Directors can do so.
(CA Final, New Course, May, 2010)

Answer

Increase in the number of directors: As per Section 259 of the Companies Act, 1956 in the case of a company incorporated after 21st July, 1951 any increase in the number of its Directors beyond the maximum fixed by its Articles of Association as originally adopted and registered and in the case of a company existing prior to that date, any increase in the number of Directors shall not have any effect unless approved by the Central Government. However, such approval from the Central Government is not required if the number of Directors is increased to 12 or less than that. The above mentioned provisions of Section 259 of the Companies Act, 1956 are applicable only to public companies or private companies which are subsidiaries of public companies.

In view of the above, since Rajasthan Toys Private Limited is a private company and it is also not subsidiary of any public company, the provisions of Section 259 of the Companies Act, 1956 are not applicable and the Board of Directors of the said company may increase the number of Directors without seeking approval of the Central Government.

Additional Directors (Section 260)

Question 14

The Articles of Association of a company have fixed the maximum strength of the board as 12 directors. At present the Board has 9 directors of whom 6 are liable to retire by rotation and 3 not liable to retire by rotation. The Board wishes to appoint 3 additional directors. Can they appoint as desired?

Answer

As per Section 260 of the Companies Act, 1956, Board can appoint additional directors provided the Articles give power to the Board to appoint such directors, and provided the number of directors and additional directors shall not exceed the maximum strength fixed by the Articles. In the instant case, after the appointment of 3 additional directors, the total strength of the Board will go up to 12, which is within the maximum fixed by the Articles. Hence, Board can appoint the additional directors.

Question 15

Can an additional Director Continue to be in office where the annual general meeting is not held as per Section 166?

Answer

In *Krishna Prasad Pilani vs. Colaba Land Mills Co.* 29 Comp. Crs 273, it was observed that an additional Director shall vacate his office latest on the date on which the annual general meeting

could have been held under Section 166. He cannot continue in office on the ground that the meeting was not held or could not be called within the time prescribed.

Question 16

Can an additional Director be appointed in general meeting?

Answer

Where the articles have conferred the power of appointing additional directors on the Board of Directors the company in a general meeting is precluded from appointing additional directors [*Blair Open Hearth Furnance Co. vs. Reigart*, (1913) 108 L.T. 665]. However, though in ordinary circumstances the company in general meeting is precluded from appointing such directors yet if owing to a deadlock or otherwise there is no board capable of making the necessary appointment the company in a general meeting may do so [*Barrow vs. Potter*, (914) 1 Ch. 895].

Question 17

Prince Ltd., desires to appoint an additional director on its board of directors. The Articles of the company confer upon the board to exercise the power to appoint such a director. As such M is appointed as an additional director. In the light of the provisions of the Companies Act, 1956, examine:

- (i) *Whether M can continue as director if the annual general meeting of the company is not held within the stipulated period and is adjourned to a later date?*
 - (ii) *Can the power of appointing additional director be exercised by the Annual General Meeting?*
 - (iii) *As the Secretary of the company what checks would you make after M is appointed as an additional director?*
- (May, 2010)**

Answer

Section 260 of the Companies Act, 1956 empowers the Board of Directors, if authorized by the Articles to appoint additional directors, provided that such additional directors shall hold office only up to the date of the next AGM of the company, and the number of the directors including additional directors shall not exceed the maximum strength fixed for the Board by the Articles. These directors also must acquire the qualification shares within the statutory period of 2 months. The appointment of such directors must be in the interest of the general body of shareholders. (*Anantha Lakshmi vs. Indian Traders Ltd. A 1953 Mad. 567*).

Based on the above provisions answers to the given questions shall be as under:

- (i) M. cannot continue as director till the adjourned AGM, since he can hold the office of directorship only up to the date of the next AGM. Such an additional director shall vacate his office latest on the date on which the AGM could have been held under

Section 166. He cannot continue in the office on the ground that the meeting was not held or could not be called within the time prescribed. (*Krishna Prasad Pilani v. Colaba Land Mills Co.* 29 Comp. Case. 273)

- (ii) Where the articles have conferred the power of appointing additional directors on the Board of Directors, the company in a general meeting is precluded from appointing additional director. (*Blair Open Hearth Furnance Co. vs Reigart*, (1913) 108 L.T. 665). However, though in ordinary circumstances the company in general meeting is precluded from appointing such directors yet if owing to a deadlock or otherwise there is no board capable of making the necessary appointment the company in a general meeting may do so. (*Barrow v. Potter* (914) 1 Ch. 895). Therefore, in ordinary circumstances the general meeting cannot exercise the power to appointment additional director.
- (iii) As the Secretary of the company the following checks would be made after M is appointed as an additional director:
 - (a) Whether the appointment was made by the Board?
 - (b) Whether the maximum strength fixed for the Board was not exceeded by the appointment?
 - (c) Whether the additional directors held office only up to the date of the next AGM?

Filling of casual vacancies among directors (Section 262)

Question 18

The Board of Directors of XYZ Limited appointed Mr. A as a Director in the casual vacancy caused by resignation of Mr. X. Mr. A is proposed to be re-appointed as a Director at the Annual General Meeting, when he vacates his office. Examine with reference to the relevant provisions of the Companies Act, 1956 whether Mr. A can be considered as a 'Retiring Director' and state the legal requirements to be fulfilled to give effect to the proposed appointment of Mr. A as a Director at the Annual General Meeting. **(November, 2003)**

Answer

Re-appointment of a person acting against the casual vacancy:

If a person who is not a 'retiring director' is proposed to be appointed as a director at any annual general meeting, the formalities prescribed under section 257 of the Companies Act, 1956 are to be followed:

The expression 'retiring director' appearing in sections 256 and 257 means a 'director retiring by rotation'. (Explanation under Section 256). The expression 'a director retiring by rotation' refers only to a director appointed by the company in general meeting and retiring (Section 255 read with Section 256).

If office of any director who was appointed at the general meeting is vacated before he is due to retire on normal course, such casual vacancy can be filled in by the Board of Directors [Section 262(1)]. The person so appointed would continue in office until the date when retirement of the original director in whose place the former is appointed would fall due in the usual course [Section 262(2)].

Hence the director appointed by the Board in a casual vacancy is not a 'retiring director' within the meaning of Section 257. When such a person is proposed to be appointed as a regular director in the annual general meeting, a notice to appoint him as director has to be received from the member under Section 257 at least 14 days before the meeting along with a deposit of Rs.500/-. The deposit will be refunded when the person succeeds in getting elected as director at the Annual General Meeting.

Question 19

The Board of Directors of XYZ Ltd. filled up a casual vacancy caused by the death of Mr. P by appointing Mr. C as a director on 3rd April, 2009. Unfortunately Mr. C expired on 15th May, 2009 after working about 40 days as a director. The Board now wishes to fill up the casual vacancy by appointing Mrs. C in the forthcoming meeting of the Board. Advise the Board in this regard.

(June 2009)

Answer

Section 262 of the Companies Act, 1956 authorises the Board of Directors to fill up casual vacancies if the office of any director appointed by the company in general meeting is vacated before his term of office and hence the appointment of C was in order. In normal course, C could have held his office as director up to the date to which Mr. P would have held but Mr. C expired on 15th May 2009 and again a vacancy has arisen in the office of director owing to death of Mr. C who was appointed by the board to fill up the casual vacancy.

Hence the present vacancy cannot be considered as casual vacancy as stated in section 262 and therefore the board cannot fill up the same.

The Board may however appoint Mrs. C as an additional director under section 260 of the Act provided the articles of association authorises the board to do so, in which case Mrs. C will hold the office until the conclusion of the next annual general meeting

Appointment of directors to be voted on individually (Section 263)

Question 20

XYZ Company Ltd. in its annual general meeting appointed all its directors by passing one single resolution. No objection was made to the resolution. Examine the validity of appointment of directors explaining the relevant provisions of the Companies Act, 1956. Will it make any difference, if XYZ Company was a private company?

(May, 2003)

Answer

Section 263 (1) of the Companies Act 1956 requires that the appointment of every director shall be voted on individually. Thus two or more directors cannot be appointed by a single resolution. However an exception has been carried out where under if a resolution has been first passed to the effect that all the directors shall be appointed by a single resolution without any vote being against it.

Any resolution, as per Section 263(2), in contravention of the aforesaid provisions shall be void whether or not objection was taken at the time of its being so moved.

The aforesaid provision, however apply to a public company or a private subsidiary of a public company. Hence, the appointments so made are void. However if XYZ co. was a private limited company, then the condition of provision of Section 263(1)(2) were not applicable as regards the condition of single resolution is concerned.

Consent of candidate for directorship to be filed with the company and consent to act as director to be filed with the Registrar (Section 264)

Question 21

Mr. John has been appointed as Additional Director on the Board of MCX Ltd. on 12th January, 2006. Mr. John has filed his consent to Act as a Director, if appointed, only with the company. Examine with reference to the provisions of the Companies Act, 1956 whether he is also required to file his consent with the Registrar of Companies. **(May 2006)**

Answer

Filing of consent under section 264: Problem as asked in the question is based on the provisions of Section 264(1) and (2) of The Companies Act, 1956 and also the case ruling in *Lalitbhai C. Kapadia Vs. Laljibhai B. Desai*. Section 264(1) of the Companies Act, 1956 requires that a person proposed as a candidate for the office of director should file with the company his consent to act as a director, if appointed. Section 264(2) stipulates that a person shall not act as a director unless he has filed with the Registrar of Companies his consent in writing (Form No. 32) to act as such. Additional and alternate directors are not required to file consent under section 264(2) (*Lalitbhai C. Kapadia v. Laljibhai B. Desai* (1973) 43 Comp. Cases 17). Accordingly, applying the above provisions and the ruling of the case, John is not required to file his consent for accepting Additional Directorship.

Question 22

Mr. Sachin was appointed as an additional Director of Conservative Finance Ltd. w.e.f. 1st October, 2009, in a casual vacancy by way of a circular resolution passed by the Board of Directors. The next annual general meeting of the company was due on 31st March, 2010, but the same was not held due to delay in the finalisation of the accounts. Some of the shareholders of the company have questioned the validity of the appointment of Mr. Sachin

and his continuation as additional director beyond 31st March, 2010. Advise the company on the complaints made by the shareholders. **(CA Final, New Course, May, 2010)**

Answer

Appointment of director in a Casual vacancy: Section 262 of the Companies Act which deals with the filling of a casual vacancy provides that a director can be appointed only at a validly convened and constituted board meeting. Hence the appointment of Mr. Sachin by passing a circular regulation is not valid and the shareholders who made a complaint in this regard are correct. The tenure of a director appointed against a casual vacancy will be up to the date to which the original director in whose place he is appointed would have held office. On the other hand, an additional director appointed by the Board will hold office only up to the next date of annual general meeting and he cannot continue in office beyond the last date of the annual general meeting i.e; 31st March, 2010 on the ground the annual general meeting could not be held. (*Krishna Prasad Pilani vs. Colaba Land Mills Co AIR, 1960, BOM, 312.*)

Appointment of directors by proportional representation (Section 265)

Question 23

A company has in its Articles of Association provided for appointment of not less than two-thirds of the total number of its directors according to the principle of proportional representation. Can the directors so appointed be removed by the company in general meeting?

Answer

The articles of a public company or a private company which is subsidiary of a public company may adopt the principle of proportional representation for appointing not less than 2/3rd if the total number of the directors, whether by a single transferable vote or by a system of cumulative voting or otherwise. In such a case, appointments will be so made once in every three years and interim casual vacancies will be filled in conformity with the provisions of Sections 262 and 265. Cumulative voting denotes that if there are five candidates or distributes his five votes. He can cast all the five votes in favour of one candidate or distribute his five votes among different candidates. This system of voting ensures that the Board will have fair representation of the minority interest

Resignation of Directors

Question 24

Due to internal problems in the working of M/s Infighting Detergents Ltd., Mr. Satyam, the Executive Director, and Mr. Shivam, a Director, have submitted their resignations and decided to dissociate themselves with the working of the company. Mr. Sundram, the Managing Director, decides to refuse their resignations. Examine whether the Managing Director can compel Mr. Satyam and Mr. Shivam to continue as per the provisions of the Companies Act. **(November 2001)**

Answer

There is no provision in the Companies Act, 1956 relating to the resignation of his office by a director. If there is any provision in the articles giving the right to a director to resign at any time, the resignation shall take effect without any need for its acceptance by the Board or the Company in General Meeting. However, it is not clear what will be the position if the articles do not contain any provision relating to resignation of directors. One view is that the ordinary rule of common law as regards resignation by an officer or agent must be followed namely, resignation by notice given either to the Company or the Board and acceptance of the same. (*Glossop V. Glossop; Latchford Premier Cinema Ltd. vs. Ennion*). Another view is where the resignation says that it is to take effect immediately, acceptance is not necessary unless the articles or any provision of law makes it necessary. Further the directors do not have the power to refuse the resignation of the co-director unless such a provision is there in the Articles of Association. (*Re. Neokratine Safety Explosives Co. of New Ltd. (1891)*). Hence in the absence of contrary provisions in Articles, the Company (i.e., Mr. Sundaram) cannot compel Mr. Shivam to continue as a director.

However, the position is somewhat different in the case of a managing or whole time director. In such a case a formal acceptance of resignation by the company is essential so as to make it compete and effective. This is because the managing director occupies two positions (i) one that of a director and (ii) the other that of a whole time employee. An employee cannot give up office at his pleasure simply by giving notice. The notice or letter of resignation is required to be accepted by the company and the officer concerned has to be relieved of his duties and responsibilities, attaching to the office which he has resigned from. [*Achutha Pai vs. Registrar of Companies (1956) 36 comp. Case 598*]. Thus as the Executive Director, Mr. Satyam is full time employee of the company, the managing Director (Mr. Sundaram) can compel him to work as per the terms of employment agreed into at the time of appointment.

Question 25

Mr. Raj, a director of POL Ltd., submitted his resignation from the post of director to the Board of Directors on 30th June, 2004 and obtained a receipt therefore on the same day. The Board of Directors of POL Ltd. neither accepted the resignation nor did it file Form No.32 with the Registrar of Companies. You are required to state whether Mr. Raj ceases to be the Director of POL Ltd. and if yes, since when?

(November, 2004)

Answer

There is no provision in the Companies Act, 1956 relating to resignation from his office by a director. If there is any provision in the articles giving the right to a director to resign at any time, the resignation will take effect without any need for its acceptance by the Board

of Directors or the company in general meeting in absence of a specific provision in the articles of association, a director can resign without being required to give reasonable notice. In *T. Murari vs. State* [(1976) 46 Comp. Cas. 613] the Madras High Court held that even in the absence of a provision in respect of resignation under the Companies Act, 1956 or under the articles of association of the company, the resignation tendered by a director or a managing director unequivocally in writing will take effect from the time when such resignation is tendered.

The said judgement was followed by the same court in the case of *S.S. Lakshman Pillai Vs. ROC* (1997) 47 Comp. Cas. 652. In a judgement in the case of *Mother Care (India) Ltd Vs. Prof. Ramaswamy P. Aiyar* [(2004) 51 SCL 243] the Karnataka High Court observed that as the appointment of a director is not a bilateral character, the question of acceptance of the request to relinquish the office would arise and filing of Form No.32 in terms of section 303(2) of the Companies Act, 1956 is only a consequential act to be performed by the company in obedience of the statutory provision, but it is not an act to be complied with in order to make a resignation valid.

Where the resignation letter states that it is to take effect on acceptance, or where the articles so require, acceptance is necessary to end the tenure of office of a director.

In view of the above legal position, Mr. Raj has ceased to be a director of POL Ltd. with effect from 30th June, 2004, provided his resignation letter does not state that the resignation is to take effect on acceptance or the articles of POL Ltd. does not so require.

DIRECTOR IDENTIFICATION NUMBER (SECTIONS 266A – 266G)

Application for allotment of Director Identification Number (Section 266A)

Question 26

What do you understand by the term “Director Identification Number” (DIN)? Describe the procedure to obtain the same as enumerated under the Companies Act, 1956 read with the relevant Rules.

(May 2008, CA Final, New Course, June 2009)

Answer

Director Identification Number (DIN) is a Unique Identification Number given by the Ministry of Corporate Affairs. It is required to be obtained by every person who is intended to become a director of any company. DIN is a pre-requisite for filing various forms with the Registrar of Companies. The electronic system of the Ministry of Corporate Affairs will not allow filing / submitting the forms if DIN of the signatory director is not mentioned in the form being filed / submitted.

In order to obtain DIN from the Ministry of Corporate Affairs following procedure is to be adopted:

- (i) To check whether the computer system through which the DIN Application is being made has the requisite hardware and the software as well as the internet facility.
- (ii) Using the internet facility, DIN Application Form has to be downloaded from the website of Ministry of Corporate Affairs
- (iii) The DIN application form is to be filled up and submitted electronically
- (iv) On electronic submission of the DIN application form, a provisional DIN will be generated and displayed on the said application form.
- (v) Thereafter, the form is to be printed, signed and submitted to the Ministry of Corporate Affairs – DIN Cell along with following papers/documents:
 - (a) Passport size photograph of the applicant duly attested by a Magistrate or a Notary Public or a practicing Chartered Accountant or a practicing Company Secretary or a practicing Cost Accountant or a Gazetted Officer.
 - (b) Attested copy of any one of the following as a proof of identity
 - (i) Passport
 - (ii) Election / Voter Identity card
 - (iii) Driving Licence
 - (iv) Income tax PAN card
 - (v) Ration Card
 - (vi) Any other document which will prove the identity of the applicant
 - (c) Attested copy of any one of the following as a proof of residence
 - (i) Passport
 - (ii) Election / voter identity card
 - (iii) Driving Licence
 - (iv) Ration Card
 - (v) Electricity Bill
 - (vi) Telephone Bill
 - (vii) Bank Account Statement
 - (viii) Any other document which will prove the identity of the applicant

On submission of the above, the DIN Cell of the Ministry of Corporate Affairs shall allot Final DIN and send an intimation letter to the applicant.

MANAGING DIRECTORS (SECTIONS 267 – 269)

Appointment of managing or whole-time director or manager to require Government approval in only certain cases (Section 269)

Question 27

M/s Supreme Technologies Limited propose to appoint Mr. E and Mr. F as whole-time directors for a period of three years with effect from 1st June, 2003. The company proposes to pay a consolidated salary of Rs. 80,000 per month to each of them.

Mr. D, the managing director of the company, has been appointed for a period of five years with effect from 1st January, 2001 on a remuneration payable in the form of commission at the rate of five per cent of net profit subject to a minimum remuneration of Rs. 80,000 per month.

The effective capital of the company at the end of the financial year ending 31st December, 2002 is Rs. 4.5 crores and it has been increased to Rs. 5.5 crores on 1st April, 2003 by way of right issue of equity shares. The company did not repay public deposits on the date of maturity from 1st January, 2003 onwards, but the default was made good on 1st April, 2003.

The company seeks your advice on the steps to be taken to comply with the requirements of Section 269 read with Schedule XIII to the Companies Act, 1956 with regard to the proposed appointment of Mr. E and Mr. F as whole time directors. Advise explaining the relevant provisions. **(May 2003)**

Answer

Appointment of whole-time directors

Mr. E and Mr. F are proposed to be appointed as whole time directors for a period of 3 years with effect from 1st June, 2003. Each of them will get a consolidated salary of Rs.80,000 per month. It has been stated that both of them satisfy the conditions laid down in Part-I of Schedule XIII. It is necessary to examine whether the proposed payment of remuneration is within the limits laid down under A or B or C of Section II of Part II of Schedule XIII in order to determine the legal requirements to be complied with to give effect to the proposed appointment of Mr. E and Mr. F as whole-time directors.

The appointment is to be made on 1st June 2003. According to Explanation II (b) (of Schedule XIII), the effective capital shall be calculated as on the last date of the financial year preceding the financial year in which appointment is made. In this case the effective capital on 31-12-2002 is the last date of the preceding financial year is Rs.4-5 crores. The right issue of equity shares on 1st April 2003 is not relevant here for the purpose of ascertaining effective capital. According to Schedule XIII, Part II, Section II(A) if the effective capital is Rs. 1 crore or more but less than Rs. 5 crores monthly remuneration payable shall not exceed Rs.1,00,000. This ceiling shall apply for each M.D and/or whole-

time director. The proposed minimum remuneration for each of the directors Mr. E and Mr. F and also the existing director Mr. D is only Rs.80,000 i.e. within the ceiling laid down in Schedule XIII, Part-II, Section II(A).

It has been stated that the company has defaulted in repayment of public deposits during the period of 1st January 2003 to 31st March, 2003. According to proviso (ii) if the company has defaulted in repayment of debts including public deposits for a continuous period of 30 days during the preceding financial year (i.e. year 2002) before the date of appointment of the managerial person, then the appointment requires approval of Central Government as one of the conditions laid down in Schedule XIII, Part-II, Section II is not fulfilled. But as there was no default in this regard during the preceding financial year ended 31st December 2002, the company has fulfilled the above condition.

Hence the following steps are to be taken to comply with the requirements under section 269 read with Schedule XIII.

- (i) If there is no remuneration committee, remuneration committee must be formed consisting of at least 3 non executive independent directors including nominee directors, if any (explanation (iv)).
- (ii) The remuneration payable to Mr. E and Mr. F must be approved by a resolution passed by the remuneration committee taking into consideration the matters specified on Explanation V (Proviso (i)).
- (iii) Board meeting must be convened to appoint Mr. E and Mr. F as additional directors, if they are not directors and later on appoint them as whole-time directors on a consolidated salary of Rs.80,000 p.m.
- (iv) A return in the prescribed form (Form 25C) must be filed with Registrar of Companies within 90 days from the date of such appointment. The form must be certified by the auditor of the company or the secretary of the company or by a secretary in whole-time practice, if there is no secretary. They must certify that the requirements of Schedules XIII have been complied with. [Section 269(2) read with Schedule XIII – Part –III, (2)].
- (v) The appointment of Mr. E and Mr. F and remuneration payable to them must be approved by the company in general meeting by an ordinary resolution [Schedule XIII part III(i)]. There is no need to file Form No.25C once again after the general meeting at which the appointment is approved.

Question 28

Explain the action that can be taken by the Central Government, when a complaint is received from some shareholders of a Public Company that a person has been appointed as the Managing Director of the Company without seeking the approval of the Central Government,

when such approval is required. Also examine the validity of the acts of the Managing Director, if the complaint is found to be true. (CA Final, New Course, November 2009)

Improper appointment of Managing Director:

On receipt of the complaint, if the Central Government is prima facie, of the opinion that the Managing Director has been appointed without approval of the Central Government, when in fact such approval was necessary, the Central Government may refer the matter to the Company Law Board (Tribunal) for decision [Section 269(7)]. The Company Law Board will issue show-cause notice to the Company as well as the concerned Managing Director [Section 269(8)]. The Company Law Board will hear the case, and if it comes to a conclusion that the appointment is in contravention of requirements of Schedule XIII, it will make an order to that effect [Section 269(9)]. On such order, the appointment of the concerned Managing Director shall be deemed to have come to an end. The person so appointed shall in addition to being liable to pay a fine of Rs 1 lakh, refund to the company the entire remuneration received by him between the date of his appointment and the passing of such an order [Section 269(10)]. But all acts done by him prior to the declaration of invalidity will be valid, if they are otherwise valid [Section 269(12)].

Resignation by MD

Question 29

A is Managing Director of APAR Ltd. He gave his resignation letter to the Chairman of the Board of Directors on 31st December, 2005 and requested that he should be relieved immediately. When does the resignation of Mr. A take effect? (May 2006)

Answer

A director can resign from his office by serving a notice of his resignation upon the Company or the Board. There is no need for its acceptance by the Board or the Company.

However, if a Managing Director resigns, he cannot give up his office at his pleasure simply by serving the notice. This is because he occupies two positions i.e., of a director and an employee. In case of Managing Director, the notice or letter of resignation is required to be approved or accepted by the company and he has to be relieved of his duties and responsibilities attaching to his office from which he has resigned. Similar views were accepted in the case of *Achutha Pal vs. Registrar of Companies (1956) 36 Comp. Cases 598*.

Accordingly, in the given case, the resignation of A, the Managing Director shall be effective when approved or accepted by the company and he is relieved of his duties and responsibilities attaching to his office from which he has resigned.

SHARE QUALIFICATION (SECTIONS 270 – 273)

Time within which share qualification is to be obtained and maximum amount thereof (Section 270)

Question 1

Mr. A has been appointed as a director in a Public Limited Company? Referring to the provisions of the Companies Act, 1956 state:

- (a) Whether the director should possess any share qualification?*
- (b) If so what is the number of share(s), which he should acquire and at what value?*
- (c) Whether the articles of the company can insist on the director for compulsory acquiring of share qualification?*

Answer

It is that number of shares which a shareholder must hold in order to be eligible for election as a director. The Companies Act, 1956 does not prescribe for any share qualification for a director. However, Regulation 66 of Table A provides that the qualification for being a director of a company is the holding of at least one share in the company. The articles of a company usually prescribe for such qualifications so that a director has a personal interest in the company. In the event of such a provision by the articles, it becomes incumbent on the part of every director to hold qualification shares and if does not hold them at the time of his appointment as director, he must acquire them within two months after his appointment as director. *Any provision, made in the articles of the company requiring a person proposed for directorship to hold qualification shares either before appointment or within a third shorter than two months after his appointment will be void. The nominal value of qualification shares must not exceed Rs. 5,000 and if the nominal value of each share is Rs. 5,000 or more than the number of shares prescribed, as qualification will be only one. It is, of course, not necessary for any company to insist upon the holding of shares for the purpose of qualification for directors.* For the purpose of share qualification, the bearer of a share warrant is not deemed to be the holder of the shares mentioned in the warrant (Section 270). A Director acting without qualification shares is punishable with fine, which may extend to Rs. 500/- for every day during which he continues as director (Section 272). The provisions relating to the share qualification of a director do not apply to a private company, unless it is subsidiary of a public

company (Section 273): nor do they apply to directors appointed by the Central Government under Section 408.

Question 2

Discuss the validity of the arguments of the Director in the following cases:

In the General Meeting of X Ltd., held on 2.5.2000, Mr. A was appointed as a Director. On that day, he was not holding any equity shares in X Ltd. As per the Articles of Association of X LTD, the share qualification is the holding of 500 equity shares. On 15.6.2000 Mr. A applied for 1,000 equity shares in X Ltd and the shares were allotted on 10.7.2000. Mr. A claims that he was holding the qualification shares within the time specified in Companies Act. (November, 2000)

Answer

Under Section 270 of the Companies Act, 1956, the director must obtain qualification shares within two months from the date of appointment. In this case, he was appointed on 2.5.2000 and therefore he must obtain qualification shares on or before 2nd July, 2000 but the shares were allotted on 10th July, 2000. Only after the date of allotment, he was looking those shares and not on the date of application. Therefore, the argument of A is not correct.

Question 3

- (i) *The Articles of Association of MKP Limited incorporated with an Authorised Share Capital of Rs.50 crores divided into 5 crore Equity Share of Rs.10 each contained the following clause:*

“The qualification of a director shall be the holding of at least 1,000 Equity Shares in the Company and such a director, if not already so qualified shall have to obtain his qualification within a period of 30 days from the date of his appointment as a director.”

Examine the validity of the above clause in the light of the provisions of the Companies Act, 1956.

- (ii) *Redraft the above clause which would conform to the provisions of the Companies Act, 1956. (November, 2004)*

Answer

- (i) The subject matter of the question is covered by the provisions of section 270 of the Companies Act, 1956. The Companies Act, 1956 does not provide for any qualification for becoming a director of any company. According to the said section, any person appointed as a director is required to obtain the qualification if it is so provided by the Articles of Association of the company.

The said section states that in case the Articles of Association of a company provides

for the qualification of a director, then such a director is required to obtain the requisite qualification within a period of two months from the date of his appointment as a director. The section further states that any clause in the Articles of Association requiring the director to obtain the qualification shares within a shorter time than two months shall be void.

The said section also puts a maximum limit on the qualification that can be prescribed by the Articles of Association. Such maximum limit being shares with nominal value not exceeding Rs.5,000 or in a case where the nominal value of one shares exceeds Rs. 5,000 then the qualification share shall be maximum one share.

Based on the provisions of section 270 of the Companies Act, 1956 as explained above, the clause in the Articles of Association as given in the question is void since it stipulates the obtaining of the qualification shares within a period of 30 days which is shorter than two months. Moreover the clause also violates the maximum limit of share qualification by prescribing the same to be 1,000 shares of Rs.10 each totaling Rs.10,000 which is more than the limit of Rs. 5,000 as prescribed in the said section.

- (ii) The clause to be included in the Articles of Association regarding qualification of directors conforming to the provisions of the Companies Act, 1956 may be as follows:

“The qualification of a director shall be the holding of shares with a nominal value not exceeding Rs.5,000 or one share with a nominal value of Rs.5,000, and such a director if not already so qualified shall have to obtain his qualification within a period of two months from the date of his appointment as a director.”

Question 4

The Articles of Association of MKP Limited incorporated with an Authorised Share Capital of Rs.50 crores divided into 5 crores Equity Shares of Rs.10 each contained the following clause:

“The qualification of a director shall be the holding of at least 1,000 Equity shares in the Company and such a director if not already so qualified shall have to obtain his qualification within a period of 30 days from the date of his appointment as director.”

Examine the validity of the above clause in the light of the provisions of the Companies Act, 1956.

(CA Final, New Course, June 2009)

Answer

The subject matter of the question is covered by the provisions of Section 270 of the Companies Act, 1956. The companies Act, 1956 does not provide for any qualification for becoming a director of any company. According to the said Section, any person appointed as a director is required to obtain the qualification if it is so provided by the Articles of Association of the Company.

The said Section states that in case the Articles of Association of a company provides for the qualification of a director, then such a director is required to obtain the requisite qualification within a period of two months from the date of his appointment as a director. The Section further states that any clause in the Articles of association requiring the director to obtain the qualification shares within a shorter time than two months shall be void.

The said Section also puts a maximum limit on the qualification that can be prescribed by the Articles of Association. Such maximum limit being shares with nominal value not exceeding Rs. 5,000 or in a case where the nominal value of one share exceeds Rs. 5,000 then the qualification share shall be maximum one share.

Based on the provisions of Section 270 of the Companies Act, 1956 as explained above, the clause in the Articles of Association as given in the question is void since it stipulates the obtaining of the qualification shares within a period of 30 days which is shorter than two months. Moreover the clause also violates the maximum limit of share qualification by prescribing the same to be 1,000 shares of Rs.10 each totaling Rs.10,000 which is more than the limit of Rs. 5,000 as prescribed in the said Section.

It is pertinent to note that as per Section 9 of the Companies Act, 1956, any clause in the Articles of Association of any company which is ultra virus the Act is void.

Question 5

The Articles of Association of MKP Limited incorporated with an Authorised Share Capital of Rs.50 crores divided into 5 crores Equity Shares of Rs.10 each contained the following clause:

“The qualification of a director shall be the holding of at least 1,000 Equity shares in the Company and such a director if not already so qualified shall have to obtain his qualification within a period of 30 days from the date of his appointment as director.”

Examine the validity of the above clause in the light of the provisions of the Companies Act, 1956.

(CA Final, New Course, June 2009)

Answer

The subject matter of the question is covered by the provisions of Section 270 of the Companies Act, 1956. The companies Act, 1956 does not provide for any qualification for becoming a director of any company. According to the said Section, any person appointed as a director is required to obtain the qualification if it is so provided by the Articles of Association of the Company.

The said Section states that in case the Articles of Association of a company provides for the qualification of a director, then such a director is required to obtain the requisite qualification within a period of two months from the date of his appointment as a director. The Section further states that any clause in the Articles of association requiring the director to obtain the qualification shares within a shorter time than two months shall be void.

The said Section also puts a maximum limit on the qualification that can be prescribed by the Articles of Association. Such maximum limit being shares with nominal value not exceeding Rs. 5,000 or in a case where the nominal value of one share exceeds Rs. 5,000 then the qualification share shall be maximum one share.

Based on the provisions of Section 270 of the Companies Act, 1956 as explained above, the clause in the Articles of Association as given in the question is void since it stipulates the obtaining of the qualification shares within a period of 30 days which is shorter than two months. Moreover the clause also violates the maximum limit of share qualification by prescribing the same to be 1,000 shares of Rs.10 each totaling Rs.10,000 which is more than the limit of Rs. 5,000 as prescribed in the said Section.

It is pertinent to note that as per Section 9 of the Companies Act, 1956, any clause in the Articles of Association of any company which is ultra virus the Act is void.

Penalty (Section 272)

Question 6

Mr. Busybody has been appointed as a Director of ACE Automobiles Limited on 2nd April, 2002. The articles of association of the company provide that the qualification of a director shall be holding of at least 10 shares in the company. Mr. Busybody applied for 10 equity shares of the company on 31st May, 2002. But the shares were allotted only at the Board meeting held on 19th August, 2002. Examine with reference to the relevant provisions of the Companies Act, 1956 whether Mr. Busybody has complied with the requirements relating to qualification shares. If not, what are the consequences? **(May, 2003)**

Answer

The Companies Act, 1956 does not provide for any share qualification of any director. But Regulation 66 of Table A provides that a Director must hold at least one share in the company. Usually the Articles of a company provides for holding qualification share by a Director. Where a share qualification has been prescribed in the Articles of a company which is a public company or a private company which is a subsidiary of a public company, the provisions of section 270 regarding holding of share qualification by a Director shall apply whereby such director must take his qualification share within 2 months after his appointment.

If a person acts as a director without acquiring the qualification share in accordance with the provisions of section 270, he shall be punishable with fine which may extend to Rs.500/- for every day during which he continues to act as a director (Section 272). Moreover a director who fails to hold qualification shares is liable to vacate his office. (Section 283(i)(a)).

In this case, Mr. Busybody was appointed as Director of ACE Automobiles Ltd on 2nd April, 2002. He applied for shares of the company on 31st May, 2002 which was allotted only at the Board Meeting held on 19th August 2002. Unless the shares applied for by Mr. Busybody has

been allotted in his favour it cannot be said that he held the shares before expiry of 2 months from the date of his appointment. Therefore Mr. Busybody must vacate his office of director.

Question 7

The articles of association of DEF Ltd. mentioned in it that Mr. X and Mr. Y will act as directors of the company from the date of incorporation. The company was incorporated on 2nd January, 2007. The articles also provided that the directors will have to obtain qualification shares within one month from the date of appointment as director. Mr. X purchased the shares of the company on 28th February, 2007 and Mr. Y purchased on 28th March, 2007 thus violating the provisions contained in the articles. Having regard to the provisions of the companies Act. Examine the validity of the appointments of Mr. X and Mr. Y as directors.
(November 2007)

Answer

Without prejudice to the restrictions imposed by section 266, it shall be the duty of every director who is required by the articles of the company to hold a specified share qualification and whom is not already qualified in that respect, to obtain his qualification within two months after his appointment as director [Section 270(1)]

So it becomes incumbent on the part of every director to hold qualification share within the time specified and if he does not held the same at the time of his appointment as director he must acquire them within two months after his appointment as director. Any provision made in the articles of the company requiring a person proposed for directorship to hold qualification share either before appointment or within a shorter than two month after his appointment will be void.

Here the provision in the articles of association to hold shares within one month shall be void. Keeping the above provision in consideration the appointment of Mr. X will be valid as he acquired the share before the expiry of two months. As far the appointment of Mr. Y is concerned he has failed to acquire the share within two-month period. As per section of 283(1)(a) the office of director shall become vacant if he fails to obtain the shares within the time specified in section 270(1) therefore Mr. Y shall have to vacate his office. Here the date of incorporation is taken as the date of appointment.

Question 8

The Articles of Association of Sunrise Ltd. provide that the qualification of a director shall be holding of at least 10 shares in the company. Mr. Rao has been appointed as a director in the said meeting on 1st May, 2008. Mr. Rao applied for 10 equity shares of the company on 30th July, 2008. The said shares were allotted to him on 20th August, 2008 when the Board meeting was held.

Discuss the relevant provisions of the Companies Act, 1956 in the matter of share qualification requirements and the consequences of non-compliance thereof. Also state whether Mr. Rao has complied with the requirements in this regard.
(November 2008)

Answer

The Companies Act, 1956 does not provide for any share qualification of any director but Regulation 66 of Table 'A' provides that a director must hold at least one share in the company. Usually, the articles of the company provide for holding qualification shares by a director. Where a share qualification has been prescribed in the Articles of a company which is a public company or a private company which is a subsidiary of a public company, the provisions of Section 270 of the Companies Act, 1956 is applicable where under a director must take his qualification shares within 2 months after his appointment. Any provision in the articles of the company shall be void in so far as it requires a person to hold the qualification shares before his appointment as a director or to obtain them within a shorter time than two months after his appointment as such. The nominal value of the qualification shares shall not exceed Rs.5000/- or the nominal value of one share where it exceed Rs.5000/.

A person acting as a director without acquiring qualification shares is punishable under Section 272 of the said Act. Moreover, a director who fails to hold qualification shares is also liable to vacate his office under Section 283 of the Companies Act, 1956.

In the instant case Mr. Rao was appointed as Director of Sunrise Limited on 1st may 2008. He applied for shares of the company on 30th July 2008 which were allotted only at the Board meeting held on 20th August 2008. It can not therefore be said that he held the shares before expiry of 2 months from the date of his appointment. In view of this Mr. Rao must vacate his office as director as provided in Section 283(1)(a).

DISQUALIFICATIONS OF DIRECTORS (SECTION 274)

Question 1

Whether the following persons can be appointed as a Director of a Public company:

- (i) *Mr. John, who has huge personal liabilities far in excess of his Assets and Properties, has applied to the court for adjudicating him as an insolvent and such application is pending.*
- (ii) *Mr. Smith, who was caught red-handed in a shop lifting case two years ago, was convicted by a court and sentenced to imprisonment for a period of eight weeks.*
- (iii) *Mr. Tom, a Former Bank Executive, was convicted by a court eight years ago for embezzlement of funds and sentenced to imprisonment for a period of one year.*
- (iv) *Mr. Samuel is a Director of PQR Limited, which has not filed its Annual Returns pertaining to the Annual General Meetings held in the calendar years 2006, 2007 and 2008. Advice.*

Answer

All the cases stated above are based on the provisions of Section 274(1) of the Companies Act, 1956 dealing with disqualifications of directors. Based on the provisions of the said section, each case can be discussed as follows:

- (a) Section 274(1)(c) states that a person shall not be capable of being appointed as a director of a company if he has applied to be adjudicated as an insolvent and his application is pending in the present case, Mr. John has applied to be adjudicated as an insolvent and his application is pending with the Court. Hence, he cannot be appointed as a Director of a Company – whether public or private.
- (b) Section 274(1)(c) states that a person shall not be capable of being appointed as a director of a company if he has been convicted by a court of any offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than six months, and a period of five years has not elapsed from the date of expiry of the sentence. In the present case, although the sentence was only two years ago, but the period of sentence was only eight weeks, i.e., less than six months. Hence, Mr. Smith

does not come under the prescribed disqualification and can be appointed as a director of a company.

- (c) This case also falls within the provisions of section 274(1)(c). In this case the imprisonment was for a period of one year, i.e., for more than six months, but since more than five years have elapsed from the expiry of the sentence, Mr. Tom has come out of the prescribed disqualification and can be appointed as a director of a company.
- (d) Section 274(1)(g) states that a person who is already a director of a public company which has not filed the annual accounts and annual returns for any continuous three years, then such a person shall not be eligible to be appointed as a director of another public company. In the present case, PQR Limited has failed to file only annual returns and not annual accounts. Hence, the disqualification for Mr. Samuel is not attracted and he can be appointed as a director.

Question 2

Mr. A is a director of ABC Limited failed to repay matured deposits from 1st April, 2001 onwards and the default continues. But ABC Limited is regular in filing annual accounts and annual returns. Mr. A is also a director of PQR Limited and XYZ Limited.

Answer the following questions with reference to the relevant provisions of the Companies Act, 1956:

- (i) *Whether Mr. A is disqualified under Section 274(1)(g) of the Companies Act, 1956 and if so, whether he is required to vacate his office of director in PQR Limited and XYZ Limited.*
- (ii) *Is it possible for Board of Directors of DEF Limited to appoint Mr. A as an Additional Director at the board meeting to be held on 15th May, 2002? Would your answer be different if Mr. A ceased to be a Director of ABC Limited by resignation on 1st March, 2002?*

State also the auditor's responsibility with regard to reporting of disqualification under Section 274(1)(g). **(May, 2002)**

Answer

- (1) A person who is already a director of a public company becomes disqualified for being appointed as a director, if the concerned company has committed default on either of the two counts mentioned in sub-clauses (A) and (B) of section 274 (1) (g) of the Companies Act, 1956. In this case ABC Ltd., is regular in filing annual accounts and annual returns. But ABC Ltd failed to repay matured deposits from 1st April 2001 onwards and such failure continues for more than one year. Hence ABC Ltd committed default under section 274(1)(g)(B) and Mr. A, being a director of ABC Ltd is disqualified under Section 274(1)(g).

This disqualification would come into operation only at the time of appointment or reappointment of Mr. A as a director in any other public company after the default has become effective. Hence Mr. A. need not vacate the office of director in PQR Ltd and XYZ Ltd as there is no such requirement either in section 274 or in section 283 which provides for vacation of office.

- (2) According to proviso to section 274(1)(g), Mr. A is disqualified to act as director of any other public company for a period of 5 years from the date on which ABC Ltd. in which he is a director makes default under section 274(1)(g)(A) or 274(1)(g)(B). Hence, the Board of Directors of DEF Ltd cannot appoint Mr. A as additional director at the board meeting to be held on 15th May 2002.

The words 'such a person is already a director of public company' in section 274(1)(g) indicates that this disqualification would attach only if the two conditions are satisfied (i) either of the two defaults have taken place while the person was a director of the concerned public company and (ii) he holds that directorship at the time of his appointment/re-appointment in public company. The essential condition, therefore, is that a person should be a director of a public company at the relevant time when the default under sub-clause (B) takes place. The failure under sub-clause (B) takes place only when such failure continues for one year or more. If Mr. A ceased to be a director of ABC Ltd. by resignation on 1st March 2002, he would not attract disqualification for a period of 5 years from being eligible to be appointed as a director of any other public company. Hence Mr. A can be appointed as a director in DEF Ltd.

The auditor is required to state in his report whether any of the directors of the company, whether public or private are disqualified from being appointed as a director in terms of section 274(1)(g). [Section 227(3)(f)]. Section 274(1)(g) is applicable to appointment of directors both in public and private companies but the reporting will be limited to this directors of a company who are also directors of any public company.

Question 3

Mr. Ram is a Director of ABC Limited, XYZ Limited and PQR Limited. ABC Limited was regular in filing annual returns, but did not file annual accounts for the year ended 31st March, 2002. Further ABC Limited failed to pay interest on loans taken from a public financial institution from 1st January, 2002 onwards and also failed to repay the matured deposits on due date from 1st April, 2002 onwards.

Mr. Ram is proposed to be appointed as additional director of MN Limited on 1st June, 2003. MN Limited has sought a declaration from Mr. Ram to the effect that the disqualification specification Section 274(1) (g) of the Companies Act, 1956 is not applicable in his case. Mr. Ram seeks your advice on the following:

- (i) *Whether it is in order for him to give the declaration sought by MN Limited in view of the defaults committed by ABC Limited.*
- (ii) *Whether he can continue as a Director in XYZ Limited and PQR Limited and also seek reappointment when he retires by rotation at the annual general meetings of respective companies to be held in September, 2003.*

Advise explaining the relevant provisions of the Companies Act, 1956. Would your answer be different, if Mr. Ram resigned his office of director in ABC Limited on 31st December, 2002?

(May 2003)

Answer

According to Section 274 (1)(g) of the Companies Act, 1956, a person who is already a director of a public company becomes disqualified for being appointed as director; if the concerned company has committed default on either of the two counts mentioned below:-

- (i) The concerned public company has not filed the annual accounts and annual returns for any continuous three financial years commencing on and after 1st April, 1999 or
- (ii) The concerned public company has failed to repay its deposit or interest on due date or redeem its debentures on due date or pay dividends and such failure continues for one year or more.

Such a person is disqualified to act as a director of any other public company for a period of five years from the date on which the public company (in which he is a director) makes default as specified in the (A) or (B) above.

Here Mr. Ram is a director of ABC Ltd. ABC Ltd was regular in filing annual returns but did not file annual accounts (i.e. Balance sheet and profit and loss accounts) for only one year i.e financial year ended 31st March 2002. The disqualification specified in 274(i)(g) (A) will not apply unless the company has committed defaults in respect of both the matters i.e annual returns and annual accounts for three consecutive financial years. Hence Section 274(i)(g)(s) is not attracted in this case.

ABC Ltd. failed to pay interest on term loan taken from a public financial institution from 1.1.2002 onwards and also failed to repay matured deposits from 1.4.2002 onwards. The disqualification specified in sub-clause (B) will not apply unless the company has committed default in respect of loans from public financial institution is not covered under section 276(i) (g)(B). But as ABC Ltd has failed to repay its deposits on due date and the failure continues for more than one year, Mr. Ram is disqualified under section 274(1)(g)(B) and he cannot give the declaration sought by MN Ltd. In view of his disqualification u/s 274(1)(g)(B), Mr. Ram is not eligible to be appointed as additional director in MN Ltd. from 1st June 2003 onwards.

The disqualification would come into operation only at the time of appointment or reappointment of Mr. Ram as director on any public company after the default has become effective. Till such time, Mr. Ram can continue to hold the office of director in all public companies in which he is a director. He need not vacate the office of director in XYZ Ltd and PQR Ltd. as there is no such requirement either in section 274(1)(g) or section 283 (Section 283 stipulates the circumstances under which the office of a director shall become vacant). But Mr. Ram cannot seek reappointment on XYZ Ltd and PQR Ltd when he returns by rotation at the AGMs to be held in September, 2003.

If Mr. Ram resigned his office of director in ABC Ltd. on 31st December 2002, he is not a director when the default u/s 274(i)(g)(B) becomes effective i.e. 31st March, 2003. Hence he can give the declaration sought by MN Ltd. He can also seek re-appointment as a director in XYZ Ltd. and PQR Ltd. when he retires by rotation.

Question 4

State with reference to the relevant provisions of the Companies Act, 1956 whether the following persons can be appointed as a Director of a Public company:

- (i) *Mr. A, who has huge personal liabilities far in excess of his Assets and Properties, has applied to the court for adjudicating him as an insolvent and such application is pending.*
- (ii) *Mr. B, who was caught red-handed in a shop lifting case two years ago, was convicted by a court and sentenced to imprisonment for a period of eight weeks.*
- (iii) *Mr. C, a Former Bank Executive, was convicted by a court eight years ago for embezzlement of funds and sentenced to imprisonment for a period of one year.*
- (iv) *Mr. D is a Director of DLT Limited, which has not filed its Annual Returns pertaining to the Annual General Meetings held in the calendar years 2001, 2002 and 2003.*

(May, 2004)

Answer

All the cases stated in the question are based on the provisions of Section 274(1) of the Companies Act, 1956 dealing with disqualifications of directors. Based on the provisions of the said section, each case can be discussed as follows:

- (a) Section 274(1)(c) states that a person shall not be capable of being appointed as a director of a company if he has applied to be adjudicated as an insolvent and his application is pending in the present case, Mr. A has applied to be adjudicated as an insolvent and his application is pending with the Court. Hence, he cannot be appointed as a Director of a Company – whether public or private.
- (b) Section 274(1)(c) states that a person shall not be capable of being appointed as a director of a company if he has been convicted by a court of any offence involving

moral turpitude and sentenced in respect thereof to imprisonment for not less than six months, and a period of five years has not elapsed from the date of expiry of the sentence. In the present case, although the sentence was only two years ago, but the period of sentence was only eight weeks, i.e., less than six months. Hence, Mr. B does not come under the prescribed disqualification and can be appointed as a director of a company.

- (c) This case also falls within the provisions of section 274(1)(c). In this case the imprisonment was for a period of one year, i.e., for more than six months, but since more than five years have elapsed from the expiry of the sentence, Mr. C has come out of the prescribed disqualification and can be appointed as a director of a company.
- (d) Section 274(1)(g) states that a person who is already a director of a public company which has not filed the annual accounts and annual returns for any continuous three years, then such a person shall not be eligible to be appointed as a director of another public company. In the present case, DLT Limited has failed to file only annual returns and not annual accounts. Hence, the disqualification for Mr. D is not attracted and he can be appointed as a director.

Question 5

Clever, a Director of ABC Ltd. Made default in filing of Annual Accounts and Annual Returns with the Registrar of Companies for a continuous period of three financial years ending 31st March, 2005. Referring to the provisions of the Companies Act, 1956 examine the validity of the following:

- (i) *Whether X can continue to be a Director of ABC Ltd. And also EF Ltd., where he is a Director. Also state whether he can be reappointed as a Director in ABC Ltd. as well as EF Ltd.*
- (ii) *Would your answer be still the same in case X is a nominee Director of a Public Financial Institution?*
- (iii) *What would be your answer in case the defaulting company (i.e. ABC Ltd.) is a Private Company?*
(May 2006)

Answer

In accordance with the provisions of Section 274(1)(g) a person shall not be capable of being appointed as director of a company if such person is already a director of a public company, which –

- (A) has not filed the annual accounts and annual returns for any continuous three financial years commencing on and after the first day of April, 1999;

Provided that such person shall not be eligible to be appointed as a director of any other public company for a period of 5 years from the date on which such public

company, in which he is a director failed to file annual accounts and annual returns under this clause.

Applying the above provisions as contained in Section 274(1)(g), answers to the given questions are:

1. In the given case, Mr. Clever, the Director of ABC Ltd. is disqualified to be appointed as Director of other public companies for a period of 5 years from the date on which default has been committed.
2. In the second case, Mr. Clever, as a nominee of the Public Financial Institution, shall not be disqualified to be appointed as Director for the reason that the Public Financial Institutions are exempted from the provisions of Section 274(1)(g) of the Companies Act, 1956.
3. A director of a private company is not disqualified even if that company is a defaulter in filing return.

Mr. Clever does not cease to be a director in ABC Ltd. and EF Ltd. immediately because Section 283 which provides for 'vacation of office' has not been amended. He can continue as a director till his term ends. But he can be reappointed in the defaulting company ABC Ltd., but not in EF Ltd. as the disqualification applies only to 'any other public company'.

Question 6

Mr. John is a director of MNC Ltd., which had accepted deposits from public. The Financial position of MNC Ltd. turned very bad and it failed to repay the deposits which fell due for payment on 10th April, 2007 and such repayment has not been made till 5th May, 2008. Another company JKL Ltd. wants to appoint the said Mr. John as its director at its annual general meeting to be held on 6th May, 2008. You are required to state with reference to the provisions of the Companies Act, 1956 whether Mr. John can be appointed as a director of JKL Ltd.

(May 2008)

Answer

Section 274(1) (g) of the Companies Act, 1956 states that where a person is a director of a public company which has failed to repay its deposit on due date and such failure continues for one year or more, then such person shall not be eligible to be appointed as a director of any other public company for a period of five years from the date on which such public company, in which he is a director, failed to repay its deposit. In the instant case, MNC Ltd., has failed to repay its deposit on due dates and the default continues for more than one year. Hence, Mr. John will not be eligible to be appointed as a director of JKL Ltd.

Question 7

Mr. Ramanathan is a Director of Fraudulent Ltd, Honest Ltd. and Regular Ltd. For the financial year ended on 31st March, 2008 two irregularities were discovered against fraudulent

Ltd. for the financial year ended on 31st March, 2008 two irregularities were discovered against Fraudulent Ltd. Fraudulent Ltd. did not file its annual accounts for the year ended 31.3.2008 and failed to pay interest on loans taken from a financial institution for the last three years.

On 1st June, 2009 Mr. Ramnathan is proposed to be appointed as additional director of Goodwill Ltd, which company has sought a declaration from Mr. Ramnathan and he also submitted the declaration stating that the disqualification specified in Section 274 of the Companies Act, 1956 is not attracted in his case. Decide under the provisions of the Companies Act:

- (i) Whether the declaration submitted by Mr. Ramanthan to Goodwill Ltd. is in order?*
- (ii) Whether Mr. Ramnathan can continue as a Director in Honest Ltd. and Regular Ltd.? (June 2009)*

Answer

According to section 274 (1) (g) of the Companies Act, 1956, a person who is already a Director of a public company becomes disqualified for being appointed as Director, if the concerned company has committed default on either of the two counts mentioned below:-

- (a) The concerned public company has not filed the annual accounts and annual return for any continuous three years (financial) commencing on and after 1st April, 1999 or.
- (b) The concerned public company has failed to repay its deposits or interests on due date or redeem its debentures on due date or pay dividend and such failure continues for one year or more.

Such a person is disqualified to act as a Director of any other public company for a period of five years from the date on which the public Company make default as specified above.

Here Mr. Ramanthan is a Director of Fraudulent Limited. Fraudulent Limited was regular in filing Annual returns but did not file annual accounts for only one year i.e. financial year ended 31st March, 2008. The disqualification will not apply unless the company has committed defaults in respect of both the matters for three consecutive financial years. Hence the provision of section 274 is not attracted.

The disqualification specified in sub-clause (b) is not applicable in matter of loans from public financial institutions. In view of this Mr. Ramnathan is eligible to be appointed as additional Director in Goodwills Limited and declaration submitted by him is in order

The disqualification if any would come in to operation only at the time of appointment or reappointment Hence Mr. Ramnathan can continue as director of Honest Ltd and Regular Ltd.

Question 8

Mr. Ravindranathan is holding the post of Director in three companies out of which Goodluck Colours Limited is one. For the financial year ended on 31st March, 2009, Goodluck Colours

Limited failed to pay interest on loans taken from a financial institution and also failed to repay the matured deposits. On 1st June, 2009 Mr. Ravindranathan accepting the post of Additional Director in Soma Footwear Limited, submitted a declaration that the disqualification specified in Section 274 of the Companies Act, 1956 is not applicable in his case. Decide whether the declaration submitted by Mr. Ravindranathan to Soma Footwear Limited is in order.

(CA Final, New Course, May 2010)

Answer

According to Section 274(1)(g) of the Companies Act, 1956 a person who is already a director of a public company becomes disqualified for being appointed as Director if the concerned public company has failed to repay its deposits or interest on due date or pay dividend and such failure continues for one year or more. The disqualification specified in Section 274(i) (g) of the Companies Act, 1956 is not applicable in matters of loan from public financial institutions. But Goodluck Colours Limited has failed to repay its deposits on due date and the said failure continues for more than one year, Mr. Ravindranathan is disqualified under the said section of the said Act. The declaration submitted by him is not in order and he is not eligible to the appointment as Additional Director in Soma Footwear Limited.

RESTRICTIONS ON THE NUMBER OF DIRECTORSHIPS (SECTIONS 275 – 279)

No person to be a director of more than fifteen companies (Section 275)

Question 1

Mr. Influential is already a director of 19 companies. He is being appointed as a director of another company named M/s Expensive Remedies Ltd. Advise Mr. Influential in regard to the following:

- (i) *Restrictions on the number of directorships to be held by an individual and whether he can accept the new appointment in view thereof.*
- (ii) *What are the companies to be excluded for the purpose of calculating the ceiling on the appointment of directors?* **(November, 2001)**

Answer

- (i) After the commencement of the Companies (Amendment) Act, 2000, (i.e. w.e.f. 14.12.2000), no person, shall save as otherwise provided in section 276, hold office at the same time as director in more than 15 companies (Section 275). Earlier the limit was 20 companies.

For calculating the limit certain companies are to be excluded as provided in section 278(1).

Any person holding office as Director in more than 15 companies immediately before the commencement of the Companies (Amendment) Act, 2000, has to make a choice of 15 companies in which he wishes to continue as Director. He has to make this choice within 2 months from the commencement of the Companies (Amendment) Act, 2000 (i.e. 12.2.2001) [Section 276(1)]. No such person shall act as a director in more than 15 companies after the expiry of 2 months from the commencement Companies (Amendment) Act, 2000 [Section 276 (3) (1)].

In view of the above, it is not possible for Mr. Influential to be a director in 19 companies after excluding the companies listed in section 278 (1). In the absence of information about companies, it is not possible to ascertain the exact number of directorship held by Mr. Influential for the purpose of section 275.

There are two possibilities. Either Mr. Influential is a director in less than 15 companies (say 14 Companies) or 15 Companies. If he is a director in 14 Companies he can accept the directorship of M/s Expensive Remedies Limited. If he is already a director in 15 companies, he must within 15 days of his appointment as a director in M/s Expensive Remedies Ltd., relinquish any of his directorship. If he does not exercise the option within 15 days and does not vacate his directorship in any of the 15 companies, the appointment in M/s Expensive Remedies Ltd., shall become void immediately on the expiry of the 15 days [Section 277(1)].

- (ii) For calculating the limit of 15 companies the following companies can be excluded:
- (i) a private company which is neither a subsidiary nor a holding company of a public company.
 - (ii) An unlimited company.
 - (iii) An association not carrying on business for profit or which prohibits the payment of a dividend.
 - (iv) A company in which the person is only acting as alternate director.[Section 278(1)].

In making the above said calculation, any company referred to in (i), (ii) & (iii) above shall be excluded for a period of 33 months from the date on which the company ceases to fall within the purview of these clauses [Section 278(2)].

Question 2

Mr. PMC is Director in 14 Public Limited Companies as on 30th July, 2003. He continues to be so till 4th September, 2003. The following companies appoint Mr. PMC as a Director at their respective Annual General Meetings held on dates mentioned against their names.

- (i) PQR Ltd. (AGM held on 29th September, 2003).
- (ii) BCD Private Ltd. (AGM held on 25th September, 2003).
- (iii) City Traders Association (A company registered under Section 25 of the Companies Act, 1956- AGM held on 26th September, 2003).
- (iv) TSP Ltd. (AGM held on 25th September, 2003).

You are required to state with reference to the relevant provisions of the Companies Act, 1956 the options available to Mr. PMC in respect of accepting or not accepting the appointment of Director of the above companies. **(November, 2003)**

Answer

Section 275 of the Companies Act, 1956 debars any person to hold office as a director of more than 15 companies simultaneously. As per provisions of Section 277(2) of the Companies Act, 1956 where a person holds directorship of 14 or less companies is

appointed as a director of other companies and such appointments make the total number of his directorships more than 15, then the person concerned has to choose the directorships which he wishes to continue to hold or to accept so that the total number of directorships, old and new henceforth to be held by him does not exceed 15.

The said section further provides that none of the new appointments shall be effective until such a choice is to be made and in case of failure of the person to make such a choice within 15 days of the day on which the last of the new appointments was made, all the new appointments shall become void.

Section 278 of the Companies Act, 1956 states that for the purpose of section 275 and section 277 the number of companies of which a person maybe a director, following companies are not to be counted:

- (a) A private company unless it is a subsidiary of a public company.
- (b) An unlimited company.
- (c) An association not carrying on business for profit or which prohibits the payment of dividend.
- (d) A company in which such a person is only an alternate director.

In view of the above mentioned legal provisions, Mr. PMC who is already a director in 14 companies has to consider the following aspects:

As per provisions of section 278 of the Companies Act, 1956, BCD Private Ltd. being a private company and City Traders Association being an association not carrying on business for profit and prohibiting payment of dividend by virtue of being a company registered under section 25 are not to be counted for the purpose of section 277 read with section 275.

Thus, Mr. PMC can accept the appointment in BCD Private Ltd and City Traders Association without any obstacle.

The appointment of Mr. PMC in the other two public companies along with the old directorships in 14 companies makes a total of 16, which is in excess of 15 prescribed by section 275. As per provisions of section 277, Mr. PMC has to decide within 15 days from 29th September, 2003, the date on which the last appointment was made, as to the directorships which he wishes to continue to hold or to accept so that the number of his total directorships does not exceed 15 and in case he fails to decide within the said 15 days, then his appointments as a director of PQR and TSP Ltd shall become void on the expiry of the said 15 days.

Question 3

Mr. Raj is director in 14 public limited companies as on 30th July, 2007 and continues to be so till 26th September, 2007. The following companies appoint Mr. Raj as a director at their

respective Annual General Meetings held on dates mentioned against their names:

- (1) MLP Ltd. (AGM held on 27th September, 2007)
- (2) PAT Private Ltd. (AGM held on 25th September, 2007)
- (3) Retail Traders Association (a company registered under Section 25 of the Companies Act, 1956 (AGM held on 26th September, 2007)
- (4) KMC Ltd. (AGM held on 29th September, 2007)

You are required to state with reference to the relevant provisions of the Companies Act, 1956 the options available to Mr. Raj in respect of accepting or not accepting the appointment of the above companies.
(May 2008)

Answer

Section 275 of the Companies Act, 1956 debars any person to hold office as a director of more than 15 companies simultaneously.

As per the provisions of Section 277(2) of the Companies Act, 1956 where a person holds directorship of 14 or less companies is appointed as a director of other companies and such appointments make the total number of his directorships more than 15, then the person concerned has to choose the directorships which he wishes to continue to hold or to accept so that the total number of directorships, old or new, henceforth to be held by him does not exceed 15.

The said section further provides that none of the new appointments shall be effective until such a choice is to be made and in case of failure of the person to make such a choice within 15 days of the day on which the last of the new appointments was made, all the new appointments shall become void.

Section 278 of the Companies Act, 1956 states that for the purpose of Section 275 and Section 277 the number of companies of which a person may be a director, following companies are not to be counted.

- (a) A private company unless it is a subsidiary of a public company
- (b) An unlimited company
- (c) An association not carrying on business for profit or which prohibits the payment of dividend
- (d) A company in which such person is only an alternate director.

In view of the abovementioned legal provisions, Mr. Raj who is already a director in 14 companies has to consider the following aspects.

As per provisions of Section 278 of the Companies Act, 1956 PAT Private Ltd. being a private company and Retail Traders Association being an association not carrying on business for profit and prohibiting payment of dividend by virtue of being a company registered under section 25 are not to be counted for the purpose of Section 277 read with Section 275.

Thus Mr. Raj can accept the appointment in PAT Private Ltd. and Retail Traders Association without any obstacle.

The appointment of Mr. Raj in the other two public companies along with the old directorships in 14 companies makes a total of 16 which is excess of 15 prescribed by Section 275. As per provisions of Section 277, Mr. Raj has to decide within 15 days from 29th September, 2007, the date on which the last appointment was made, as to the directorships which he wishes to continue hold or to accept so that the number of his total directorships does not exceed 15 and in case he fails to be decide within the said 15 days then his appointments as a director of MLP Ltd. and KMC Ltd. shall become void on the expiry of the said 15 days.

Note: A different view can also be taken to the extent that the appointment of Mr. Raj in MLP Ltd. on 26th September, 2007 will make the total number of directorships to 15 which is within the prescribed parameters. However, his appointment as Director of KMC Ltd. on 29th September, 2007 will make it 16 which is in excess of the permissible limit. Hence, the appointment in KMC Ltd. will become void and ineffective in case Mr. Raj does not decide about which of the two companies he should choose within 15 days.

VACATION OF OFFICE BY DIRECTORS (SECTIONS 283 – 284)

Removal of Directors (Section 284)

Question 1

Mr. Stubborn is a director of M/s Doubtful Industries Ltd. He along with other two directors has been running the Company for the past twenty years without declaring any dividends or giving any benefit to the shareholders. Frustrated by this, some shareholders are desirous of giving notice to pass a resolution with the support of other shareholders for his removal as a director in the Annual General Meeting of the Company to be held in the month of December of 2001. State the procedure to be followed for the removal of Mr. Stubborn as a director and the right of Mr. Stubborn to defend his position.

(November, 2001)

Answer

Mr. Stubborn a director of M/s Doubtful Industries Ltd., can be removed by following the procedure laid down in Section 284 of the Companies Act, 1956. The procedure is as under:

- (i) An ordinary resolution is required to be passed at the general meeting of the company.
- (ii) A special notice, as provided in Section 190 of the Act is required to be given to the company at least 14 days before the general meeting.
- (iii) On receipt of the notice, the company has to send a copy of the notice to Mr. Stubborn and he is entitled to be heard on the resolution at the meeting.
- (iv) Mr. Stubborn is also entitled to make a representation in writing to the company and the same has to be sent to all the members by the company.
- (v) In case the representation has reached or the same could not be sent to all the members the same has to be read out at the meeting.
- (vi) Such a representation need not be sent to the members or read out at the meeting if on the application of the company or any person aggrieved, the Company Law Board is satisfied that the rights conferred under this section are being abused to secure needless publicity for defamatory matter and passes an order to this effect.

If at the general meeting the resolution is passed by a simple majority, Mr. Stubborn will have to step down from the office as director of the company.

Question 2

- (i) *Mr. SDR, a shareholder in M/s JKP Ltd. holding ten equity shares of Rs. 10 each fully paid up wants to give a special notice to the company for removal of Mr. EDM, a Director of M/s JKP Ltd. without stating any reason in the notice. You are required to state as per the provisions of the Companies Act, 1956 and/or any decided case law whether Mr. SDR is entitled to do so.*
 - (ii) *Would your answer be different, if Mr. EDM was a Director appointed by the Central Government under Section 408 of the Companies Act, 1956?*
 - (iii) *Explain briefly the provisions of the Companies Act, 1956 relating to removal of a Director in case of receipt of an appropriate special notice by the company for this purpose.*
- (May, 2004)**

Answer

- (i) The problem as stated in the question is governed by the provisions of section 284 of the Companies Act, 1956. Sub-section (2) of the said section states that a special notice is required of any resolution to remove a director. The section does not put any condition in respect of the number of members or their shareholding and furnishing any reason therefore. Accordingly, the Karnataka High Court in the case of *Karnataka Bank Ltd. Vs. A.B. Datar & Others reported at [1994] 79 Comp. Cases 417* held that there is no requirement with regard to the number of members or their shareholding and even one member is entitled to give special notice for removal of director. The court also held that there is no need to give any reason for removal of a director in the resolution proposed to be moved. Hence Mr. SDR holding only ten equity shares can alone give a special notice for removal of Mr. EDM from the office of director of M/s JKP Ltd.
- (ii) According to section 284(1) of the Companies Act, 1956, the provisions relating to removal of directors are not applicable to the directors appointed by the Central Government under section 408 of the said Act. Hence, in case Mr. EDM was a director appointed by the Central Government under the said section 408, Mr. SDR would not be entitled to give any special notice under section 284 for removal of director.
- (iii) On receipt of notice of a resolution to remove a director, the relevant provisions of the Companies Act, 1956 in this regard are as follows:
 - (a) The company has to forward a copy of the notice to the concerned director. [Section 284 (3)].

- (b) The concerned director, whether he is a member of the company or not, shall be entitled to be heard on the resolution at the meeting. [Section 284 (3)].
- (c) In case the concerned director makes any representation in writing of reasonable length and requests the company to notify the same to the members of the company, the fact of receiving the representation should be stated in the notice of the meeting and a copy should be circulated to all the members of the company. [Section 284 (4)].
- (d) In case the representation received by the company is too late for inclusion in the notice or if there is an omission of the part of the company, the same should be read out at the meeting [Section 284(4)].
- (e) The company or the person who claims to be aggrieved may make an application to the Central Government seeking exemption from circulating or reading out the representation if the rights are sought to be abused to secure needless publicity for defamatory matter and the Central Government may pass an order granting such exemption. [Proviso to Section 284 (4)].

Question 3

Mr. Adam, a 15% shareholder of a company and other shareholders have lost confidence in the Managing Director (MD) of the company. He is a director not liable to retire by rotation and was re-appointed as Managing Director for 5 years w.e.f. 1.4.2005 in the last Annual General Meeting of the company.

Mr. Adam seeks your advise to remove the MD after following the procedure laid down under the Companies Act, 1956.

- (i) *Specify the steps to be taken by Mr. Adam and the Company in his behalf;*
- (ii) *Draft a suitable resolution to be passed for removal of MD;*
- (iii) *Is it necessary to state reasons to support the resolution for his removal? (May 2006)*

Answer

- (i) Under Section 284 of the Companies Act, 1956, a company may, by ordinary resolution, remove a director before the expiry of his tenure. For the purpose, special notice from a shareholder (Mr. Adam in the present case) shall be required to be given to the company for moving a resolution to remove a director. On receipt of notice, the company shall forthwith send a copy thereof to the director concerned (MD in the present case) and he shall be entitled to be heard on the proposed resolution at the meeting. Copy of the representation, if any, made by the director be also sent to all members of the company to whom notice of the general meeting is normally sent. In case, the representation is received too late, the same shall be read at the meeting.

The representation need not be sent if the Company Law Board is satisfied that it will cause needless publicity for defamatory matter.

Under Section 190, special notice of the intention to move the resolution shall be given not less than 14 days before the meeting.

In the present case, if the AGM is due to be held, Mr. Adam may send the special notice 14 days before the AGM. Otherwise, he may request the company to convert EGM under section 169 for consideration of the special notice and resolution for removal of MD. He already holds more than 10% shares in the company.

Once the ordinary resolution is passed in the general meeting, MD will cease to be a director of the company and consequently MD of the company.

- (ii) Mr. Adam may give special notice of his intention to move the following resolution, as ordinary resolution: "RESOLVED THAT Mr., Managing Director of the Company be and is hereby removed as a director of the company under Section 284 of the Companies Act, 1956 with immediate effect."
- (iii) A statement of reasons is not necessary to support the resolution for removal of a director. *LIC vs. Escorts Ltd. (1986) 59 Comp. Cases 548(SC)*

Question 4

- (i) *Mr. SDR, a shareholder in M/s JKP Ltd. Holding ten equity shares of Rs. 10 each fully paid up wants to give a special notice to the company for removal of a Mr. EDM, a director of M/s JKP Ltd. without stating any reasons in the notice. You are required to state as per the provisions of the Companies Act, 1956 and / or any decided case law whether Mr. SDR is entitled to do so?*
- (ii) *Would your answer be different, if Mr. EDM was a director appointed by the Central Government under Section 408 of the Companies Act, 1956?*
- (iii) *State the relevant provision of the Companies Act, 1956 in case of an appropriate special notice is received by the company for removal of any director. (May 2007)*

Answer

- (i) The problems as stated in the question is governed by the provisions of section 284 of the Companies Act, 1956. Sub-Section (2) of the said section stated that a special notice is required of any resolution to remove a director. The section states that a special notice is required of any resolution to remove a director. The section does not put any condition in respect of the number of members or their shareholding and furnishing any reason therefore. Accordingly the Karnataka High Court in the case of *Karnataka Bank Ltd. Vs. A.B. Datar & Other reported at [1994] 79 Comp. Cases 417* held that there is no requirement with regard to the number of members of their

shareholding and even one member is entitled to give special notice for removal of director, The Court also held that there is no need to give any reason for removal of a director in the resolution proposed to be moved. Hence Mr. SDR holding only ten equity shares can alone give a special notice for removal of Mr. EDM from the office of director of M/s. JK Ltd.

- (ii) According to section 284 (1) of the Companies Act, 1956, the provisions relating to removal of directors are not applicable to the directors appointed by the Central Government under section 408 of the said Act. Hence, in case Mr. EDM was a director appointed by the Central Government under the said section 408, Mr. SDR would not be entitled to give any special notice under section 284 for removal of director.
- (iii) On receipt of notice of a resolution to remove a director, the relevant provisions of the Companies Act, 1956 in this regard are as follows:
 - (a) The Company has to forward a copy of the notice to the concerned director, [Sec 284(3)].
 - (b) The concerned director, whether he is a member of the company or not, shall be entitled to be heard on the resolution at the meeting. [Sec 284(3)].
 - (c) In case the concerned director makes any representation in writing of reasonable length and requests the company to notify the same to the members of the company, the fact of receiving the representation should be stated in the notice of the meeting and a copy should be circulated to all the members of the company. [Sec. 284 (4)]
 - (d) In case the representation received by the company is too late for inclusion in the notice or if there is an omission of the part of the company, the same should be read out at the meeting. [Sec 284 (4)]
 - (e) The company or the person who claims to be aggrieved may make an application to the Central Government seeking exemption from circulation or reading out the representation if the rights are sought to be abused to secure needless publicity for defamatory matter and the Central Government may pass an order granting such exemption. [Proviso to Sec 284 (4)].
 - (f) The Central Government may also order the company's costs on the application to be paid in whole or in part by the director concerned notwithstanding that he is not a party to it. [Proviso to Sec 284 (4)].
 - (g) The Board of Directors is not entitled to appoint a person as a Director if he has been removed from his office under the provision of section 284 of the Companies Act, 1956. [Proviso to Sec 284 (6)]

MEETINGS OF BOARD (SECTIONS 285 – 290)

Board to meet at least once in every three calendar months (Section 285)

Question 1

The Board of Directors of ABC Ltd. met thrice in the year 2004 and the 4th Meeting, though called, could not be held for want of quorum.

Examine with reference to the relevant provisions of the Companies Act, 1956, the following:

- (i) *Whether any provisions of the Companies Act, 1956 have been contravened?*
- (ii) *Is a Director bound to attend the Board Meetings and when his frequent absence from the Board Meeting may be excused?* **(November 2005)**

Answer

- (i) As per Section 285 of the Companies Act, 1956, a company must hold a meeting of its Board of Directors at least once in every three calendar months and there should be at least four directors' meeting every year. However, the Central Government may by notification in the official Gazette, direct these provisions will not apply in relation to any class of companies or will apply in relation thereto subject to such exceptions, modifications or conditions as may be specified in the notification. But in the terms of Section 288(2), a company shall not be deemed to have contravened the provisions of Section 285 where the meeting had been called but could not be held for want of a quorum.
- (ii) Though a director is not so bound to attend the Board meetings, nonetheless, he will be guilty of breach of duty if he fails to attend the Board meetings with reasonable regularity without sufficient cause being shown for his non-attendance. Willful non-attendance on his part may give rise to his liability on ground of negligence if it is patently prejudicial either to the company or to the general body of shareholders. Fairly frequent absence from the Board meetings may, however, be excused if the entire control is exercised by a single director or if the Board is pretty large in number (*Re Denhom & Co. D.25 ch. D. 752 Marquis of Bute's Case (1892)2 Ch. 100*). The fewer the directors, the more onerous is the duty to attend.

Question 2

What is the procedure to be followed, when a board meeting is adjourned for want of quorum?

Answer

- (i) Section 288 of the Companies Act, 1956 provides: that if a Board meeting could not be held for want of quorum, then, unless the articles otherwise provide, the meeting shall automatically stand adjourned till the same day in the next week, at the same time and place, or if that day is a public holiday, till the next succeeding day which is not a public holiday, at the same time and place. It is also provided that section 285 (i.e. frequency of Board meetings) shall not be deemed to have been contravened merely by reason of the fact that a meeting of the Board which had been called in compliance with the terms of that provision, could not be held for want of quorum.
- (ii) Section 289 of the Companies Act, 1956 provides for passing a resolution by circulation, or what are commonly known as circular resolutions. No such resolution shall be deemed to have been duly passed by the Board or a committee thereof, of a company, unless the following conditions are complied with, viz:
 - (a) the draft resolution, together with supporting papers has been circulated, to all the directors, or members of the Committee of the quorum for a Board meeting and
 - (b) to all directors of the Board or members of the Committee who are not in India, at their usual address in India, and
 - (c) the same has been approved by such of the directors then in India, or by a majority of them, who are entitled to vote on the resolution.

Question 3

PQR Limited held three board meetings till 31st December, 2008 during the financial year 2008-09. The next board meeting was due to be held on 27th March, 2009, but for want of quorum the meeting could not be held. A group of shareholders complained that the Company has violated the provisions of Section 285 of the Companies Act, 1956 in not holding the required board meeting. Further, Mr. P and Mr. Q who are the directors of the Company informed the Company their inability to attend the meeting because the notice of the meeting was not served on them. Discuss whether there is any default on the part of the Company and the consequences thereof. What will be the quorum in the given situation? (November 2009)

Answer

Section 285 of the Companies Act, 1956 requires Board of Directors to meet at least once in every three months, irrespective of whether it is the board of a public Company or a private Company and at least four such meetings must be held in every year. However, the Central Government may, by notification in the Official Gazette, direct that these provisions will not apply in relation to any class of Companies or will apply in relation thereto subject to such exceptions, modifications or conditions as may be specified in the notification

As per Section 288 of the Act, if a meeting of the board could not be held for want of quorum, then, unless the articles otherwise provide, the meeting shall automatically stand adjourned till the same day in the next week, at the same time and place, or if that day is a public holiday, till the next succeeding day which is not a public holiday, at the same time and place.

The provisions of Section 285 shall not be deemed to have been contravened merely by reason of the fact that a meeting of the board which had been called in compliance with the terms of that Section could not be held for want of a quorum.

As the meeting could not be held for want of quorum, it cannot be said that PQR Ltd has violated the provisions of Section 285 of the act.

Notice of every meeting has to be served in writing on each director for the time being in India, and at his usual address in India to every other director (Section 286). Every officer of the Company whose duty is to serve the notice as aforesaid and who fails to do so shall be punishable with fine extending to Rs.1000 (Section 286).

As no notice, was served on officer of the Company who is responsible for the default shall be punishable with fine to the extent of one thousand rupees.

The Supreme Court, in case of *Parmeshwari Prasad vs. Union of India* (1974) has held that the resolutions passed in the board meeting shall not be valid, since notice to all the Directors was not given in writing. Notice must be given to each Director in writing. Hence, even though the directors concerned knew about the meeting, the meeting shall not be valid and resolutions passed at the meeting also shall not be valid.

In relation to board meeting quorum implies fully qualified and disinterested directors who must be present at the meeting, so as to enable the board of which they are the constituents to legally transact the business thereat. According to Section 287 the quorum of board meeting is one third of the total strength of board (any fraction contained in the said one third being rounded off as one) or two directors whichever is higher. The total strengths are to be derived after deducting the number of directors whose offices are vacant.

Notice of meetings (Section 286)

Question 4

A director goes abroad for a period of more than 3 months and an alternate director has been appointed in his place under Section 313(1). During the period of absence of the original director, a board meeting was called. In this connection, with reference to the provisions of the Companies Act, 1956, advice whom should the notice of Board meeting be given to the "original director" or to the "alternate director"?

Answer

Notice of every Board meeting has to be served in writing on each director for the time being in India, and at his usual address in India to every other director. Every officer of the company

whose duty is to serve the notice as aforesaid and who fails to do so shall be punishable with fine extending to Rs. 100 (Section 286). It is usually the secretary of the company on whom it casts the duty to serve the notice as aforesaid. It should be noted that the company is not liable for the default in the service of the said notice; it is only the officer in default who is subject to the said penalty. Although there is no legal precedence in this regard, it would be a prudent practice on strictly construing Section 286 that the notice should be served to the alternate director as well as on the original director who is outside India for the time being.

Question 5

The Board of Directors of M/s Infotech Consultants Limited, registered in Calcutta, proposes to hold the next board meeting in the month of May, 2000. They seek, your advice in respect of the following matters:

- (i) *Can the board meeting be held in Chennai, when all the directors of the company reside at Calcutta?*
- (ii) *Whether the board meeting can be called on a public holiday and that too after business hours as the majority of the directors of the company have gone to Chennai on vacation.*
- (iii) *Is it necessary that the notice of the board meeting should specify the nature of business to be transacted?*

Advise with reference to the relevant provisions of the Companies Act.

(May, 2000)

Answer

- (i) There is no difficulty at all in holding the board meeting at Chennai even if all the directors of the company reside at Calcutta and the registered office is situated at Calcutta provided requirements regarding signing of register of contracts, etc. are complied with.
- (ii) Under provisions of Section 166 of the Companies Act, 1956, the annual general meeting shall be held during business hours and on a day that is not a public holiday. There is no similar provision in the Act with regard to board meetings. Therefore, in the absence of any specific restrictive provision, the board meeting can be held even on a public holiday and out of the business hours. The term "public holiday" in this context should be understood. According to the proviso to Section 2 (38) no day declared by the Central Government to be a public holiday shall be deemed to be a public holiday unless the declaration was notified before the issue of the notice of the meeting. Suppose, the notice of a meeting was issued on April 1st where by it was to be held on May 3. If on April 2, the Central Government declares the 3rd day of May as a public holiday, there is no bar to the holding of the meeting on May 3 in spite of its being declared as a public holiday. If, however, the declaration is notified before the issue of

the notice convening the meeting, say on 31st March, the meeting cannot be held on May 3.

- (iii) If the articles of association of the company are silent, the notice of board meeting is not required to specify the nature of business to be transacted thereat [*Compagnie de Mayville v. Whitley* (1896) 1 Ch. 788 (CA)]. If, however, the articles provide otherwise, then the notice must specify the nature of business to be transacted. All said and done, a better course seems to be that the notice should specify the purpose of the meeting, if it is an extra-ordinary or special meeting.

Question 6

The Articles of Association of M/s ABC Ltd. provide that a meeting of the Board of Directors shall be held at 11.00 A.M. on the last day of every quarter ending on 31st March, 30th June, 30th September and 31st December. Relying on the said provision, the company did not send notices to the directors in respect of a board meeting held on 31.3.2002. Some of the directors have questioned the validity of the board meeting on the ground that individual notices have not been sent to directors.

(May 2002)

The Articles of Association of Big Limited provide that a meeting of the Board of Directors of the company shall be held at 11.00 A.M. on the last day of every quarter ending 31st March, 30th June, 30th September and 31st December. Relying on such a clause in the Articles, the company did not send notices to the directors in respect of the board meeting held on 30th September, 2008. Some of the directors have questioned the validity of the board meeting on the ground that individual notices have not been sent to the directors. Examine the validity of the following with reference to the relevant provisions of the Companies Act, 1956 and/or decided case laws.

(CA Final, New Course, May 2009)

Answer

If the Articles of Association of Big Limited provides that a meeting of the board of directors shall be held on the last day of each quarter, it is not necessary that separate notices are required to be served on the directors. It was held in the case of *Arunachalam Chettiar vs. Kaleswarar Mills Ltd.* [(1956) 26 COMP. CAS. 431] that where articles of the company provide that there will be a meeting of the board of directors on the first Saturday of every month, there will be no necessity of service of notice to individual director and such clause in the articles of association is sufficient compliance of Section 286(1) of the Companies Act, 1956. In view of the said judgement the clause in the article is sufficient compliance of the requirement of sending the notice for a board meeting and the contention of some of the directors is not legally valid. However, as a good secretarial practice, notice for every board meeting should be sent to all the directors eligible to receive the notice.

Question 7

XYZ Ltd. is a foreign collaborator in ABC Ltd incorporated in India under the Companies Act, 1956. The foreign collaborator holds 49% of the shareholding. The Board meetings of ABC Ltd are usually held in India and sometimes meetings of the Board are called at a very short notice for which there is a provision in the Articles of Association that during such situations notices of the meetings of the Board can be sent by e-mail. State in this connection whether such a provision in the Articles of Association of a foreign collaborated company is valid within the purview of the provisions of the Companies Act, 1956.

Answer

In the post-Independence period, there is an upsurge of foreign consortia. Articles of foreign collaborations frequently provide that notice of Board meetings should be sent by Air Mail to foreign directors so that they may be able to attend the statutorily prescribed minimum number of meetings (i.e. 3 consecutive meeting without obtaining the leave of absence from the Board) so as to prevent the vacation of their office due to continuous non-attendance under Section 283(1) (g) of the Act. *Now a vital question crops up as to whether such a provision in the articles of foreign collaborations is valid*, because of the provisions of Section 286(1) which, as we have already stated earlier, requires the service of the said notice on a director out of India at his usual address in India. Such a question is not free from doubt. In England, such a notice is required to be given to a director abroad, only when he is within easy reach, else not. But a moot point arises whether a foreign director falls within the purview of the expression “a director other than a director for the time being in India.” On a scrutiny of the act we find that whereas Section 53 provides for service of documents like notices, etc. on members by a company there is no such or similar Section providing for services of notice on directors.

Question 8

The Articles of the company provide that there will be a meeting on the first Saturday of every month, and no notice of the meeting will be given in this regard. State in this connection whether there will be any necessity of the service of the notice under provisions of the Companies Act, 1956 and whether the proceedings of the meeting will become invalid.

Answer

It has been held in *Arunachalam Chettiar vs. Kaleshwarar Mills Ltd. (1957) I.M.L.J.254-A.I.R. 1957 Mad. 309* that where articles of the company provide that there will be a meeting on the first Saturday of every month, there will not be no necessity of the service of the notice under Section 286(1) in as much as a provision in the articles is sufficient compliance of Section 286(1).

Suppose, the above-mentioned notice, as required by Section 286(1) has not been served, in such a situation the proceedings at the meeting shall not become invalid provided (i) all the directors attend the meeting and do not raise any objection to the non-service of notice; or (ii) where the absent directors make no complaint about the want of notice, particularly when the proceedings are ratified at a subsequent meeting whereat the absentee directors are present [*Re State of Wyoming Syndicate (1901) 2 Ch. 431*].

Quorum for meetings (Section 287)

Question 9

The Board meeting of MNO Ltd. was held on 10th May, 2008 at Chennai at 11a.m. At the time of starting the board meeting the number of directors present were 7. The total number of directors were 10. The board transacted ten items in the board meeting. At 12 noon after the completion of four items in the agenda 4 directors left the meeting. Examine the validity of these transactions explaining the relevant provisions of the Companies Act, 1956.

(CA Final, New Course, November, 2008)

Answer

Section 287 of the Companies Act, 1956 provides for the quorum for meeting. The quorum for a meeting of the Board of Directors of a company shall be one third of its total strength (any fraction contained in the said one third being rounded off as one), or two directors, whichever is higher. Where at any time the number of interested directors exceeds or it's equal to two thirds of the total strength, the number of remaining directors, that is to say, the number of directors who are not interested present at the meeting being not less than two shall be the quorum during such time. In this case, the quorum is 4 (i.e. $\frac{1}{3}$ rd of 10 = 3 $\frac{1}{3}$ rounded off as 4). Hence the quorum was present at the time of commencement of meeting.

As a rule, in the case of a meeting of the Board of Directors, the meeting cannot transact any business, unless a quorum is present at the time of transacting the business. It is not enough that a quorum was present at the commencement of the business.

The quorum of the Board is required at every stage of the meeting and unless a quorum is present at every stage, the business transacted is void. (*Balakrishna vs. Balu Subudhi AIR 1949 Pat 184*). In the given situation four items were transacted with the quorum and thus they are valid. Six items were transacted after 4 Directors left the meeting resulting in the reduction of quorum as only 3 Directors were present as against the required quorum of 4 Directors. Such six transactions are void.

Question 10

ABC Ltd. has 12 directors on its Board and has the following clause in its Articles of Association:

“The questions arising at any meeting of the Board of Directors or any Committee thereof shall be decided by a majority of votes, except in cases where the Companies Act, 1956 expressly provides otherwise.”

In one of the meetings of the Board of Directors of ABC Ltd., 8 directors were present. After completion of discussion on a matter, voting was done. 3 directors voted in favour of the motion, 2 directors voted against the motion while 3 directors abstained from voting.

You are required to state with reference to the provisions of the Companies Act, 1956 whether the motion was carried or not. It is clarified that the motion being voted upon was not concerning a matter which requires consent of all the directors present in the meeting.

(CA Final, New Course, May 2009)

Answer

Regulation 74(1) of Table A of Schedule 1 to the Companies Act, 1956 provides that save as otherwise expressly provided in the Companies Act, 1956, questions arising at any meeting of the Board shall be decided by a majority of votes.

In the problem given in the question, the similar article exists in the Articles of Association of ABC Ltd. In the given case, only 8 directors out of a total strength of 12 directors are present and out of those 8 directors present only 5 directors have exercised their votes. In such a case, only those directors who are present and vote on a motion are considered for determining whether the motion is carried or not. That means out of the 5 directors who voted on the motion are to be considered. Accordingly, since number of directors who voted in favour of the motion being 3, is higher than the number of directors who voted against the motion being 2, the motion is carried or is considered to be passed by majority.

Question 11

The articles of Association of XYZ Computers Limited provide for a maximum of 15 Directors. But the company has only 10 Directors and for two of them representing Foreign Collaborators, alternate Directors have been appointed. Board Meeting held on 1st August, 2003 was attended by 4 Directors including 2 alternate Directors.

Examine with reference to the relevant provisions of the Companies Act, 1956 whether quorum was present at the Board Meeting held on 1st August, 2003.

Will your answer be different, if the articles provide for a Quorum of 6 Directors? (May, 2004)

Answer

Section 287 of the Companies Act, 1956 prescribes a quorum for meetings of Board of Directors of Companies. According to Section 287(2) quorum for a meeting of the Board of Directors of any company, public or private shall be one third of the total strength of the Board, or two directors, whichever is higher. According to Section 287(1), ‘total strength’

means the total strength of the Board of Directors of a company as determined in pursuance of the Act, after deducting there from the number of directors, if any, whose place may be vacant at the time. Hence the total strength is 10 directors (excluding 2 alternate directors) even though the Articles provide for a maximum of 15.

Section 287(2) provides that the quorum for a meeting of the Board of Directors of a company shall be one third of its total strength (any fraction contained in that one-third being rounded off as one), or two directors, whichever is higher. Hence, in this case $\frac{1}{3}$ of 10 i.e. $3\frac{1}{3}$ ↓ the fraction being rounded off as one i.e. 4 is quorum.

The alternate directors present at a meeting will be counted for quorum, if the original director is not present, the alternate directors present at a meeting will be counted for quorum. The Board meeting held on 1.8.2003 was attended by 4 directors including 2 alternate directors quorum was present at the meeting. Hence, it is a valid meeting.

Section 287 only provides for a minimum quorum. It does not forbid a company to fix a higher quorum. A company in its articles cannot provide a quorum of lesser number of directors than what is provided in Section 287(2). However, it can provide for a higher number. Hence, if the articles provide 6 as quorum, the meeting held on 1.8.2003 is not valid as it was attended only by 4 directors.

Question 12

ABC Ltd. has 12 directors on its Board and has the following clause in its Articles of Association:

“The questions arising at any meeting of the Board of Directors or any Committee thereof shall be decided by a majority of votes, except in cases where the Companies Act, 1956 expressly provides otherwise.”

In one of the meetings of the Board of Directors of ABC Ltd., 8 directors were present. After completion of discussion on a matter, voting was done. 3 directors voted in favour of the motion, 2 directors voted against the motion while 3 directors abstained from voting.

You are required to state with reference to the provisions of the Companies Act, 1956 whether the motion was carried or not. It is clarified that the motion being voted upon was not concerning a matter which requires consent of all the directors present in the meeting.

Answer

Regulation 74(1) of Table A of Schedule 1 to the Companies Act, 1956 provides that save as otherwise expressly provided in the Companies Act, 1956, questions arising at any meeting of the Board shall be decided by a majority of votes.

In the problem given in the question, the similar article exists in the Articles of Association of ABC Ltd. In the given case, only 8 directors out of a total strength of 12 directors are present

and out of those 8 directors present only 5 directors have exercised their votes. In such a case, only those directors who are present and vote on a motion are considered for determining whether the motion is carried or not. That means out of the 5 directors who voted on the motion are to be considered. Accordingly, since number of directors who voted in favour of the motion being 3, is higher than the number of directors who voted against the motion being 2, the motion is carried or is considered to be passed by majority.

Question 13

Analyse and Advise with reference to the provisions of the Companies Act, 1956, the following situations.

- (a) *The Articles of a company want to fix the quorum for the Board Meeting.*
- (b) *There are 9 directors in a company and out of which 2 offices of the directors have fallen vacant. What will be the quorum for the Board Meeting?*
- (c) *There are 15 directors in a company and during discussion of a particular item, 13 of the directors are said to be 'interested'. What shall be quorum of the meeting?*
- (d) *Continuing with above situation, what will be your advise, when all the 15 directors are said to be interested in the concerned resolution?*
- (e) *What are the situations, when interested directors will be counted for the purpose of counting quorum for the meetings of the Board?*

Answer

- (a) A quorum is the prescribed minimum number of qualified persons authorised to transact the business at a meeting. In relation to a Board meeting quorum implies fully qualified and disinterested directors who must be present at the meeting so as to enable the Board of which they are the constituents to legally transact the business thereat. In view of Section 287 which has fixed the quorum of the Board meeting, the Articles of Association of the company cannot fix the quorum for the Board meeting.
- (b) Accordingly such a quorum is one third of the total strength of Board (any fraction contained in the said one third being rounded off as one) or two directors whichever is higher. The total strength is to be derived after deducting the number of directors whose offices are vacant. Therefore, the Quorum = $\frac{1}{3}$ (of the total strength vacancies). Where total number of directors are 9 and 2 offices of the directors have fallen vacant, we find: $\frac{1}{3}$ of $(9-2) = \frac{1}{3}$ of $7 = \frac{7}{3}$ directors. If the fraction of $\frac{7}{3}$ were to be rounded off as one then 3, i.e. 2+1 directors would constitute the quorum for the Board meetings. If at any time the number of the remaining directors exceeds or is equal to two thirds of the total strength, the number of the remaining

directors who are non-interested but present at the meeting, not being less than two shall constitute the quorum.

- (c) For example, there are in all 15 directors and the Board meeting commences with all the 15 directors. During the currency of the meeting, an item comes up for discussion in respect of which 13 happen to be “interested” directors. In this case, in spite of the excess of the interested directors being more than two-thirds, the prescribed minimum number of non-interested directors constituting the quorum, namely, 2 present at the meeting are to transact the particular item of business.
- (d) If all the 15 directors cited in the above illustration are equally interested in that particular item of business and the time is so vital that but for a decision thereon, the business of the company will be greatly hampered. How to resolve this *impasse*? The Act has not made any direct provision to take with such a situation, but the Article 48 of Table A of Schedule 1 of the Act, provides a remedy. According to the said article, the Board may, whenever it thinks fit, call an extraordinary general meeting. By invoking this Article, the Board should get the aforesaid *impasse* resolved by the shareholders at the general meeting. Since according to Section 173(1) (b), all business in the case of any other meeting than the annual general meeting is to be deemed special, by virtue of sub-section (2) the notice of the extraordinary meeting must annex to it a statement setting out all the material facts concerning the item of business, including, in particular, the nature of the concern or interest there in of every director.
- (e) The interested directors are excluded from the computation of the quorum under Section 300(1). However, in the terms of Section 300(2), the interested directors can be counted for the purpose of quorum in the following cases, namely – (a) where the company is a private company which is neither a subsidiary nor a holding company of a public company; (b) where the company is a private company which is a subsidiary of a public company, in respect of any contract or arrangement thereof; (c) where there is any contract of indemnity against any loss which the directors or any one or more of them may suffer by reason of becoming or being sureties or surety for the company; (d) in respect of any contract or arrangement entered or to be entered into with a public company, or a private company, which is a subsidiary of a public company in which the director's interest consist solely (i) in his being a director holding shares of such number or value as to be just enough and not more than enough to qualify him for appointment as director, or (ii) in his being a member holding not more than 20% of the paid-up share capital of the company; (e) where it is a public company in respect of which the Central government has, through a notification in the official Gazette, waived the necessity to comply with the requirements of Section 300(1) on considerations of establishing or promoting any industry, business or trade in the public interest.

Question 14

A Board meeting could not be held for want of quorum and therefore it was adjourned to next week, same time, place. At the adjourned meeting also, the requisite quorum was not present. What advise will you give with reference to the relevant provisions of the Companies Act, 1956?

Answer

Inability to hold a Board meeting for want of quorum results, as has already been stated in the automatic adjournment thereof under Section 288. According to Section 191, a resolution passed at an adjourned meeting is deemed as having been passed thereat itself; it does not date back to an earlier date, i.e., the date of the original meeting. It would be worthwhile to recapitulate here the provisions of Sections 174(2) to (5), which deal with adjournment of the general meeting for want of quorum so as to compare them with the provisions relating to adjournment of board meetings. Unless the article of a company whether public or private – provide otherwise, if the quorum is not present within half an hour from the time fixed for the general meeting, it shall stand dissolved in case the meeting has been convened, under Section 169, on the requisition of members; in regard to any other class of meeting, it shall stand adjourned to the same day in the next week at the same time and place or to such other day and at such other time and place as the board may determine. If again at the adjourned meeting the quorum is not present within half an hour of the scheduled time then the members present shall constitute the quorum. According to Article 53 of Table A of Schedule I to the Act, where a meeting is adjourned for 30 days or more, a fresh notice of the adjourned meeting has to be served. Section 288 does not throw any light on what happens if the quorum is not there at the adjourned meeting as well whether the Board meeting is to be adjourned over and over again till the quorum is procured. Secondly, for want of quorum, the Board meeting automatically stands adjourned to the same day in the next week and at the same time and place. But the Board has no power to fix any other day or place or time for such adjourned meeting: where as in the case of general meeting, the Board can adjourn it to any other day or other time and place. Thirdly Section 288 implies that a Board meeting can be called on a public holiday, though not the adjourned meeting. Under Section 166(2) annual general meeting cannot be held on a public holiday. But in the absence of any specific prohibitions by the Act, a statutory and an extraordinary meeting can be held on a public holiday.

Procedure where meeting adjourned for want of quorum (Section 288)

Question 15

Some urgent items are left over in the agenda of Board meeting which concluded and decision cannot be deferred till its next meeting

Answer

Items of business left unconsidered at the Board meeting and which cannot be deferred till the next Board meeting may be referred to the Directors for consideration by circulation in terms of Section 289. For the purpose, of passing a resolution by circulation, requirement is that the

draft resolution should be circulated to all the directors in India, who are not below the quorum fixed for a board meeting and to all other directors at the usual address in India and the resolution should be approved by the directors in India or by a majority of them.

Question 16

A meeting of the Board of 'No Holiday Ltd' was held on a public holiday. However due to lack of quorum, the proceedings of the meeting could not be held and therefore the Chairman of the meeting decided with the consent of the majority that the Board meeting be adjourned to next Monday. However, the date fixed for the adjourned meeting happened to be a 'public holiday'. Advise and draw your analogy with reference to the provisions of the Companies Act, 1956, whether the adjourned meeting of the Board can be held on a day which is a public holiday.

Answer

Whether or not the Board meeting can be held on a public holiday and out of business hours is a question open to conflict. Under Section 288, the adjourned Board meeting is to be held on a day which is not a holiday but no such restriction has been levied on the matter of holding the original Board meeting. On the basis of the provision of Section 288, one set of arguments may be that like the adjourned meeting, the holding of the original Board meeting is equally a normal and usual work of a company and that is why it should be held during usual business hours and on a day, which is not a public holiday. On this analogy, a similar inference may be drawn from the provision of Section 166(2) as well, because it prescribes only for each annual general meeting that it be held on a day which is not a public holiday and during the business hours and also because annual general meeting is normal work of the company. Another set of arguments is that a meeting of the board can take place even on a public holiday and out of business hours because there is not such restriction as contemplated either by Section 166(2) or by Section 288. It would be prudent to subscribe to latter set of arguments. This is because if the Legislature could think of imposing similar restrictions twice—once at the time of drafting Section 166(2) in respect of only annual general meeting and the other at the time of drafting Section 288 in respect of adjourned Board meetings—it could rationally think of similar restrictions for the third time in respect of original Board meetings. If the human element of forgetfulness on the part of the draftsmen is to be given any consideration, even then it can be upheld on the first occasion when Section 166(2) was drafted. But definitely such forgetfulness is not tenable on second occasion when Section 288 was enacted especially in respect of adjourned Board meeting. Had it been the intention of the legislature, it could easily enact a provision and add it as a sub-section to Section 288. It, therefore, seems that the legislature did not deliberately think it necessary to provide for original board meeting to be held on a day other than a public holiday and during usual business hours. The law will take its course, however the course may sound irrational. Therefore, in the absence of

any specific provisions in Act it seems that the original Board meeting can be held even on a holiday and out of the business hours.

Question 17

Examine, with reference to the relevant provisions of the Companies Act, 1956, the validity/legality of the following:

A meeting of the Board of Directors of OPQ Co. Ltd. due to be held on 30.9.2001 did not take place for want of quorum. As a result, the Company did not hold any Board meeting for the quarter ended 30.9.2001 and there is a complaint that the Company has violated the provisions of the Act in this regard. **(November, 2001)**

Answer

Suppose a meeting of the Board has been convened within the prescribed period in strict conformity with the said Section but for want of quorum, the said meeting could not take place. In such a situation, the meeting automatically stands adjourned by virtue of Section 288(1) till the same day in the next week, at the same time and place. And if that "same day" is a public holiday, then the meeting stands adjourned till the next succeeding day, which is not a public holiday, at the same time and place. And because of this adjournment the meeting is obviously held after the period specified in Section 285. In terms of Section 288(2), which is not clearly couched, a company shall not be deemed to have contravened the provisions of Section 285 where the meeting does not take place for want of quorum. In view of these legal provisions, a pertinent question for our consideration comes up. For holding the next Board meeting, *which date should we take into account for the purpose of calculating the statutory period of once in every three months.* Whether the date of the original meeting, which was adjourned, for want of quorum or the adjourned date on which the meeting was actually held?

A practical difficulty arises in this regard owing to the silence of the Act on this point. Our confusion gets worse confounded when we come across Section 191 which states that where a resolution is passed at an adjourned meeting *inter alia*, of the Board of Directors of a company, it must "for all purposes" be deemed to have been passed at the date of the adjourned meeting and not on an earlier (i.e., the original) meeting. For resolving our question indicated in italics above, should we take the indirect provisions of Section 191 and conclude, by correlating the phrase 'for all purposes' with the expression 'be treated as having been passed on the date on which it was in fact passed, and shall not be deemed to have been passed on any earlier date' appearing in Section 191, that for holding the next meeting for the Board, the statutory period should be calculated from the date at which the adjourned meeting was held? There is no judicial decision to warrant this conclusion.

However, according to Buckely's Companies Act, (p.339, 12th Edition), except as regards the meetings of the three classes referred to in Section 144 of the English Companies Act (corresponding to our Section 191 which is a verbatim copy of the English Section), the legal fiction of continuity of the original meeting and all adjournments or any legal consequence emanating therefrom remains unaffected by Section 144 of the English Act. This is so notwithstanding the phrase "for all purposes", appearing in Section 144, in as much as our Section 191 is the verbatim copy of Section 144, we can rely on this treatise. And relying thereon, we may conclude that the continuity of the original meeting will remain unhampered and therefore for the purpose of holding the next Board meeting the statutory period of "every three months" should be computed from the date when the original meeting was adjourned for want of quorum.

According to the provisions contained in Section 288(2) of the Companies Act, 1956, the provisions of Section 285 relating to the holding of at least one Board meeting in a quarter cannot be deemed to have been contravened merely by reason of the fact that a Board meeting which had been called in compliance with the terms of the said section could not be held for want of a quorum. Thus the allegation that the company has contravened the provisions of Section 285 in the matter of holding the Board meeting is not correct.

Passing of Resolution by Circulation (Section 289)

Question 18

In course of administration of the affairs of a limited company, Chairman of its Board of Directors came across a matter, which required the approval by say of a board resolution. In the prevailing circumstances, it is not possible to convene and hold a Board Meeting. The Chairman approaches you to advise him of the way and the relevant procedure to obtain such approval without holding the Board Meeting. You are required to advise him on the matter as per the provisions of the Companies Act, 1956.

(May 2007)

Chairman of Board of Directors of ABC Ltd. came across a matter, which required the approval by way of a board resolution. In the prevailing circumstances, it is not possible to convene and hold a Board Meeting. The Chairman approaches you to advise him of the way and the relevant procedure to obtain such approval without holding the Board Meeting. You are required to advise him on the matter as per the provisions of the Companies Act, 1956.

(CA Final, New Course, May 2009)

Answer

As per the provisions of the Companies Act, 1956, several Board Resolutions are required in course of carrying on the affairs of a limited company. But it may sometimes so happen that a Board Meeting can not be held. To meet such eventualities, the Companies Act, 1956 contains the solution in section 289. According to this section, the board resolution can be passed by

way of circulation. It may however be noted that the matter listed in the provisions of section 292 and other sections requiring passing of resolution at the board meetings only can not be passed by way of circulation and can be passed only at the Board Meeting. The Chairman of the company is advised that the approval in the form of a Board Resolution may be obtained by way of passing the relevant resolution by circulation if the matter is not covered by the barring sections of the said Act.

The procedure to be adopted for the purpose shall be as follows:

- (i) Send the draft of the resolution in duplicate together with the necessary papers, if any, to all the directors then in India. It is to be ensured that the number of such directors is not less than the directors required to form the quorum for a Board meeting.
- (ii) Send the draft of the resolution in duplicate together with the necessary papers, if any, to all other directors at their usual address in India.
- (iii) Obtain one copy of the draft resolution duly signed by the directors, whether approving the resolution or disapproving the same. It may be noted that the resolution shall be deemed to be passed by the Board if all the directors then in India or majority of all directors as are entitled to vote on the matter approve the resolution by signing one copy and returning the same to the company.
- (iv) The resolution passed by circulation shall be placed before the next Board Meeting for confirmation.

The resolution shall be recorded in the minutes of the next Board Meeting.

Question 19

Proximo Limited has 9 Directors out of whom 3 Directors have gone abroad. The Chairman had an urgent matter to be approved by the Board of Directors which could not be postponed till the next Board meeting. The Company, therefore, circulated the resolution for approval of the Directors. 4 out of 6 Directors in India approved the resolution. The Company claimed that the resolution was passed. Examine with reference to the provisions of Section 289 of the Companies Act, 1956 the validity of the resolution. (CA Final, New Course, June 2009)

Answer

According to Section 289 of the Companies Act, 1956, a resolution by circulation shall not be deemed to have been passed, unless the resolution has been circulated in a draft, together with the necessary papers, if any to all the directors then in India (not less in number than the quorum fixed for a meeting of the Board) as the case may be, and all other directors at their usual addresses in India, and has been approved by such of the directors as are then in India or by majority of such of them, as are entitled to vote on the resolution. In this case, the resolution has been approved by 4 directors out of 6 in India; the majority of total number of

directors who were entitled to vote was 5 as against 4 directors who approved the resolution. Thus both the alternate conditions were not fulfilled. The resolution cannot be deemed to have been passed.

Validity of acts of directors (Section 290)

Question 20

State whether the acts done by the Board meeting be invalid if it was found afterwards that there was some defect in the appointment of directors or any person acting as a director?

Answer

All Acts done by the Board meeting by its committee meeting or by any person acting as a director shall be as valid as if every such director or such person had been duly appointed and was qualified to be a director. The validity of all such acts done is not affected even if it discovered later on that there was some defect in the appointment of any one or more of such directors or of any person acting as a director. The said acts will also remain unaffected even the directors are later on discovered to be disqualified (Article 80). This provision has been intended to prevent the validity of transactions from being questioned where there has been a slip in the appointment of a director. But the provision cannot be utilized to ignore or override the substantive provisions pertaining to such appointment. It is applicable only to acts of directors whose appointment or qualification is later on discovered to be faulty. Where, however, their appointments have not taken place at all but they merely choose to act on the company's behalf, the protection prescribed by either Article 80 or Section 290 cannot be invoked [*Morris vs. Danssen (1964) 1, A.E.R. 586 (H, L.)*] This is because the said subsequent discovery must be a discovery of the defect; it must not be discovery of facts which go to constitute the defect [*British Asbestos Co. vs. Body (1903) 2 Ch. 439*].

Suppose a regulation like Articles 80 is included in the Article of association of a company. What would be the possible impact of this? The impact has been summed up in Halsbury's Laws of England (*vide p. 277, 3rd Edition, Vol. VI*) thus: "An Article validating the acts of persons acting as directors, though it is afterwards discovered that there was a defect in their appointment or qualification, operates not only between the company and outsiders but also as between the company and its members; as where *defecto* directors make a call, summon meetings of the company, elect other directors or allot shares, A *defecto* director may be ordered to furnish a statement of affairs in winding up. Directors can not take advantage of any infirmity in their proceedings in which they have themselves participated; they are stopped as between themselves and the company; they are also stopped from saying they have been improperly appointed if, they have acted after appointment, persons dealing with them who know of the invalidity are likewise stopped."

It should also be noted that Section 290 applies to act of an individual director, whereas Article 80 covers Act of the Board and of its committee.

Question 21

Mr. MTP was appointed as a director at the Annual General Meeting of a limited company held on 30th September, 2005 and he carried on his duties and functions as a director. In the month of August, 2006, it was found out that there were certain irregularities in his appointment and on 31st August, 2006, his appointment was declared invalid. But Mr. MTP continued to act as director even after 31st August, 2006. You are required to state, with reference to the provisions of the Companies Act, 1956, whether the acts done by Mr. MTP are valid and binding upon the company ?

(May 2007)

Answer

In accordance with the provision of the Companies Act, 1956 as contained in section 290, acts done by a person as a director shall be valid, notwithstanding that it may afterwards be discovered that his appointment was invalid by reason of any defect or disqualification or had terminated by virtue of any provision contained in this Act or in the articles:

The Proviso to section 290 further provide that nothing in this section shall be deemed to give validity to acts done by a director after his appointment has been shown to the company to be invalid or to have terminated.

In view of the provision of section 290 of the Companies Act, 1956, the acts done by Mr. MTP prior to 31st August, 2006 are to be treated as valid and binding on the Company.

However in view of the Proviso to the said section 290, the acts done by Mr. MTP after 31st August, 2006 shall be deemed to be invalid and not binding upon the Company.

Minutes of Board Meeting

Question 22

Accurate Arcs Ltd. maintains the Minutes Book of the Board Meetings in loose-leaf system and get them bound once in three months. Can it do so? Board meetings were held on 24th March, 2000 and 15th April, 2000. Mr. Rameshwar, who was the Chairman of these two Board Meetings died on 1.5.2000, without signing the Minutes. How should be the Minutes be signed and by whom?

(November, 2000)

Answer

Ordinarily minutes cannot be kept in loose-leaf system. Section 193(1) of the Companies Act, 1956 enjoins the Minutes must be entered within 30 days of the conclusion of the relevant meeting. Ordinarily Minutes cannot be kept in loose-lead system. The Department of Company Affairs, however, has expressed that it would refrain from taking any action against a company which maintained its minutes in the loose-leaf form, provided that adequate safeguards are taken against falsification, and loose-leaves are bound in books at reasonable intervals, say six months.

In this case, since the Minutes Book leaves are bound once in three months (January to March, 2000), and as such the same is in order.

The minutes of the Board Meeting are required to be written within a period of 30 days from the date of the meeting held. [Section 193(1)]. But there cannot be any insistence that the same must be signed within a period of 30 days from the date of the Board Meeting. (Dept.'s circular No. 25/76 dated 1.9.1976). According to section 193(1A), the minutes of a Board Meeting may be signed by the Chairman of the said meeting or the Chairman of the next succeeding meeting.

In this case, Mr. Rameshwar, who was the Chairman of the Board Meeting held on 24.3.2000 and 15.4.2000 died on 1.5.2000 without signing the minutes.

The Chairman of the Board Meeting held after 15th April, 2000 for the first time may sign the minutes of Board Meeting, held on 15th April, 2000 in accordance with section 193(1A)(a).

According to the provisions of section 193(1) read with section 193(1A) the minutes of Board Meeting held on 24th March, 2000 should have been signed by Mr. Rameshwar himself as he was the Chairman of the Board Meeting held on 24th March, 2000 as well as the Chairman of the next succeeding meeting. There is no specific provision in the Companies Act, 1956 as to the person who can sign the minutes of Board Meeting held on 24th March, 2000 in this case. Hence a board meeting may be convened and the Chairman of the said meeting may sign the minutes of Board Meeting held on 24th March, 2000.

BOARD'S POWERS AND RESTRICTIONS THEREON (SECTIONS 291 – 293)

General Powers of the Board (Section 291)

Question 1

M/s ABC Ltd. had power under its memorandum to sell its undertaking to another company having similar objects. The Articles of the company contained a provision by which directors were empowered to sell or otherwise deal with the property of the company. The Shareholders passed an ordinary resolution for the sale of its assets on certain terms and required the directors to carry out the sale. The Directors refused to comply with the wishes of the shareholders where upon it was contended on behalf of the shareholders that they were the principal and directors being their agents were bound to give effect to their decision. Based on the above facts, decide the following issues, having regard to the provisions of the Companies Act, 1956 and case laws.

- (i) *Whether the contention of shareholders against the non-compliance of their wishes by the directors is tenable.*
- (ii) *Can shareholders usurp the powers which by the articles are vested in the directors by passing a resolution in the general meeting?* **(November 2007)**

Answer

General Powers vested in the Board of Directors:

The provisions relating to the general powers which are vested are given under Section 291 of the Companies Act, 1956. As per this section, the Board of Directors of a company is entitled to exercise all such powers and to do all such acts and things as the company is authorized to exercise and do. This means the powers of the Board of Directors are co-extensive with those of the company. The proposition is, however subject to two conditions:

Firstly, the Board shall not do any act which is to be done by the company in general meeting. Secondly, the Board shall exercise all such powers subject to the provisions contained in the Companies Act, 1956 or in the Memorandum or the Articles of the Company or in any regulations made by the Company in general meeting. But no regulation made by the company in general meeting shall invalidate any prior act of the Board which would have been valid if that regulation had not been made.

It is the first and elementary principle of company law that when powers are vested in the Board of directors by the Articles of a company, they cannot be interfered with by the shareholders as such (*Murarka etc. Works Ltd. vs. Mohal Lal AIR (1961) Col 251*).

In exercising their powers the directors do not act as agent for the majority members or even all the members. The members therefore cannot by resolution passed by a majority or even unanimously supersede the powers of directors or instruct them how they shall exercise their powers. The above problem is based on decision given by the *Chancery Court in the case Automatic Self Cleansing Filter Syndicate Co. Ltd. Vs. Cunninghame (1906) 2ch 34* and this case also followed in India in *MPLV Works vs Murarka AIR 1961 Col 251*.

In view of above discussion, the contention of shareholders against the non-compliance of their wish by the directors is not tenable and shareholder cannot usurp the power which by articles vested in the directors by passing even a resolution of a numerical majority at the general meeting. The shareholders have, however, the power to alter the Articles of Association of the company in the manner they like subject to the provisions of the Companies Act, 1956.

Certain powers to be exercised by Board only at meeting (Section 292)

Question 2

Out of the powers exercisable by the Board under section 292, the board wants to delegate to the Managing Director of the company the power to borrow monies otherwise than on debentures. Advise whether such a delegation is possible? Would your answer be different, if the delegation is given to the manager or any other principal officer including a branch officer of the company?

Answer

According to Section 292, the following powers can be exercised by the Board only by means of resolution passed at its meetings:

- (a) to make calls; (aa) to authorise the buy back of shares
- (b) to issue debentures;
- (c) to borrow money otherwise than on debentures;
- (d) to invest the funds of the company;
- (e) to make loans.

The Board may, however, by resolution passed at meeting, delegate the last three powers mentioned above to the extent specified hereunder. Such a delegation can be made to any committee of directors, the managing director, the manager or any other principal officer of the company or in the case of a branch office of the company, a principal officer thereof. Every

resolution delegating the power referred to in (c), (d) and (e) above shall specify: (i) the total amount outstanding at any time up to which money may be borrowed by the delegate; (ii) the total amount up to which the funds may be invested as well as the nature of investment; and (iii) the total amount of loans and the purpose thereof up to which and for which loans may be raised respectively. It is to these extents that the delegate may exercise the aforesaid three powers. The company in general meeting may impose restrictions and conditions on the exercise by the Board of any of the five powers mentioned above.

In connection with the power mentioned in (c) above, a question may arise whether borrowing on a promissory note is within the powers of the directors.

It has been held in [*P. Rangaswami Reddiar and Another vs. R. Krishnaswami Reddiar and another* (1971) 43 Comp. Case 232] that where such a borrowing permissible under the company's articles and moneys were borrowed on promissory notes, such transaction would come within the powers of the director. It has also been held in the same case that where a person was appointed as the managing director of the company by the Board's resolution vested with full powers of the management of the affairs of the company and authorised to sign all the papers of the company, he would have full powers to borrow money on a promissory note even without a resolution of the Board as contemplated by Section 292(c) of the Act.

Question 3

The Directors of X & Co. Ltd. desire to authorise the Managing Director to enter into the following transactions namely-

- (a) *invest from time to time surplus funds in the purchase of shares of other companies:*
- (b) *borrow from banks money required for the purpose:*
- (c) *give loans to persons, including firms in which directors or their relatives are partners and*
- (d) *give donations to charitable trusts in which any of the directors may be interested as trustees.*

State whether these delegated powers are within the purview of the relevant provisions of the Companies Act, 1956.

Answer

- (a) Although Section 292 empowers the Board of Directors of a company to delegate to the Managing Directors the power to invest, in general terms, the funds of the company nevertheless because of the overriding provisions of Section 372(5) (which Section we shall discuss in detail in Study paper 3), the transaction in the instant case would be invalid. Section 372(5) provides that no investment in shares of a company can be made by the Board of Directors of an investing company in pursuance of sub-section

(2), unless it is sanctioned by a resolution passed at a meeting of the Board with the consent of all the directors present at the meeting except those not entitled to vote thereat, and unless further notice of the resolution to be moved at the meeting has been given to every director in the manner specified in Section 286. Since Section 372 does not provide for delegation of the power, the proposed delegation to the Managing Director in question, notwithstanding the general provision of Section 292, cannot be made.

- (b) In terms of Section 292 the Board of Directors may also delegate to the Managing Director the power to borrow money otherwise than debentures, which it can exercise only by means of resolutions passed at Board meetings. As per Explanation to Section 292(1), it is the arrangement for an overdraft or cash credit that constitutes the exercise of the borrowing power and not the actual utilisation of the arrangement. In other words, an arrangement for an overdraft or cash credit to the tune of say Rs.5 lakhs constitutes the exercise of the borrowing power and not the actual drawing of this amount on the basis of the overdraft or cash credit. Consequently, the transaction in the instant case shall be valid. But before implementation of the proposal, the Board must pass a resolution at its meeting authorising the Managing Directors to borrow from banks money required for the purpose of the company's business. Also the resolution delegating this power shall specify the total amount outstanding at any one time up to which the delegate may borrow money.

If however, the moneys to be borrowed together with the money already borrowed by the company (apart from temporary loans obtained from the Company's bankers in the ordinary course of business) will exceed the aggregate of the paid up capital of the company and its free reserves, [that is to say, reserves not set apart for any specific purpose] the Board of Directors of the company in question must obtain the consent of the company in its general meeting. Consequently, care should be taken to ensure that while delegating the power to the managing director the aforesaid provision has not been violated; also it should be ensured that the memorandum of association permits borrowing.

- (c) Since according to Section 295(1), (which we shall discuss later) without obtaining prior approval of the Central Government in that behalf, a company can not directly or indirectly lend money to persons including firms, in which directors or their relatives are partners, the company in question must in the first instance seek the Central Government's approval. Secondly since the power to make loans may be delegated under Section 292(1)(e), the Board of Directors of the company in question must pass a resolution therefore and every resolution delegating this power to the Managing Director shall specify the total amount up to which loans may be made by the delegate, the purpose for which loans may be made and the maximum amount of loans which

may be made for each such purpose in individual cases. Thirdly, by virtue of Section 291(1), the Board must see with reference to the memorandum and articles whether the company is authorised to exercise the power.

- (d) Under Section 293(1) (e), the Board of Directors of a public company can contribute or donate to charitable and other funds not directly related to the business of the company or the welfare of its employees any amount the aggregate of which will not, in any financial year exceed Rs.50,000 or 5% of its average net profits during the three financial years preceding whichever is greater. If this power of the company is not *ultra vires* the memorandum of the company, then only the Board can act in pursuance of the above-mentioned resolution of the company and in so acting, it can authorise the Managing Director to exercise the power on behalf of the Board.

It may be noted that the power of the Board to donate to general charities is not conditional to the existence of any profits. In such case, they may contribute up to the limit given in Section 293(1)(e), even though the company may be working at a loss.

Question 4

A Managing Director was authorized by the Board to borrow money on a Promissory Note. State in this connection whether borrowing on a promissory note is within the powers of the directors.

Answer

It has been held in *[P. Rangaswami Reddiar and Another vs. R. Krishnaswami Reddiar and another (1971) 43 Comp. Case 232]* that where such a borrowing permissible under the company's articles and moneys were borrowed on promissory notes, such transaction would come within the powers of the director. It has also been held in the same case that where a person was appointed as the managing director of the company by the Board's resolution vested with full powers of the management of the affairs of the company and authorised to sign all the papers of the company, he would have full powers to borrow money on a promissory note even without a resolution of the Board as contemplated by Section 292(c) of the Act.

Question 5

M/s Hurybury Builders Limited is contemplating to enter into a joint venture agreement with another construction company for the development of landed properties located at Bangalore. Since it is not possible to convene the Board Meeting immediately, as the directors are at different places in connection with various works, the Managing Director seeks your advice on the following matters:

- (i) *Whether the resolution pertaining to the joint venture agreement is required to be passed at the Board Meeting convened for this purpose or whether it can be passed by means of a circular resolution.*

- (ii) *What are the resolutions that are required to be passed only at the meetings of the Board of Directors?*
- (iii) *The steps that are required to be taken to pass the Board resolution by circulation. Advise.* **(May, 2002)**

Answer

The directors of the company act together as a body and generally at the meeting of the Board duly convened, unless special powers are delegated to an individual director or the managing director. Where it is not possible to hold board meetings because the directors are busy elsewhere or the time for convening such a meeting is short, it is possible that the required resolution can be passed by way of circular resolution as provided in section 289 of the Companies Act, 1956. However, under section 292, certain powers can be exercised by the Board of directors only by means of a resolution passed at meeting convened for this purpose. They are (i) to make calls (ii) to issue debentures (iii) to borrow money otherwise than on debentures (iv) to invest the funds of the company and (v) to make loans. In view of the above, the Managing Director can go ahead and complete the joint venture agreement after obtaining the approval of the board by passing a circular resolution. For this purpose, the proposed resolution has to be circulated in draft along with the other necessary papers, if any, to all the directors in India at their usual residential addresses. The resolution will become valid if the same is approved by majority of the directors and who are entitled to vote on the resolution. There after the resolution as passed by way of circulation will be entered in the minutes book of the Board of Directors and is enough compliance of the provisions of Companies Act in this regard.

Question 6

Advise the Board of Directors of a public company about their powers in respect of the following proposals explaining the relevant provisions of the Companies Act, 1956:

- (i) *Donation of Rs. 5,00,000 to a hospital established exclusively for the benefit of employees.*
- (ii) *Buy-back of shares of the company for the first time upto 10% of the paid-up equity share capital.*
- (iii) *Delegating to the managing director of the company the power to invest surplus funds of the company in the shares of some companies.* **(May, 2003)**

Answer

- (i) **Donation to a hospital run exclusively for the benefit of employees of the company:** The limit of 5% of average net profits during the last 3 financial years is applicable only to contributions to charitable and other funds not directly relating to the

business of the company or the welfare of its employees [Section 293(1)(e), Companies Act, 1956]. Hence the Board is empowered to make the proposed donation to the hospital.

- (ii) Section 292 has been amended by Companies (Amendment) Act 2001 to facilitate buy back of shares upto 10% of the total paid-up equity capital and free reserves [Section 292(i)(aa)]. Hence special resolution in general meeting of the company is not required. Hence the proposed buy back of shares is in order provided other conditions laid down on section 77A are fulfilled.
- (iii) Section 292 of the Companies Act, 1956, empowers the Board of Directors to delegate to the M.D the power to invest in general terms. But Section 372A(2) provides that no investment shall be made, unless it is sanctioned by a resolution passed at a meeting of the Board with the consent of all the directors present. Section 372A does not provide for delegation. Hence the proposed delegation of power to invest to the M.D. is not in order.

Question 7

Decide in the light of the provisions of the companies Act, 1956 the validity and extent of powers of Board of Directors and the procedure to be complied with in the following matters:

- (i) *Delegation of power of the Managing Director of the company to invest surplus funds of the company in the shares of some companies.*
- (ii) *Donation of Rs.5 lakhs to a hospital established exclusively for the benefit of employees and a donation of Rs.5 lakhs to a charitable trust registered under Section 12A and exempted under Section 80G of the Income-tax Act, 1961.*
- (iii) *Donation of Rs.5 Lakhs to a political party registered with the appropriate authority.*

(June 2009)

Answer

- (i) Section 292 of the Companies Act, 1956 empowers the Board of Directors to delegate to the Managing Director the power to invest in general terms. But section 372A (2) of the said act provides that no investment shall be made, unless it is sanctioned by a resolution passed at a meeting of the Board with the consent of all the directors present. Section 372A does not provide for delegation. Hence the proposed delegation of power to the Managing Director to invest is not in order.
- (ii) Donation to a hospital run exclusively for the benefit of employees of the company is in order. The limit of 5% of average net profits during the last three financial years is applicable only to contributions to charitable and other funds not directly relating to the business of the company or the welfare of its employees. Thus, under section 293 (1)

(e) of the Companies Act, 1956, the Board is empowered to make the proposed donation to the hospital.

However the donation of Rs.5 Lakhs to a charitable trust is subject to the limit laid down in section 293(1) i.e. Rs.50,000 or 5% of the average net profits of the company during the last three financial years whichever is higher.

Thus to contribute Rs.5 lakhs the average net profits for last three financial years should be Rs.100 lakhs.

- (iii) Donation of Rs.5 Lakhs to a political party can be made if the company is in existence for more than 3 years and the donation amount cannot exceed 5% of the average net profit for the preceeding three years. Further the procedure laid down in Section 293 A should also be complied with.

Question 8

Advise the Board of Director of Spectra Papers Ltd. regarding validity and extent of their powers, under the provisions of the Companies Act, 1956 in relation to the following matters:

- (i) *Buy-back of the shares of the Company, for the first time, upto 10% of the paid up equity share capital without passing a special resolution.*
- (ii) *Delegation of Power to the Managing Director of the company to invest surplus funds of the company in the shares of some companies. (CA Final, New Course, May, 2010)*

Answer

- (i) Section 292 (i) (aa) of the Companies Act, 1956 facilitates buy-back of shares upto 10 % of the total paid up equity capital and free reserves. Hence, special resolution in general meeting of the company is not required. The proposed buy-back of shares is in order provided other conditions laid down in Section 77A of the Companies Act, 1956 are fulfilled.
- (ii) Section 292 of the Companies Act, 1956 empowers the Board of Directors to delegate to the Managing Director the power to invest in general terms. But Section 372A (2) of the said Act provides that no investment shall be made unless it is sanctioned by a resolution passed at a meeting of the board with the consent of all Directors present. Section 372A does not provide for delegation. Hence the proposed delegation of power to the Managing Director to invest is not in order

Audit Committee (Section 292)

Question 9

An Audit Committee of a Public Limited Company constituted under section 292A of the Companies Act, 1956 submitted its report of its recommendation to the Board. The Board, however, did not accept the recommendations. In the light of the situation, analyze whether:

- (a) *The Board is empowered not to accept the recommendations of the Audit Committee.*
- (b) *If so, what alternative course of action, would be Board resort to?*
- (c) *As a Chairman of the Audit Committee, how would you respond to the situation?*

Answer

- (i) As per Section 292A, a recommendations of the audit Committee on any matter relating to financial management, including the audit report, shall be binding on the Board.
- (ii) If the Board does not accept the recommendations of the Audit Committee, it shall record the reasons therefore and communicate such reasons to the shareholders.
- (iii) The Chairman of the Audit Committee shall attend the Annual General Meeting(s) of the company to provide any clarifications on matters relating to Audit.

Question 10

The paid-up capital of XYZ Limited has been increased from Rs.4 crores to Rs.6 crores. The Board of Directors of XYZ Limited purpose to constitute an 'Audit Committee'. At present the board consists of 10 directors including a Managing Director. Draft a board resolution taking into account the requirements under the Companies Act relating to the constitution of the Audit Committee and the chairman of the audit Committee. XYZ Limited is not a listed public company.
(May, 2002)

Answer

- (1) As per section 292 A of Companies Act, 1956, every public company having paid up capital of Rs. 5 cores or more must constitute a committee of Board as 'Audit Committee'.
- (2) The audit committee shall consist of minimum 3 directors. Out of the total members of committee, at least two-third shall be on executive directors, that is those who are not managing or whole time directors. The committee shall elect its own Chairman. Terms of reference will be specified in writing by the Board (Section 292A(2)).
- (3) *Draft Board resolution.*

Resolved that, pursuant to section 292A of the Companies Act, 1956 an Audit committee consisting of the following directors be and is hereby constituted

- 1. Shri_____, Nomineee of IFCI
- 2. Shri_____, Nomineee of IDBI
- 3. Shri_____,
- 4. Shri_____,
- 5. Shri_____, Managing Director

Further resolved that the Charmin of the Audit Committee shall be elected by its members from amongst themselves. Further resolved that the Audit Committee shall have the authority to investigate into any matter what may be prescribed under the said section 292 A and the following matters

1. _____
2. _____
3. _____
4. _____

Question 11

A private company having a paid-up capital of Rs. 6 crores has been converted into a public company. The company proposes to constitute an Audit Committee. Draft a board resolution covering the following matters taking into account the provisions of the Companies Act, if any, in this regard:

- (i) *Members of the audit committee*
- (ii) *Chairman of the audit committee*
- (iii) *Quorum for a meeting of the audit committee*
- (iv) *Any two main functions of the committee.*

(May, 2003)

Answer

Draft Board Resolution – Audit Committee

Resolved that, pursuant to section 292 A of the Companies Act, 1956, an audit committee consisting of the following Directors be and is hereby constituted.

1. Shri _____, Nominee of IDBI
2. Shri _____, Nominee of ICICI
3. Shri _____, Nominee of State Bank of India
4. Shri _____,
5. Shri _____, Managing Director

Further, resolved that the Chairman of the Audit Committee shall be elected by its members from amongst themselves.

Further resolved that the quorum for a meeting of the Audit Committee shall be 1/3rd of the total number of members or two directors (other than the Managing Director) whichever is higher.

Further resolved that the Audit Committee shall have the authority to investigate into any

matter that may be prescribed under the said section 292 A and any other matter that may be referred to it by the Board from time to time.

Further resolved that the Audit Committee shall conduct discussion with the auditors periodically about internal control systems, the scope of audit including the observation of auditors.

Further resolved that the Audit Committee shall review the quarterly and annual financial statements and submit the same to the Board with its recommendations, if any

Question 12

What do you understand by Corporate Governance? Explain, how the provisions of the Companies Act, 1956 relating to Audit Committee will help in achieving some of the objectives of Corporate Governance. (May 2005)

Answer

The vast amount of literature available on the subject ensures that there exist innumerable definitions of corporate governance. To get a fair view on the subject it would be prudent to give a narrow as well as a broad definition of corporate governance.

In a narrow sense, corporate governance involves a set of relationships amongst the company's management, its board of directors, its shareholders, its auditors and other stakeholders. These relationships, which involve various rules and incentives, provide the structure through which the objectives of the company are set, and the means of attaining these objectives as well as monitoring performance are determined. Thus, the key aspects of good corporate governance include transparency of corporate structures and operations, the accountability of managers and the boards to shareholders, and corporate responsibility towards stakeholders.

In a broader sense, however, good corporate governance, the extent to which companies are run in an open and honest manner, is important for overall market confidence, the efficiency of capital allocation, the growth and development of countries' industrial bases, and ultimately the nations' overall wealth and welfare.

AUDIT COMMITTEE

For better corporate governance, the concept of Audit Committee for companies was introduced by section 292A of the Companies Act, 1956. Every public company having paid up capital of not less than Rs.5.00 Crores must have an Audit Committee.

The auditors, the internal auditor, if any, and the director-in-charge of finance shall attend and participate at meetings of the Audit Committee [Section 292A(5)].

As per section 292A(6) of the said Act, the function of the Audit Committee includes the following:

- (a) The Audit Committee should discuss with the auditors periodically about internal control systems, the scope of audit including the observations of the auditors.
- (b) The Audit Committee should review half yearly and annual financial statements before submission to the Board.
- (c) The Audit Committee should ensure compliance of internal control systems.

The Audit Committee shall have authority to investigate into any matter in relation to the items specified in this section or referred to it by the Board and for this purpose, shall have full access to information contained in the records of the company and external professional advice, if necessary. [Section 292A (7)].

The recommendations of the Audit Committee on any matter relating to financial management including the audit report, shall be binding on the Board and if the Board does not accept the recommendations of the Audit Committee, it shall record the reasons therefore and communicate such reasons to the shareholders. [Section 292 A (8) & (9)].

The above provisions of law relating to powers and functions of the Audit Committee relating to financial statements will help in achieving one of the objectives of corporate governance, i.e., accountability and avoidance of poor financial reporting. It also ensures that the companies are managed in clean and transparent manner.

Question 13

MNC Ltd., a company, whose paid up capital was Rs. 4.00 Crores, has issued rights shares in the ratio of 1:1. The said company is listed with Mumbai Stock Exchange. Whether the company is required to appoint any Audit Committee and if yes, draft a suitable Board Resolution to appoint an Audit committee covering the aspects as provided in the Companies Act, 1956 and the listing Agreement with the Stock Exchange. In case the company is not required to appoint any Audit Committee, state the provisions of the Companies Act, 1956 in respect of appointment of Audit Committee by a Company. (May 2007)

Answer

As per provision of section 292A of the Companies Act, 1956, a public company having a paid up capital of Rs. 5.00 Crores or more is are required to have an Audit Committee. Since, after the rights issue by MNC Ltd. its paid up capital has increased to Rs. 8.00 Crores, it is required to appoint an Audit Committee.

The relevant Board Resolution for appointment of an Audit Committee is as follows:

“Resolved that pursuant to the provision contained in section 292A of the companies Act 1956 and clause 49 of Listing Agreement with the Mumbai Stock Exchange, an Audit Committee of the Company be and is hereby constituted as under:

1. Mr. A -- An Independent Director.

2. Mr. B -- An Independent Director
3. Mr. C -- Director nominated by IDBI
4. Mr. D -- An Independent Director
5. Mr. FD -- Financial Executive
6. Mr. MD -- Managing Director

Further resolved that the Chairman of the Committee, who shall be an independent Director, be elected by the members from amongst themselves.

Further resolved that the quorum for a meeting of the Audit Committee shall be 1/3rd of the total number of members or two directors (other than the Managing Director), whichever is higher.

Further resolved that the Audit Committee shall comply with the following:

- (1) The Audit Committee shall have meetings periodically as it may deem fit with at least three meeting in a year, viz., one meeting before finalization of annual accounts and one every six months.
- (2) The Audit Committee shall invite such of the executives (and particularly the head of the finance function) to be present at the meeting of the Committee whenever required by it.
- (3) The finance Director, head of internal audit and the auditors of the company shall attend and participate at the meeting without right to vote.

Further resolved that the audit Committee shall have the authority to investigate into any matter that may be prescribed under the said section 292A of the Companies Act, 1956 and the matters as mentioned in the Listing Agreements entered into between the Company and the Mumbai Stock Exchange and all the matters as may be referred to it by the Board from time to time and for this purpose the Audit Committee shall have full access to information contained in the records of the Company and external professional advice, if necessary.

Further resolved that the Audit committee shall conduct discussions with the auditors periodically about internal control system, the scope of audit including the observations of the auditors.

Further resolved that the Audit Committee shall review the quarterly and annual financial statements and submit the same to the Board with its recommendations, if any.

Further resolved that the recommendations made by the Audit Committee on any matter relating to financial management including the audit report shall be binding on the Board. However, where such recommendations are not accepted by the Board, the reasons for the

same shall be recorded in the minutes of the Board meeting or communicated to the shareholders.

Further resolved that the Audit Committee have the minutes of its meetings drawn and approved by the Chairman of the Committee and the same be circulated to the members of the Board within thirty days from the date of such meeting.

Further resolved that the Company Secretary of the Company shall be the Secretary to the Audit Committee.

Further resolved that the Chairman of the Audit Committee shall attend the annual general meeting of the Company to provide any clarifications on matters relating to audit as may be required by the members of the company.

Further resolved that the Board's Report/Annual Report to the members of the Company shall include the particulars of the constitution of the Audit Committee."

Question 14

Supra Limited, a private company, has been converted into a public company and under the provision of the Companies Act, 1956. The company proposes to constitute an audit committee. Taking into account the provisions of the Companies Act, 1956 draft a board resolution covering the following matters:

- (i) Member of the audit committee.
- (ii) Chairman of the audit committee.
- (iii) Quorum for meeting of the said committee.
- (iv) Any two functions of the said committee.

(November 2008)

Answer

AUDIT COMMITTEE – BOARD'S RESOLUTION:

"Resolved that pursuant to Section 292A of the Companies Act, 1956 an Audit Committee consisting of the following Directors be and is hereby constituted.

- 1. Mr. ---- Nominee of IDBI
- 2. Mr. ---- Nominee of ICICI
- 3. Mr. ---- Nominee of the SBI.
- 4. Mr. ---
- 5. Mr. ----- Managing Director.

Further resolved that the Chairman of the Audit Committee shall be elected by its members from amongst themselves.

Further resolved that the quorum for a meeting of the Audit committee shall be 1/3rd of the total number of members or two directors (other than the Managing Director) whichever is higher.

Further resolved that the Audit Committee shall have the authority to investigate into any matter that may be prescribed under Section 292A of the Companies Act, 1956 and any other matter that may be referred to it by the Board from time to time.

Further resolved that the Audit committee shall conduct discussion with the auditors periodically about internal control systems, the scope of audit including the observation of auditors.

Further resolved that the Audit Committee shall review the quarterly and annual financial statements and submit the same to the Board with its recommendations if any”.

Question 15

Explain how the provisions of the Companies Act, 1956 relating to Audit Committee will help in achieving some of the objectives of Corporate Governance.

(CA Final, New Course, May 2009)

Answer

For better corporate governance the concept of Audit committee for companies was introduced by section 292A of the Companies Act, 1956. Every public company having paid up capital of not less than Rs.5.00 crores must have an audit Committee.

The auditors, the internal auditor, if any and the Director-In-Charge of finance shall attend and participate at meetings of the Audit Committee [Section 292A (5)]

As per Section 292A(6) of the said Act, the functions of the Audit Committee includes the following:

- (a) The Audit Committee should discuss with the auditors periodically about internal control systems, the scope of audit including the observations of the auditors.
- (b) The Audit Committee should review half yearly and annual financial statements before submission to the Board.
- (c) The Audit Committee should ensure compliance of internal control systems.

The Audit committee shall have authority to investigate into any matter in relation to the items specified in this Section or referred to it by the Board and for this purpose, shall have full access to information contained in the records of the company and external professional advice , if necessary. [Section 292A (7)].

The recommendations of the Audit Committee on any matter relating to financial management including the audit report shall be binding on the Board and if the Board does not accept the

recommendations of the Audit Committee, it shall record the reasons therefore and communicate such reasons to the shareholders. (Section 292A (8) & (9)).

The above provisions of law relating to powers and functions of the Audit committee relating to financial statements will help in achieving one of the objective of corporate governance i.e. accountability and avoidance of poor financial reporting.

Restrictions on powers of Board (Section 293)

Question 16

The Board of Directors of Stepping Stones Publications Ltd. at a meeting held on 15.1.2001 resolved to borrow a sum of Rs. 15 crores from a nationalized bank. Subsequently the said amount was received by the company. One of the Directors, who opposed the said borrowing as not in the interest of the company has raised an issue that the said borrowing is outside the powers of the Board of Directors. The Company seeks your advice and the following data is given for your information:

- (i) Share Capital Rs. 5 crores
- (ii) Reserves and Surplus Rs. 5 crores
- (iii) Secured Loans Rs. 15 crores
- (iv) Unsecured Loans Rs. 5 crores

Advice the management of the company.

(May, 2001)

Answer

According to the provisions of Section 293(1)(d) of the Companies Act, 1956 there are restrictions on the borrowing powers to be exercised by the Board of directors. According to that section, the borrowings should not exceed the aggregate of the paid up capital and free reserves. While calculating the limit, the temporary loans obtained by the company from its bankers in the ordinary course of business will be excluded. However, from the figures available in the present case the proposed borrowing of Rs. 15 crores will exceed the limit mentioned. Thus the borrowing will be beyond the powers of the Board of directors. However the share holders have the power to ratify the act of the Board of Directors, if it is not beyond the powers of the company as laid down in the memorandum of association. In that case the shareholders can ratify as it is intra vires the company even though it may be beyond the powers of the Board of Directors.

Thus the management of Stepping Stone Publications Ltd., should take steps to convene the annual general meeting and pass a resolution by the members in the meeting as stated in Section 293(1)(d) of the Act. Then the borrowing will be valid and binding on the company and its members.

Question 17

The last three years' Balance Sheet of PTL Ltd., contains the following information and figures:

	As at 31.03.2003	As at 31.03.2004	As at 31.03.2005
	Rs.	Rs.	Rs.
Paid up capital	50,00,000	50,00,000	75,00,000
General Reserve	40,00,000	42,50,000	50,00,000
Credit Balance in <i>Profit & Loss Account</i>	5,00,000	7,50,000	10,00,000
Debenture Redemption Reserve	15,00,000	20,00,000	25,00,000
Secured Loans	10,00,000	15,00,000	30,00,000

On going through other records of the Company, the following is also determined:

Net Profit for the year (as calculated in accordance with the provisions of Section 349 & 350 of the Companies Act, 1956	12,50,000	19,00,000	34,50,000
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In the ensuing Board Meeting scheduled to be held on 5th November, 2005, among other items of agenda, following items are also appearing:

- (i) *To decide about borrowing from Financial institutions on long-term basis.*
- (ii) *To decide about contributions to be made to Charitable funds.*

Based on above information, you are required to find out as per the provisions of the Companies Act, 1956, the amount upto which the Board can borrow from Financial institution and the amount upto which the Board of Directors can contribute to Charitable funds during the financial year 2005-06 without seeking the approval in general meeting.

(November 2004, November 2005)

Answer

- (i) **Borrowing from Financial Institutions:** As per Section 293(1)(d) of the Companies Act, 1956, the Board of Directors of a public company or a private company which is a subsidiary of a public company, without obtaining the approval of shareholders in a general meeting, can borrow the funds including funds already borrowed upto an amount which does not exceed the aggregate of paid up capital of the company and its free reserves. Such borrowing shall not include temporary loans obtained from the company's bankers in ordinary course of business. Here, free reserves do not include

the reserves set apart for specific purpose.

Since the decision to borrow is to be taken in a meeting to be held on 5th November, 2005, the figures relevant for this purpose are the figures as per the Balance Sheet as at 31.03.2005. According to the above provisions, the Board of Directors of PTL Ltd. can borrow, without obtaining approval of the shareholders in a general meeting, upto an amount calculated as follows:

	Rs.
Paid up Capital	7,500,000
General Reserve (being free reserve)	5,000,000
Credit Balance in Profit & Loss Account (to be treated as free reserve)	1,000,000
Debenture Redemption Reserve (This reserve is not to be considered since it is kept apart for specific purpose of debenture redemption)	----
Aggregate of paid up capital and free reserve	13,500,000
Total borrowing power of the Board of Directors of the company, i.e, 100% of the aggregate of paid up capital and free reserves	13,500,000
Less: Amount already borrowed as secured loans	3,000,000
Amount upto which the Board of Directors can further borrow without the approval of shareholders in a general meeting.	10,500,000

- (ii) **Contribution to Charitable Funds:** As per Section 293(1)(e) of the Companies Act, 1956, the Board of Directors of a public company or a private company which is a subsidiary of a public company, without obtaining the approval of shareholders in a general meeting, can make contributions to charitable and other funds not directly related to the business of the company or the welfare of its employees upto an amount which, in a financial year, does not exceed Rs.50,000/- or five per cent of its average net profits as determined in accordance with the provisions of Sections 349 and 350 of the Companies Act, 1956 during the three financial years immediately preceding, whichever is greater.

According to the above provisions, the Board of Directors of the PTL Ltd. can make contributions to charitable funds, without obtaining approval of the shareholders in a general meeting, upto an amount calculated as follows:

Net Profit for the year (as calculated in accordance with the provisions of Sections 349 & 350 of the Companies Act, 1956:

	Rs.
For the financial year ended 31.12.2003	12,50,000
For the financial year ended 31.12.2004	19.00,000
For the financial year ended 31.12.2005	<u>34,50,000</u>
TOTAL	<u>66,00,000</u>
Average of net profits during three preceding financial years	<u>22,00,000</u>
Five per cent thereof	<u>1,10,000</u>

Since this amount is higher than Rs.50,000/-, the Board of Directors of PTL Ltd. can make contribution to charitable funds upto Rs.1,10,000/- during the financial year 2005-06 without obtaining the approval of shareholders in a general meeting.

Question 18

Examine the validity of the resolution passed at the Annual General Meeting of a public company for payment of dividend at a rate higher than that recommended by the board of directors. Is it possible for the board of directors of the company to revoke the dividend declared at the Annual General Meeting?

The Board of Directors of XYZ Limited having paid-up share capital of Rs. 6 crores and free reserves of Rs.3 crores proposes to increase the sitting fee which is at present Rs.5,000. They seek your advice about the maximum amount upto which the sitting fee may be increased without seeking the approval of the Central Government. Advise explaining the relevant provisions of the Companies Act, 1956.

(CA Final, New, November, 2008)

Answer

According to Regulation 85 of Table A of the Companies Act, 1956, a company in general meeting may declare dividends, but no dividend shall exceed the amount recommended by the Board of Directors of the company. The shareholders at an Annual General Meeting may reduce the amount of dividend recommended by the Board of Directors of the company, but they cannot increase it. Hence the resolution passed at the Annual General Meeting for payment of dividend at a rate higher than that recommended by the Board of Directors is not valid.

Revocation of declared dividend

Ordinarily, a dividend once declared at Annual General Meeting, cannot be revoked, except, with the consent of the shareholders, for a declaration of dividend creates a debt to the shareholders in whose favour it is declared. If a dividend is declared and the amount is paid or credited to the shareholders as dividend, the character of the credit or payment as dividend cannot be altered by a subsequent resolution (*Kishanchand Chellaram VCIT (1962) 32 Company cases 1046,105C (SC).*

But where a dividend has been illegally declared, or where, due to events intervening — after the declaration, such as fire destroying the company's property, or the out break of a war, or the composition of new heavy tax burden or other causes diminishing the assets of the company makes it advisable to conserve the remaining assets, the Board of Directors will be justified in revoking the declaration of dividend.

Sitting fees

The company proposes to increase the Sitting fees payable to directors for attending Board meetings without seeking the approval of the Central Government for such increase. According to the first provision to Section 310 of the Companies Act, 1956, any increase in sitting fees up to prescribed limit will not require approval of the Central Government. As per rule 10b of Companies (Central Governments) General Rules & Forms, 1956 maximum sitting fees payable per meeting of Board of Directors or its committee is as follows-

- (a) Rs.20,000 per meeting if paid up capital plus free reserves are Rs.10 crore or more or turnover is Rs.50 crore or more (since word used is "or", it is so sufficient if one of the conditions is satisfied).
- (b) Rs. 10,000 per meeting in other cases (i.e. company whose paid up capital plus free reserves is less than Rs.10 crore and turnover is less than Rs.50 crore).

The paid up capital plus free reserves of XYZ Ltd is less than Rs. 10 crore and information regarding turnover is not available. If the turnover of the company is also less than Rs.50 crore, the Sitting fees can be increased only up to Rs.10,000 per meeting ,without seeking approval of the Central Government. If the turnover is Rs.50 crore or above Sitting fees can be increased up to Rs.20,000 without approval of the Central Government.

Question 19

Big Ben Ltd., a reputed public company, had advanced certain sum of money to one of its Directors, namely, Mr. Tanmay on certain terms and conditions and fixing the time limit for repayment thereof. Now, Mr. Tanmay has approached the Company with a request to extend the time limit for repayment of balance of loan amounting to Rs.12.00 lacs by another six months.

You are required to state with reference to the provisions of the Companies Act, 1956, the answer to the following:

- (i) *Who is authorized to grant the extension as requested by Mr. Tanmay?*
- (ii) *Draft an appropriate notice for the meeting where such extension may be granted.*

(CA Final, New Course, June 2009)

Answer

- (i) As per provisions of Section 293(1)(b) of the Companies Act, 1956, the Board of Directors of Big Ben Ltd., a public company can not give time for the repayment of any debt due by Mr. Tanmay, a director of the company except with the consent of the

Company by way of an ordinary resolution passed in a General Meeting. In view of this provision of the law, the Company in a General Meeting is authorized to grant the extension as requested by Mr. Tanmay.

- (ii) Notice for calling the General Meeting of the company:

BIG BEN LIMITED

Registered Office: _____

NOTICE FOR EXTRA ORDINARY GENERAL MEETING

NOTICE is hereby given that an Extra Ordinary General Meeting of the members of the company will be held at the Registered office of the Company on _____, the _____ day of _____, 2009 at 11.00 A.M. to transact the following business:

- (1) To pass, with or without modification, the following resolution as an Ordinary Resolution:

“RESOLVED THAT pursuant to the provision of Section 293(1)(b) of the Companies Act, 1956, consent be and is hereby accorded to the company for extending the time for the repayment of the balance amount of Rs. 12.00 Lacs advanced to Mr. Tanmay, a Director of the company, by a further period of six months ending on _____, 2009.”

FOR & ON BEHALF OF THE BOARD

Dated. _____, 2009 _____

Company Secretary _____

Notes:

- (1) A member entitled to attend and vote at the Meeting is entitled to appoint a proxy to attend and vote instead of himself and such proxy need not be a member of the Company. Proxies in order to be valid must be deposited at least 48 hours prior to commencement of the Meeting.
- (2) Explanatory Statement pursuant to Section 173(2) of the companies Act, 1956 is annexed hereto

Question 20

The Board of Directors of LM Limited propose to donate Rs.3,00,000 to a school established exclusively for the benefit of children of employees and also donate Rs.50,000 to a political party during the Financial year ending 31st March, 2010. The average net profits determined

in accordance with the provisions of Sections 349 and 350 of Companies Act, 1956 during the three immediately preceding financial years is Rs.40,00,000. Examine with reference to the provisions of the Companies Act, 1956 whether the proposed donations are within the power of the Board of Directors of company.
(CA Final, New Course, June 2009)

Answer

Donations: As per section 293(1) (e) of the Companies Act, 1956, the Board of Directors of a Company must obtain approval of the shareholder by way of resolution passed in their meeting for contributing in any year, to charitable and other funds not directly relating to the business of the company or the welfare of to employees any amount exceeding Rs.50,000 or 5% of its average net profits of the last 3 financial years, whichever ever higher. In the given case, the school is established exclusively for the benefit of the children of the employees of the company and hence the restriction under section 293 (1) (e) is not applicable and the Board is empowered to make the proposed donation.

Donation to political parties: It is presumed that LM Ltd is not a Government Company. It has been in existence for more than 3 years. The proposed donation to a political party is only Rs.50,000 which is less than 5% of the average net profit for 3 immediately preceding financial years. Hence the Board of Directors is empowered to make a donation by passing a resolution at a Board meeting. The company is also required to make is proper disclosure in the profit and loss account. (Section 293 A).

POLITICAL CONTRIBUTIONS (SECTIONS 293A – 293B)

Prohibitions and restrictions regarding political contributions (Section 293A)

Question 1

The Board of Directors of Very Well Ltd., are contributing every year to a charitable organization a sum of Rs.60, 000/-. In a particular year, the company suffered losses and the directors are contemplating to contribute the said amount in spite of the losses. In this connection, state whether the directors can do so?

Answer

The power to donate to general charities is not conditional to existence of any profit. In such a case they may contribute up to the limit given in sec. 293(1) (e), even though the company may be working at a loss. Under the section the section a public company can contribute in any financial year not exceeding Rs 50,000 or 5% of its average net profits during the three preceding financial years whichever is greater.

Question 2

M/s XYZ Ltd. was incorporated on 1st January, 2000. On 1st November, 2002 a political party approaches the company for a contribution of Rs. Ten lakhs for political purpose. Advise in respect of the following:

- (i) *Is the company legally authorised to give this political contribution?*
- (ii) *Will it make any difference, if the company was in existence on 1st October, 1999?*
- (iii) *Can the company be penalised for defiance of Rules of this regard?*

Answer

- (i) No. prior to amendment of Section 293 A, by the Companies (Amendment) Act 1985, there was a blanket ban on political Contributions by Companies. But the amended section seeks to continue the existing blanket ban against political contributions in case of government companies and companies which have been in existence for less than three financial years.

Since XYZ Co. has not completed three years of existence on 2nd November 2002, it is not eligible to give political contribution.

- (ii) Yes, because in that case, XYZ ñî. limited shall complete three financial years of its existence, therefore, will be eligible to give political contribution subject to the condition that such a political contribution should not exceed five percent of the average net profits and a resolution authorising such contribution is passed at a meeting of the Board of Directors.
- (iii) The Amended Section 293A seeks to impose an obligation on every company to disclose in its profit and loss account contributions made by it to any political party or for any political purpose. Contravention of the provisions of this section will make a company liable to fine which may extend to three times the amount so contributed. Further every officer of the company in default would be liable to imprisonment for a term which may extend to three years and also to fine.

APPOINTMENT OF SOLE SELLING AGENTS (SECTIONS 294 – 297)

Prohibition on payment of commission to sole selling agents for loss of office in certain cases (Section 294 A)

Question 1

Randhir was appointed as the sole selling agent of S Ltd. for a period of five years in a general meeting of the company. Exactly after 1-½ years, S. Ltd. was amalgamated with another company A. Ltd. Randhir was not appointed as the sole selling agent of A. Ltd. S Ltd. paid Randhir Rs. 6 lacs as selling agency commission during the said 1-½ years. Is Randhir entitled to any company and if yes what is the quantum.

Answer

Section 294A prohibits payment of compensation to the sole selling agent for the loss of his office in the following cases:

- (i) where the appointment of the sole selling agent ceases to be valid by virtue of section 294(2A).
- (ii) where he resigns his office as a result of reconstruction or amalgamation of the company and is appointed as the sole selling agent of the reconstructed company or the body corporate resulting from the amalgamation.
- (iii) where he resigns his office otherwise than in the circumstances envisaged in the foregoing clause (ii).
- (iv) where he 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; and
- (v) where he has instigated or taken part directly or indirectly in bringing about the termination of the sole selling agency.

In this case, Randhir has not been appointed as the sole selling agent of A Ltd. None of the other prohibitions also apply. Hence Randhir would be entitled to compensation.

The amount of compensation payable for the loss of office must in no case exceed the remuneration which he would have earned, if he had been in office for the unexpired residue of his term, or for 3 years, whichever is shorter. The amount thereof is to be calculated on the basis of the average remuneration actually earned by him during a period of 3 years immediately preceding the date on which he had ceased to be in office or his appointment

was terminated. In case he had held his office for a period lesser than 3 years, the basis would be the average remuneration that he had earned during such shorter period. The average remuneration earned is $6/1.5 = 4$ lakhs. The compensation payable would be $4 \times 3 =$ Rs. 12 lakhs.

Question 2

On 1st January, 2001 the Board of Directors of XL Co. Ltd. appointed Mr. Y as Sole Selling Agent of the Company for a period of five years. On 6th February, 2001 XL Co. Ltd. in its General Meeting disapproved the appointment of Mr. Y as Sole Selling Agent of the Company. Explain:

- (a) *Is Mr. Y entitled to payment of compensation for Loss of Office?*
 - (b) *Are there some other circumstances when compensation for loss of office is prohibited to a Sole Selling Agent?*
- (November, 2002)**

Answer

- (i) According to Section 294(2) of the Companies Act, 1956, the Board of Directors of XL Ltd. "shall not appoint a sole selling agent for any area except subject to the condition that the appointment shall cease to be valid if it is not approved by the company in the first general meeting held after the date on which the appointment is made".

It has been held that the appointment of a sole selling agent must be made by the company in its general meeting and such clause must be inserted as a mandatory condition in all appointments of sole selling agents; an appointment without such a clause being inserted is void ab-intio (Arante manufacturing Corp. vs. Bright Bills Private Ltd. 1967 Comp/ Case 759 Shelagram Jhaigharia vs. National Co. Ltd. 1965 Comp. Cas. 706) If the company in the general meeting disapproves the appointment it shall become invalid from the date of the general meeting.

In the given case, assuming that the general meeting of XL Co. Ltd. held on February 6, 2001 was their first general meeting after January 1, 2001 and the disapproval of the company, in this meeting will make the appointment of Mr. Y as sole selling agent invalid w.e.f. February 6, 2001.

- (ii) Section 294(A) prohibits payment of compensation to the sole selling agent for the loss of his office in the following cases in addition to the one discussed in part (2) above :
 - (a) Where the sole selling agent resigns his office as a result of reconstruction or amalgamation of the company, and is appointed as the sole selling agent of the reconstructed company or the body corporate resulting from the amalgamation.
 - (b) Where the sole selling agent resigns his office otherwise than in the circumstances envisaged in the foregoing clause (i)

- (c) Where a sole selling agent has been found to be 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.
- (d) Where the sole selling agent has investigated or taken part directly or indirectly in bringing about the termination of the sole selling agency.

Question 3

Mr. BPK was appointed as the sole selling agent of M/s KMP Ltd. with effect from 1st January, 2002 for a period of five years. Mr. BPK earned his remuneration as follows during the years 2002 to 2004:

<i>Year</i>	<i>Amount of remuneration</i>
2002	Rs.4,41,000
2003	Rs.6,32,000
2004	Rs.7,45,000

On and from 1st January, 2005, the sole selling agency agreement was terminated by M/s KMP Ltd. You are required to calculate the amount of compensation payable by the said company to Mr. BPK under the provisions of the Companies Act, 1956.

What would be your answer in a case where the said M/s KMP Ltd. was amalgamated with another company with effect from 1st January, 2005 and Mr. BPK refused to act as the sole selling agent of the amalgamated company after amalgamation. **(May 2005)**

Answer

As per provisions of section 294A(2) of the Companies Act, 1956, any compensation payable by a company to its sold selling agent for premature loss of office shall not exceed the remuneration which he would have earned if he would have been in office for the unexpired residue of his term, or for three years, which ever is shorter, calculated on the basis of the average remuneration actually earned by him during a period of three years immediately preceding the date on which his office ceased or was terminated, or where he held his office for a period lesser than three years, then average remuneration actually earned by him during such lesser period.

Based on the above provision of the Companies Act, 1956, Mr. BPK is entitled to compensation for the unexpired residue of his term, i.e., for two years since it is shorter than three years. Such compensation shall be calculated on the basis of average remuneration received by him during the years 2002 to 2004. On the basis of figures given in the question, the amount of compensation shall be as follows:

Year	Amount of remuneration (Rs.)
2002	4,41,000/-
2003	6,32,000/-
2004	<u>7,45,000/-</u>
Total Remuneration	<u>18,18,000/-</u>
Average Remuneration per annum	<u>6,06,000/-</u>
Compensation payable to Mr. BPK for two years	<u>12,12,000/-</u>

As per provisions of section 294A(1) of the Companies Act, 1956, where the sole selling agent resigns his office in view of amalgamation with any other company and he is appointed as sole selling agent after such amalgamation, then he is not entitled to any compensation and the company is also prohibited from paying any compensation to the sole selling agent. Thus, in second case, Mr. BPK shall not be entitled to any compensation for premature loss of office since he himself has refused to act as the sole selling agent after amalgamation.

Question 4

M/s FAB Electronics Ltd. (FEL) has appointed four private companies as its selling agents for sale of its white goods in the four regions of the country. A complaint has been made to the Registrar of Companies, new Delhi that the four selling agents are in fact functioning as sole selling agents and that the terms and conditions of their appointment are not in the interest of FEL. Advise FEL about the provisions of the Companies Act and the action that may be taken by the authorities under the Act. (November 2007)

Answer

According to Section 294(6) of the Companies Act, 1956 where a company has more selling agents than one, by whatever name called and it appears to the Central Government that it is necessary to obtain information about the terms and conditions and appointment of such agents for the purpose of determining whether any of those selling agents are in fact working as sole selling agents. The Central Government has the power to call for such information as may be necessary to find out the correct position. On the basis of the information obtained, the Central Government may by an order declare that selling agents be the sole selling agent for the area so related with effect from such date as may be specified in the order. From the date so specified in the order, the appointment of the sole selling agent shall be regulated by the terms and conditions as may be varied by the Central Government. It shall be the duty of the company to furnish all information and documents and refusal to do so will involve penalty which may extend upto Rs. 50,000/-. Thus it is imperative for the company to furnish all the information and documents in its possession to the Registrar of Companies or any authority making any enquiry in this regard that the selling agents are not functioning as sole selling agents.

Question 5

On 24th January, 2010, the Board of Directors BUI Limited appointed Mr. A as the company's Sole Selling Agent for a period of 5 years. At the first general meeting of the company, held after the Board meeting, on April 10, 2010, the above appointment was disapproved. Referring to the provisions of the Companies Act, 1956.

- (i) State the date from which the above appointment comes to an end.*
 - (ii) What would be your answer in case a condition in the above appointment that "the appointment must be made by the company in General Meeting" was not attached thereto?*
- (May, 2010)**

Answer

According to Section 294(2) of the Companies Act, 1956, the Board of Directors of BUI Ltd. shall not appoint a sole selling agent for any area except subject to the condition that the appointment shall cease to be valid if it is not approved by the company in the first general meeting held after the date on which the appointment is made. It has been held that the appointment of a sole selling agent must be made by the company in its general meeting and such clause must be inserted as a mandatory condition in all appointments of sole selling agents; an appointment without such a clause being inserted is void ab-intio (*Arante manufacturing Corp. Vs. Bright Bills Private Ltd. 1967 Com/Case 769, Shelagram Jhaigharia Vs National Co. Ltd. 1965 Com. Cas. 706*). If the company in the general meeting disapproves the appointment, it shall become invalid from the date of the general meeting.

- (i) Thus, appointment of Mr. A as the sole selling agent will come to an end on 10th April 2010.*

Yes, as discussed above, in absence of the above clause, the appointment of Mr. A as the sole selling agent of the company will be void ab-initio.

Question 6

Mr. Agent having 'substantial interest' in ABC Ltd is appointed as a Sole selling agent by the Board of Directors for a period of 5 years. The company's paid-up share capital is Rs.49 crores. The Board did not place the matter in the AGM and communicated to Mr. Agent about his appointment, who in turn accepted the offer.

Examining the provisions of the Companies Act, 1956,

- (a) Whether the appointment is in order?*
- (b) What course of action you would take as the Secretary of the company, in case Mr. Agent does not have substantial interest?*

Answer

Appointment of Sole Selling Agent: Section 294 and 294AA of the Companies Act, 1956 regulate the appointment of sole selling agents. These sections provide that:

1. No company shall appoint a sole selling agent for any areas for a term exceeding 5 years at a time and the term may be extended for another period but not exceeding 5 years on each occasion. [Section 294(1)].
2. The Board of Directors may appoint a sole selling agent but only subject to the condition that the appointment shall cease to be valid if it is not approved by the company in the first general meeting held after the date on which the appointment is made. In case, the company in general meeting, as aforesaid, disapproved the appointment, it shall cease to be valid with effect from the date of that general meeting [Section 294(2) and (2A)].
3. Where the Central Government is of opinion that the demand for goods of any category, to be specified by that government is substantially in excess of the production or supply of such goods and the services of sole selling agents will not be necessary to create a market for such goods, the Central Government may by notification in the Official Gazette, declare that sole selling agents shall not be appointed by a company for the sale of such goods, for such period, as may be specified in the declaration.
4. No company shall appoint any individual firm or body corporate, who or which has a substantial interest in the company as sole selling agent of that company unless such appointment has been previously approved by the Central Government.
5. A company having a paid-up share capital of Rs.50 lakhs or more shall not appoint a sole selling agent except with the consent of the company accorded by a special resolution and the approval of the Central Government.
6. The Central Government may vary the terms and condition of appointment of a sole selling agent if those are found to be prejudicial to the interest of the company.
7. In case a company has more than one selling agents in any area, the Central Government may declare any one of such agents as the sole selling agent for such area after obtaining from the company and considering the terms and conditions of appointment of the selling agents.

Procedure for appointment of sole selling agents:

1. Call a meeting of the Board of Directors and determine the name of the sole selling agent to be appointed. If the paid-up share capital of the company is less than Rs.50 lakhs and the appointee does not have a substantial interest in the company, the Board may also resolve to appoint him as sole selling agent subject to the approval of the general body meeting. Date for the general meeting may also be fixed by the Board in its meeting, appointing the sole selling agent.

2. In case the appointee either has a substantial interest in the company, or the paid-up share capital of the company is Rs.50 lakhs or more, application for the approval of the Central Government should be made in Form 1 of the Companies (Appointment of Sole Agents) Rules, 1975.
3. See that the terms and conditions of appointment or reappointment do not contain the tenure exceeding 5 years, at a time.
4. Issue notices for holding the general meeting. Where the paid-up share capital of the company is Rs.50 lakhs or more, it shall require passing a special resolution; otherwise an ordinary resolution shall be sufficient.
5. Forward three copies of the notices and a copy of the proceedings of the general meeting to the Stock Exchange(s) with which the shares of the company are listed (if listed).
6. If the proposed sole selling agent is to be appointed in a foreign country, obtain the prior permission of the RBI.

Thus applying the above provisions (i) the appointment of J is not in order, as there have been a number of violation on the part of the company as per the Companies Act, 1956. Appointment without the approval of the general meeting and without the approval of the Central Government is not valid since the company's paid-up share capital is more than Rs.50 lakhs in this case. Moreover, since J has substantial interest in the company, approval of Central Government in Form 1 is must. Thus, the appointment of J is not in order.

In the second question (ii), the answer would not be different, as the capital (paid-up share capital) is more than 50 lakhs Rupees. In this case though the appointee (J) does not have substantial interest, but the company's paid share capital is more than 50 lakhs, consent of the company in general meeting (special resolution) and the approval of the Central Government is required.

Power of CG to prohibit the appointment of role selling agents in certain cases (Section 294 AA)

Question 7

The Board of Directors of 'X Ltd. having a paid-up share capital of Rs. 40 lakhs appointed 'Y Ltd, as sole selling agent for a period of 5 years with effect from 1st January, 2003 and the said appointment was approved by the company in the Annual General Meeting held on 30th April, 2003. The Directors of 'Y Ltd. was holding fully paid-up shares of face value of Rs. 3 lakhs in 'X Ltd.' Answer the following explaining the relevant provisions of the Companies Act:

- (i) *Is the appointment of the sole selling agent in order?*
- (ii) *Would your answer be different if both are Private Companies or if the Directors of Y Ltd. (acquired the aforesaid shares in 'X Ltd.) on 1st April, 2003?*

Answer

- (i) **Sole Selling Agents:** (i) According to Section 294AA(2) of the Companies Act, 1956 a company shall not appoint any individual, firm or body corporate, who or which has a substantial interest in the company, as sole selling agent of that company unless such appointment has been previously approved by the Central Government.

Here a body corporate is appointed as sole selling agent. A body corporate can be said to have "substantial interest" in the company, if such body corporate or one or more of its directors or any relative of such director, whether singly or taken together hold beneficial interest in the shares of the company, the aggregate amount paid-up on which exceeds Rs. 5 lakhs or 5% of the paid-up share capital the company, whichever is less. Here 5% of the paid-up share capital of X Ltd. works out to Rs. 2 lakhs. The directors of Y Ltd. were holding fully paid-up shares of face value of Rs. 3 lakhs in X Ltd.. and hence Y Ltd. can be said to have substantial interest in X Ltd. Therefore, the appointment of Y Ltd. as sole selling agent requires prior approval of the Central Government under Section 294AA(2). In this case the appointment has been made by the Board of Directors and approved by the company in general meeting. As the prior approval of the Central Government has not been obtained, the appointment is not in order and the company has contravened the provisions of Section 294AA(2).

- (ii) Section 294AA is applicable to both private and public limited companies. So it is immaterial whether X Ltd. is a private or public company. Again the body corporate includes both private and public companies. Hence the provisions of Section 294AA(2) are attracted even if the sole selling agency company is a private company. Therefore even if both the companies are private companies, the appointment of sole selling agent without approval of the Central Government is not in order.

It has been clarified by the Department of Company Affairs that in case the provisions of Section 294AA(2) are not attracted to the appointment of sole selling agents the time of entering of agreement with them, it will not be obligatory on the companies to comply with the said provisions for the continuance of the said appointments for the remaining duration of their current tenure even if the provisions of Section 294AA(2) become applicable after the appointment due to the sole selling agents acquiring substantial interest as defined in the explanation under the Section. If the directors Ltd. were not holding shares in X Ltd. at the time of appointment but acquired the shares subsequently the appointment is in order and it does not violate the provisions of section 294AA(2).

Question 8

Randhir was appointed as the sole selling agent of S Ltd. for a period of five years in a general meeting of the company. Exactly after one and half years, S Ltd. was amalgamated

with another company A Ltd. Randhir was not appointed as the sole selling agent of A Ltd. S Ltd. paid Randhir Rs.6 lacs as selling agency commission during the said one and half years. Is Randhir entitled to any compensation and if yes, what is the quantum? (November, 2000)

Answer

Section 294A prohibits payment of compensation to the sold selling agent for the loss of his office in the following cases:

- (i) Where the appointment of the sold selling agent ceases to be valid by virtue of section 294(2A).
- (ii) where he resigns his office as a result of reconstruction or amalgamation of the company and is appointed as the sole selling agent of the reconstructed company or the body corporate resulting from the amalgamation.
- (iii) where he resigns his office otherwise than in the circumstances envisaged in the foregoing clause
- (iv) where he 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; and
- (v) where he has instigated or taken part directly or indirectly in bringing about the termination of the sold selling agency.

In this case, Randhir has not been appointed as the sole selling agent of A Ltd. None of the other prohibitions also apply. Hence Randhir would be entitled to compensation.

The amount of compensation payable for the loss of office must in no case exceed the remuneration which he would have earned, he had been in office for the unexpired residue of his term, or for 3 years, whichever is shorter. The amount thereof is to be calculated on the basis of the average remuneration actually earned by him during a period of 3 years immediately proceeding the date on which he had ceased to be in office or his appointment was terminated. In case he had held his office for a period lesser than 3 years, the basis would be the average remuneration that he had earned during such shorter period. The average remuneration earned is $6/1.5=4$ lacs. The compensation payable would be $4 \times 3 = \text{Rs.}12$ lacs.

Question 9

Ram and Co. Ltd. having paid up share capital of Rs. 40 lakhs appointed on 1st January, 1995 Lakshman and Co. Pvt. Ltd. as sole selling agent for a period of 5 years with effect from 1st January, 1995 with the approval of the company in general meeting. The directors of Lakshman and Co. Pvt. Ltd. were holding 40,000 equity shares of Rs. 10 each fully paid-up in Ram and Co. Ltd. since 1st December, 1994.

State with reasons whether the appointment is valid. Will your answer be different, if Lakshman and Co. Pvt. Ltd. had acquired the aforesaid shares only on 1st December, 1995?

(May, 2003)

Answer

Under section 294AA, no company can except with the prior approval of the Central Government, appoint any individual, firm or body corporate, who or which has a substantial interest in the company as sole selling agent of that company. A person holding paid-up capital exceeding Rs.5 lakhs or 5% of the paid-up capital of the company whichever is less is deemed to have substantial interest in that body corporate [Explanation to Section 294AA].

Thus Ram & Co. should have obtained prior approval of the Central Government for appointing Lakshman & Co. Pvt Ltd as sole selling agents as the latter holds 10% of the paid-up capital of the former company. The appointment is accordingly not valid.

The situation shall be different if shares were acquired by Lakshman & Co. on 1st December 1995. According to a clarification issued by the Department of Company Affairs, if the provisions of Section 294AA(2) are not attracted to the appointment of selling agents at the time of entering into the agreement with them, it will not be obligatory on the company to comply with the said provision for continuance of said appointment for the remaining duration of the current tenure, even if the provisions of section 294AA(2), became applicable after the appointment due to sole selling agents acquiring substantial interest.

However Lakshman & Co. Ltd can continue as sole selling agents for period of 5 years i.e. upto 31st December, 1999, if it acquired the shares only on 1st December 1995 i.e after its appointment on 1st January 1995.

Question 10

The Board of Directors of ACE Limited having a paid up share capital of Rs. 70 lakhs reappointed Bre Ltd. As sole selling agent for a period of 5 years W.E.F. 2 May, 2007. The Directors of BRE Ltd. were holding fully paid up shares of face value of Rs. 3 lakhs. In ACE Ltd. the reappointment was approved by the company in the next AGM held on 30th September, 2007 but Central Government approval was not obtained until 31st December, 2007. Give your opinion explaining the relevant provision of the Companies Act, 1956.

- (i) *Is the reappointment of the sole selling agent in order?*
 - (ii) *Will your opinion be different if the directors of BRE Ltd. do not hold any shares in ACE Ltd?*
 - (iii) *If the reappointment is valid. When will the reappointment take effect from?*
- (November 2008)**

Answer

Section 294AA of the Companies Act, 1956 contains the powers of Central Government to prohibit the appointment of Sole Selling Agents in certain cases. The section further provides that no company shall appoint any individual, firm or body corporate, who or which has a substantial interest in the company, as Sole Selling Agent of that company unless such appointment has been previously approved by the Central Government (Section 294AA (2)).

Also no company having a paid up share capital of rupees fifty lakhs or more shall appoint a Sole Selling Agent except with the consent of the company accorded by a Special Resolution and the approval of the Central Government (Section 294AA(3)). Section 294AA (7) provides that if the company in general meeting disapproves the appointment referred to in sub-section (3), such appointment shall, notwithstanding anything contained in sub-section (6), cease to have effect from the date of the general meeting.

The explanation to this section provides that “appointment” includes “re-appointment “ and “substantial interest “ in relation to a body corporate, means the beneficial interest held by such body corporate or one or more of its directors or any relative of such director, whether singly or taken together, in the shares of the company , the aggregate amount paid up on which exceeds five lakhs of rupees or five per cent of the paid up share capital of the company, whichever is the lesser.

- (i) So the re- appointment of BRE Ltd. as sole selling agent is in order as general meeting approval was obtained by way of special resolution. Further, ACE Ltd. has to obtain the approval of the Central Government as required under Section 294AA (3) and the same was also obtained by 31st December 2007.
- (ii) No, even if BRE Ltd. does not hold any shares in ACE Ltd. the appointment shall remain valid as ACE Ltd has obtained the approval of the Central Government under Section 294AA(3).
- (iii) Effective date of reappointment is the date from which he is re appointed by the company. As such the re-appointment shall be valid from 2nd May 2007.

Question 11

A company proposes to appoint a Sole Selling Agent for its products. State the cases in which such appointment requires approval of Central Government. Draft a Board Resolution to appoint a sole selling agent in a case where such appointment does not require approval of Central Government.

(CA Final, New Course November, 2009)

Answer

Appointment of sole selling agents

Under Section 294AA of the companies Act,1956, in following cases, appointment of sole selling agents will require approval of Central Government:

- (a) An individual firm or body corporate who has a substantial interest in the company cannot be appointed as a sole selling agent without prior approval of Central Government [Section 294 AA(2)]. Substantial interest means shares of Rs.5. lakhs or 5% paid up capital of the company, whichever in less. The shareholding may be singly or together with relatives (in the case proposal Sole Selling Agent being an individual), partners and their relatives (in the case of a firm) directors and relatives of directors (in the case of a body corporate (Explanation (b) to Section 294AA).

- (b) Any company having paid up share capital of Rs.50 lakhs or more cannot appoint sole selling agent with approval in general meeting by a special resolution and also approval of Central Government [Section 294AA(3)]. These restrictions apply to all Companies is both Private and Public Companies.

Board Resolution

Resolved that pursuant to the provisions of section 294 of the Companies Act, 1956, and subject to the approval of the Company at a general meeting by ordinary resolution, the Board approves the appointment of 'X' as the company's sole selling agent for the sale of in the territory of for a period of five years with effect from on the terms and conditions set out in the draft agreement produced to this meeting and initiated by the chairman for purposes of identification or with such modifications (not being less advantageous to the company) as may be mutually agreed by the Board and 'X'

Loans to directors, etc (Section 295)

Question 12

A director of a public company has taken a loan from the company without the approval of the Central Government. State in this connection

- (i) *is it possible to avoid prosecution by applying to the central Government for approval or by refunding the loan?*
- (ii) *whether the offence is compoundable before or after institution of prosecution and the authority can compound the offence?*

Answer

- (i) According to Section 295 of the Companies Act, no public company shall make any loan to any of its directors either directly or indirectly without obtaining the previous approval of the Central Government. As the Act envisages prior approval, Central Government will not entertain any application from the company seeking approval for a loan already given to its director.

The company has, therefore, contravened the provisions of Section 295(1) and for this offence every person who is knowingly a party to this contravention including the person to whom the loan is made shall be punishable either with fine which may extend to Rs. 50,000 or with simple imprisonment for a term which may extend to six months [Section 255(4)]. Where any such loan has been repaid in full, no punishment by way of imprisonment shall be imposed and where the loan has been repaid in part, the maximum punishment, which may be imposed by way of imprisonment, shall be proportionately reduced. So, by refunding the loan in full, it is possible to avoid punishment in the form of imprisonment, but it is not possible to avoid prosecution and punishment in the form of fine.

- (ii) All offences other than offences which are punishable under the Companies Act with imprisonment only or with imprisonment and also with fine are compoundable under Section 621A. As the offence under Section 295 is punishable with fine or imprisonment, it is compoundable but with the permission of the Court [Section 621A(2)]. The offence may be compounded either before or after the institution of prosecution. If the offence is compounded before the institution of any prosecution, no prosecution shall be instituted in relation to such offence, either by the Registrar or by any shareholder or by any person authorised by the Central Government. Where the composition of any offence is made after the institution of any prosecution, such composition shall be brought to the notice of the court by the Registrar in writing and on such notice of the composition of the offence being given, the company or its officer in relation to whom the offence is so compounded shall be discharged [Section 621A(4)].

The offence may be compounded by the Regional Director where the maximum amount of fine, which may impose for such offence, does not exceed Rs. 50,000 and in other cases by the company Law Board. In this case, Regional Director may compound the offence, as the maximum fine is only Rs. 50,000. On receipt of applications from the persons liable for penalty under Section 295(4) along with the comments of the Registrar, the Regional Director may specify the amount not exceeding the maximum fine which shall be paid to the Central Government for compounding of the offence.

Question 13

A company is offering one of its flats on sale to one of its directors on the condition that 50% of the price to be paid in cash and the rest in equated instalments. Comment on the situation, whether this could be treated as a loan under Section 295 of the Companies Act, 1956.

Answer

- (i) This transaction does not per se amount to a loan so as to violate Section 295 of Companies Act, 1956. The burden of proving otherwise lies with the prosecution. (*M.G. Electronics Components Ltd v. Asst. Registrar of Companies*).
- (ii) The deposit of the cost of purchase of property cannot be regarded as a loan or advance to the M.D. or book debt attracting the provisions of section 295 or section 296 of the Companies Act. It is no concern of the M.D. on what terms the company secures premises for residential accommodation for him.
- (ii) In a petition in *Dr. Fredie Ardeshir Mehta v. Union of India* seeking quashing of a prosecution launched under Section 295, the Bombay High Court came to the conclusion that a company selling one of its flat to one of its directors on receiving half price in cash and agreeing to accept the balance in instalments does not give a loan to the director. It is accredit sale. It cannot continued be described even as an indirect loan. In view of this decision, the transaction in question does not amount to a loan to a director requiring approval of the Central Government.

Question 14

A & Co. Ltd. wants to sell its products to its following customers: (a) A partnership firm in which two of the directors of the company are partners; (b) A private company in which one of the directors of the company is a member; (c) A public company in which one of the directors of the company is a director. In these three cases what steps are required to be taken by A & Co. Ltd.?

Answer

(a) & (b) According to Section 297, except with the consent of the Board of Directors of a company, *firm* in which the director or directors of the company is/are partners or a *private company* of which such director or directors is or are a member or members shall not enter into any contract with the company for the sale, purchase or supply of any goods, materials or services. Therefore, the public company in the instant two cases should obtain the consent of its Board of Directors. This consent shall have to be taken by a resolution passed at the Board meeting and not otherwise. The resolution according the consent must be passed before the contract to sell the product is entered into or within 5 months of the date on which it was entered into; otherwise consent shall not be deemed to have been given. If the consent is not accorded, anything done in pursuance of the contract shall be voidable at the option of the Board. Care should be taken to ensure that the interested directors do not vote on the motions and their presence is not counted for the purpose of quorum for the meeting. Also it is to be seen that such directors have disclosed their interests in the contract pursuant to Section 299 of the Companies Act unless any of them is enjoying the exemption under sub-section (6) of the above section.

The consent contemplated above is not a general consent but consent referable to each particular or specific contract or contracts. Consent requires knowledge of the necessary facts and material, which lead to the consent and cannot be given in general or abstract manner (*Watchand Nagar Industries Ltd. vs. Ratanchand, A.I.R. Bom. 256*). Therefore, the Board of the public company should take appropriate steps in this regard.

(c) The point of the case in question relates to disclosure of interest by directors. According to Section 299(6), nothing in Section 299 shall apply to any contracts entered into or to be entered between two companies where one of the directors of the one company or two or more of them together holds or hold not more than 2% of the paid up share capital in the other company. This point is not clear from the facts in the problem. This is a contract to be entered into between two companies. And if the director of the first company holds 2% or less of the paid-up share capital in the second public company, the provisions of Section 299 will not apply to this case.

If, however, the said director holds more than the aforesaid 2% then the Board of Directors should see that the director, pursuant to Section 299, discloses his interest or concern at the meeting of the Board. This disclosure has to be made at the Board meeting at which the

contract is considered. If the interest is acquired subsequent to the meeting then it is to be disclosed at the immediately next meeting.

The Board of the first-mentioned public company should ascertain whether the interest of director aforesaid consists solely (i) in his being a director of such company and the holder of not more shares of such number and value therein as is requisite to qualify him for appointment as a director thereof, he having been nominated as such director by the company or (ii) in his being a member holding not more than 2% of its paid-up share capital. Also, there is no restriction on voting, etc. by an interested director if a notification had been issued by the Central Government under Section 300(3) exempting the company from the purview of Section 300. If, on such assertion, the interest is not found to be so consisting as aforesaid, the Board of the company should see that interested director does not participate in the discussion or vote on the contract and that his presence is excluded from the computation of quorum.

Question 15

Mr. X is a director of M/s ABC Ltd. He has approached M/s Housing Finance Co. Ltd. for the purpose of obtaining a loan of Rs.50 lacs to be used for construction of building his residential house. The loan was sanctioned subject to the condition that M/s ABC Ltd. should provide the guarantee for repayment of loan instalments by Mr. X. Advise Mr. X. (November, 2001)

Answer

According to section 295 of the Companies Act, 1956, no company shall make a loan or give any guarantee, or provide any security in connection with a loan made by any other person to any director of the lending company unless the previous approval of the Central Government is obtained in this behalf. Thus, Mr. X has to approach his company ABC Ltd by stating the full details of the loan transaction and the stipulation of M/s Housing Finance Company Ltd. Thereafter M/s ABC Ltd has to make an application to the Central Government for approval under Section 295 along with the prescribed fees. Only on receipt of the approval M/s ABC Ltd can provide guarantee to M/s Housing Finance Co. Ltd.

The company is also required to comply with the provisions of section 292 (i.e. Board Resolution) and section 372A (special resolution in a general meeting if required).

Question 16

In the light of the conditions laid down by Section 295 of the Companies Act, 1956, examine if the following transactions can be considered as loans to Directors:

- (i) *Advance payment of salary to the employee who is also the spouse of the Managing Director of the Company.*
- (ii) *A sale of flat of the company at the Current Market Rate and Price. The Director pays sixty per cent Cash immediately and contracts to pay the balance in ten monthly instalments.*
- (iii) *A loan to a firm in which the Director of the company is a Partner. (November, 2002)*

Answer

A company's power of lending money to its directors is strictly regulated by the Companies Act, 1956. The Act prohibits the company not only from directly lending money to its directors but also from giving any guarantee for a loan taken by a director from any other person, and providing any security for such loan. Section 295 deals with loans to Directors.

- (i) This transaction does not per se amount to a loan so as to violate Section 295 of the Companies Act, 1956. The burden of proving otherwise lies with the prosecution. Thus in the absence of any evidence that there has been circumvention of the section by disguising the loan to the wife of the director, who is an employee, as salary advance, the court refused to accept the case for prosecution. *M.R. Electronic Components Ltd. vs. Assistant Registrar of Companies (1987) 6 Comp. Case 8 (Mad)*.
- (ii) In a petition, *Dr. Freddie Ardeshir Mehta V. Union of India* seeking quashing of a prosecution launched under section 295, the Bombay High Court came to the conclusion that a company selling one of its flats to one of its directors on receiving more than half the price in cash and agreeing to accept the balance in installments does not amount to giving a loan to the directors. It is a credit sale. It can not even be described as indirect loan.
- (iii) Through the loan given by the company to the firm may not be direct loan to the directors of the company, yet the provisions of Section 295 of the Companies Act, 1956 prohibit any loan to a firm in which one or more of the company directors are partners. Since one of the directors of the company is a partner of this firm, a loan to this firm is in contravention of the provisions of Section 619.

Question 17

Mr. X is a director of several companies. He has approached the following companies in which he is a director for financial help to start his own personal business.

- (i) *Expandable Industries Ltd.*
- (ii) *Expensive Gadgets Private Ltd.*
- (iii) *Easy Finance Ltd.*

The first named company has agreed to grant a loan of Rs. 50 lakhs. The second company also offered another loan of Rs. 50 lakhs. The third company has agreed to provide guarantee for the repayment of a loan sanctioned to Mr. X by a Private Bank to the tune of Rs. One crore. Advise Mr. X about the legal provisions that should be complied with under the Companies Act, 1956 and the consequences if there is a non – compliance. (November 2008)

Answer

According to Section 295 of the Companies Act, 1956 no public company shall directly or indirectly make any loan to or give any guarantee or provide any security in connection with a loan made by any other person to a director of the company without obtaining the previous approval of the Central Government. Thus M/s. Expandable Industries Ltd, being a public company has to take approval of the Central Government before the loan amount of Rs. 50 lakhs is disbursed. However no approval of the Central Government is required in the case of Expensive Gadgets Private Ltd. being a Private Company. However, if the said Private Company is a subsidiary of a Public Company, the approval of Central Government is required. In the case of Easy Finance Ltd. the approval of Central Government is required and thereafter only the transaction can be entered into without committing violation of the provision of the Companies Act, 1956. If there is any violation, Mr. X the director will vacate his office as a director as provided in Section 283 (1) (h) of the Act. The said violations is however compoundable under Section 621A of the Act.

Question 18

- (i) *Mr. KMP is director of XLS Ltd. He intends to construct a residential building for his own use. The cost of construction is estimated at Rs.1.50 Crores, which Mr. KMP proposes to finance partly from his own sources to the tune of Rs.60 lacs and the balance Rs.90 lacs from housing loan to be obtained from a housing finance company. For the purpose of obtaining the loan, he has approached the housing finance company which has in principle agreed to grant the loan, but has put a condition. The condition put by the housing finance company is that the Company XLS Ltd. of which Mr. KMP is a director should provide the guarantee for repayment of the loan and interest as per the terms of the proposed agreement for granting the loan to Mr. KMP. You are required to advise Mr. KMP on the matter with reference to the provisions of the Companies Act, 1956.*
- (ii) *Draft a Board Resolution of XLS Ltd. For providing guarantee for Rs. 90.00 lacs in respect of a Loan to be obtained by Mr. KMP, a director thereof from a Housing Finance Company for construction of a residential house for his own use.*

(CA Final, New Course, June 2009)

Answer

- (a) (i) According to the provisions of Section 295 of the Companies Act, 1956, no company shall make any loan or give any guarantee or any security in connection with a loan made by any other person to any director of the lending company unless the previous approval of the Central Government is obtained in this respect.

In view of the above provisions of the law, Mr. KMP is required to approach XLS Ltd. intimating the company the full details of the loan transaction and the condition imposed by the housing finance company. The company XLS Ltd. is required to pass a Board Resolution as required by Section 292 of the Companies Act, 1956 and also a special resolution in terms of Section 372A if the facts of the case so require. Thereafter, the company is required to make an application to the Central Government for obtaining the approval under Section 295 of the Companies Act, 1956. On receipt of the approval of the Central Government, XLS Ltd. can provide the guarantee to housing finance company in respect of the loan proposed to be granted to Mr. KMP

(ii) **RESOLUTION PASSED IN THE MEETING OF THE BOARD OF DIRECTORS OF XLS LTD. HELD ON _____**

“RESOLVED that, subject to the approval of the Central Government, sanction be and is hereby accorded to the proposal of furnishing the guarantee in respect of a loan of Rs.90.00 lacs to be obtained by Mr. KMP, a director of the Company, from M/s _____, a housing finance company as per terms and conditions contained in the draft loan agreement to be entered into between the said housing finance company and Mr. KMP, a copy of which is placed before this meeting and initialed by the Chairman for the purpose of identification.

RESOLVED FURTHER that Mr. _____, Secretary of the Company by and is hereby authorized to digitally sign the e-form 24AB, submit the application to the Ministry of Corporate Affairs and comply with all other formalities in this regard.”

Question 19

- (a) *X Ltd. whose paid up share capital to Rs.3 crores proposes to purchase raw material of Rs.20 lakhs from Y Limited. It proposes to purchase raw material of Rs.10 lakhs on cash basis and the balance on 90 days credit. A who is the Managing Director of X Limited is also a director and shareholder of Y Limited. Advise the procedure.*
- (b) *Z Limited has four directors and all of them are interested in a contract. Guide?*

Answer

- (a) The provisions of Section 297 are not applicable when the company from whom the materials will be purchased is a public limited company. Mr. A has to comply with the provisions of Section 299 and disclose his interest at the Board Meeting and is not to participate in discussion at the meeting, when the above contract is put up for approval of the Board. Even if the shareholding of Mr. A in Y Ltd. together with the shareholding, if any,

of the directors is 2% or less in Y Ltd., disclosure of his interest as director in Y Ltd. shall be made.

- (b) In terms of provision of Section 287 of the Companies Act, 1956, Quorum for meeting of Board of Directors of the Company shall be one third of its total strength or two Directors whichever is higher. Interested Directors' presence shall not be considered for the purpose of quorum. In the present case, there will be no quorum in the board meeting in respect of a contract as all the directors are interested therein.

The remedy in such case seems to be to increase the strength of Board by appointing at least two disinterested directors as additional directors who are not interested in said contract, if so authorised by Articles and if the said appointment shall be within the maximum number of directors as fixed by the Articles. If this is not found practicable it would be desirable to place the proposed contract before General Meeting for consent. [Department of Company Affairs Letter No. 816(I)61-P-R dated 9/5/81].

Board's sanction to be required for certain contracts in which particular directors are interested (Section 297)

Question 20

X Ltd., recently went in for public issue of shares and for this purpose it paid brokerage to a share broking firm in which one of the Directors of the company is a partner in that firm. State in this connection:

- (i) *Whether the concerned interested director should disclose his interest in the firm to the Company. If so, when?*
- (ii) *Should he still disclose, if the company already knew of this fact.*
- (iii) *What would be your answer, if the concerned director merely acted as a broker between the firm and the company?*

Answer

- (i) According to Section 297, a director of the company or his relative, a firm in which such a director or relative is a partner, any other partner in such a firm or a private company of which the director is a member or director, must not enter into contracts with company for the sale, purchase, or supply of goods, materials or services or for underwriting shares or debentures except with the consent of the Board of Directors. If the company is having a paid-up capital of Rs.1 crore or more no such contract shall be entered into except with the previous approval of the Central Government. The consent of the Board is deemed to have been given only if it is accorded by a resolution of the Board and not otherwise, either before or within three months of the date of entering into the contract. [sub-section (4)].

In view of the legal position as stated above, the appropriate brokerage can be paid to the broking firm if the contract had been entered into with the consent of the Board of

Directors of X & Co. Ltd. the director in question is to disclose his concern or interest at the first meeting of the Board meeting held after the director becomes concerned or interested in the contract. A general notice given in this regard to the Board is deemed to be sufficient disclosure of his concern or interest, if either it is given at the meeting of the Board of Directors concerned or he takes reasonable steps to ensure that it is brought up and read at the first meeting of the board after it is given.

The condition under which the sanction of the Board of Directors in respect of contracts by directors or persons connected therewith would not be required [as contained in sub-section (2) of Section 297] have been liberalised. The restrictions do not apply to:

- (a) the purchase of goods and materials from, or sales thereof to, the company for cash at prevailing market prices;
- (b) any contract or contracts between the company and directors or persons connected therewith in respect of sale, purchase or supply of goods in which the parties to the contract regularly trade or do business in; provided they are in respect of goods and materials or services the value whereof or the cost of service would not exceed Rs.5,000 in aggregate in any year comprised in the period of the contract;
- (c) the transactions by banking or insurance company entered into with any director, relative, firm, partner, etc. in the ordinary course of his business.

Section 297(3) provides that a director or persons connected with him may enter into a contract in the circumstances of urgent necessity without obtaining consent of the Board, even if the value of such a contract exceeds Rs. 5,000 in the aggregate, but in such a case the consent of the Board must be obtained at meeting within three months of the date of entering into the contract.

- (ii) The term 'disclosure' means to make others aware of something, which they are not aware. The disclosure of interest by a director has been provided in Section 299 only with a view to know that the director occupies fiduciary position in the company should disclose his interest in any arrangement or contract either directly or indirectly so that the company is in a position to know whether he is acting in any way prejudicial to the interest of the company or for his own benefit. When board is aware of the fact of the interest of a director in a particular transaction, it would not be necessary for such a director to formerly disclose his interest. (*Ramakrishna Rao vs. Bangalore Race Club*, 40 Comp. Case 674 (Mysore). *A. Sivasailam vs. Registrar of Companies* {C.A. No. 11/621A/SRB/94 decided on 31.5.94 (CLB)}).
- (iii) A contract to act as broker where the duty of the broker is merely to bring together the two contracting parties, namely, the company, on the one hand, and the purchaser of shares or debentures, on the other, does not seem to be covered either by clause (b) or by clause (a) of sub-section (1) of Section 297. It is not covered by clause (b) for two

reasons: First, clause (b) specifically refers to underwriting and importing into that clause the act of broking is not permissible. Secondly, there is a good deal of difference between underwriting and broking. In the case of the former, the obligation extends far beyond the mere bringing together the two contracting parties together, while in the case of latter, the broker earns his commission only when he succeeds in bringing the two parties together and not otherwise. To act as a broker is also not covered by clause (a) because commission earned as a broker is not earned by supplying services. The Madras High Court has rightly held that "rendering of services should consist of the doing of an act for the benefit of another which is more than the mere making of a contract and which goes beyond the performance of an obligation undertaken in the course of an ordinary commercial contract". (*Radhakrishna Rao vs. Province of Madras AIR 1952 Mad. 718*)

Question 21

Examine whether the following contracts require previous approval of the Central Government keeping in view the effect of the proviso to Section 297(1) of the Companies Act, 1956.

(i) Contracts for purchase of goods from a public company having a paid-up share capital of more than rupees one crore by a firm in which a director of the public company is a partner. The purchase is for cash at prevailing market prices.

(ii) Contracts attracting Section 297(1) to be entered into by a Public Company having a paid-up share capital of Rupees one crore in circumstances of urgent necessity. (May, 2004)

Answer

Section 297(3) provides that a contract attracting Section 297(1) may be entered into by the company without obtaining the consent of the Board in circumstances of urgent necessity. But the consent of the Board must be obtained within three months of the date on which the contract was entered into. While section 297(2) provides an exemption, Section 297(3) provides only relaxations that too only with one of the requirements i.e. consent of the Board. In the case under reference as the paid-up share capital of the company is Rs. 1 crore, both the consent of the Board as well as approval of the Central Government are required. Hence, the relaxation provided in Section 297(3) does not apply to a company which has a paid-up share capital of Rs.1 crore. The company must obtain approval of the Central Government before entering into contract even in circumstances of urgent necessity.

Question 22

X Ltd., recently went in for public issue of shares and for this purpose it paid brokerage to a share broking firm in which one of the Directors of the company is a partner in that firm. State in this connection:

- (i) *Whether the concerned interested director should disclose his interest in the firm to the company. If so, When?*
- (ii) *Should he still disclose, if the company already knew of this fact.*
- (iii) *What would be your answer, if the concerned director merely acted as a broker between the firm and the company?*

Answer

- (i) According to Section 297, a director of the company or his relative, a firm in which such a director or relative is a partner, any other partner in such a firm or a private company of which the director is a member or director, must not enter into contracts with company for the sale, purchase, or supply of goods, materials or services or for underwriting shares or debentures except with the consent of the Board of Directors. If the company is having a paid-up capital of Rs.1 crore or more no such contract shall be entered into except with the previous approval of the Central Government. The consent of the Board is deemed to have been given only if it is accorded by a resolution of the Board and not otherwise, either before or within three months of the date of entering into the contract. [sub-section (4)].

In view of the legal position as states above, the appropriate brokerage can be paid to the broking firm if the contract had been entered into with the consent of the Board of Directors of X & Co. Ltd. the director in question is to disclose his concern or interest at the first meeting of the Board meeting held after the director becomes concerned or interested in the contract. A general notice given in this regard to the Board is deemed to be sufficient disclosure of his concern or interest, if either it is given at the meeting of the Board of Directors concerned or he takes reasonable steps to ensure that it is brought up and read at the first meeting of the board after it is given.

The condition under which the sanction of the Board of Directors in respect of contracts by directors or persons connected therewith would not be required [as contained in sub-section (2) of Section 297] has been liberalised. The restrictions do not apply to:

- (a) the purchase of goods and materials from, or sales thereof to, the company for cash at prevailing market prices;
- (b) any contract or contracts between the company and directors or persons connected therewith in respect of sale, purchase or supply of goods in which the parties to the contract regularly trade or do business in; provided they are in respect of goods and materials or services the value whereof or the cost of service would not exceed Rs.5,000 in aggregate in any year comprised in the period of the contract;
- (c) the transactions by banking or insurance company entered into with any director, relative, firm, partner, etc. in the ordinary course of his business.

Section 297(3) provides that a director or persons connected with him may enter into a contract in the circumstances of urgent necessity without obtaining consent of the Board, even if the value of such a contract exceeds Rs. 5,000 in the aggregate, but in such a case the consent of the Board must be obtained at meeting within three months of the date of entering into the contract.

- (ii) The term 'disclosure' means to make others aware of something, which they are not aware. The disclosure of interest by a director has been provided in Section 299 only with a view to know that the director occupies fiduciary position in the company should disclose his interest in any arrangement or contract either directly or indirectly so that the company is in a position to know whether he is acting in any way prejudicial to the interest of the company or for his own benefit. When board is aware of the fact of the interest of a director in a particular transaction, it would not be necessary for such a director to formerly disclose his interest. (*Ramakrishna Rao vs. Bangalore Race Club, 40 Comp. Case 674 (Mysore). A. Sivasailam vs. Registrar of Companies {C.A. No. 11/621A/SRB/94 decided on 31.5.94 (CLB)}*).
- (iii) A contract to act as broker where the duty of the broker is merely to bring together the two contracting parties, namely, the company, on the one hand, and the purchaser of shares or debentures, on the other, does not seem to be covered either by clause (b) or by clause (a) of sub-section (1) of Section 297. It is not covered by clause (b) for two reasons: First, clause (b) specifically refers to underwriting and importing into that clause the act of broking is not permissible. Secondly, there is a good deal of difference between underwriting and broking. In the case of the former, the obligation extends far beyond the mere bringing together the two contracting parties together, while in the case of latter, the broker earns his commission only when he succeeds in bringing the two parties together and not otherwise. To act as a broker is also not covered by clause (a) because commission earned as a broker is not earned by supplying services. The Madras High Court has rightly held that "rendering of services should consist of the doing of an act for the benefit of another which is more than the mere making of a contract and which goes beyond the performance of an obligation undertaken in the course of an ordinary commercial contract". (*Radhakrishna Rao vs. Province of Madras AIR 1952 Mad. 718*)

Question 23

LMB Ltd., Kolkata is a multiproduct manufacturing company having paid up capital of Rs.5.00 Crores. In order to increase the product portfolio, the said company intends to procure certain machines and equipments worth Rs.1.00 Crore from a partnership firm, namely, M/s MLPK, in which the son of managing director of LMB Ltd. is a partner. The contract for purchase of said machines and equipments is to be placed before the board of directors of the company for its consideration.

In view of above facts, you are required to explain briefly the procedure under the provisions of the Companies Act, 1956 to be followed by LMB Ltd. to enter into the said contract.
(May 2005)

Answer

As per provisions of section 297 of the Companies Act, 1956, when a Company enters into a contract in which some of the directors are interested, then consent of the Board of Directors of the Company is required to be obtained. In the present case since the Managing Director of LMB is interested in the contract for the purchase of machines and equipments because of his son's partnership in the supplier firm, the same should be approved by the board of directors of the company.

Proviso to section 297(1) states that in the case of a company having a paid-up share capital of not less than rupees one crore, no such contract shall be entered into except with the previous approval of the Central Government. Since the paid up capital of LMB Ltd. is Rs.5.00 crores the company is required to take prior approval of the Central Government.

For this purpose, following steps are required to be taken:

- (i) Hold a board meeting and place the terms of the contract for consideration. The managing director should disclose the nature of his interest as required under section 299 of the Companies Act, 1956.
- (ii) The managing director should not participate in discussion when in the board meeting; the matter in respect of the above mentioned contract is being discussed. He must not also vote on the relevant resolution. Moreover, his presence shall also not be counted for determining the quorum of the board meeting. [Section 300, Companies Act, 1956].
- (iii) The consent of the board of directors must be accorded by way of a resolution and not otherwise.
- (iv) An application to the Central Government (by delegation to Regional Director) should be made in prescribed form (Form No.24A). Following enclosures should be made with the said Form:
 - (a) a certified true copy of the board resolution approving the contract.
 - (b) a copy of the proposed agreement.
 - (c) a copy of the Memorandum and Articles of Association of the company.
 - (d) a copy of the latest audited annual accounts with directors' and auditors' reports thereon.
 - (e) Bank draft or treasury challan evidencing the payment of prescribed fees.
- (v) Necessary entries are to be made in the Register of Contracts (Section 301).

On receiving the approval from the Central Government (Regional Director), the company can proceed to enter into the contract for supply of machines and equipments with the firm M/s MLPK in which the son of managing director is a partner.

Question 24

Examine whether the following contracts require previous approval of the Central Government keeping in view the effect of the proviso to Section 297(1) of the Companies Act, 1956:

Contracts for purchase of goods from a Public Company having a paid-up Share Capital of more than Rupees one crore by a firm in which a director of the Public Company is a partner. The purchase is for cash at prevailing market prices. **(May 2004)**

Answer

Section 297(a) of the Companies Act, 1956, provides that consent of the Board of Directors of a company shall be necessary for a contract for the sale, purchase or supply of any goods, material or services entered into by the company with a director of the company or his relative or a firm in which such a director or relative is a partner. The proviso to this sub-section requires that in the case of a company having paid up share capital of not less than Rs.1 crore (i.e. Rs.1 crore or more), no such contract shall be entered into except with the previous approval of the Central Government.

Certain exemptions are provided in Sub-section (2) of Section 297. One such exemption is that noting contained in clause (a) sub-section (1) shall affect the purchase of goods and materials from the company by any director, relative, firm stated in Section 297(1) for cash at prevailing market prices. As the contract referred to in the question qualifies for exemption under section 297(2)(a), approval of Central Government is not required.

Question 25

PQR Machines Ltd. Entered into a contract with MN forgings, in which wife of P, a director of the company is a partner. The contract is for supply of certain components by the firm for a period of three years with effect from 1st September, 2005 on credit basis. The paid-up Share Capital was increased from Rs. 70 lakhs to Rs. 140 lakhs on 1st March, 2006. Explain the requirements under the Companies Act, 1956, which should have been complied with by PQR Machines Ltd. before entering into contract with MN Forgings. Whether there is any additional requirement which is required to be complied with by PQR Machines Ltd. in view of the increased paid-up Share Capital on 1st March, 2006.

What would be your answer in case MN forgings is a Private Company in which P's wife is holding substantial shares? **(May 2006)**

Answer

The contract for supply of components entered into between PQR Ltd. and MN Forgings, a partnership firm (on which wife of P, a director of the company is a partner) attracts Sections 297, 299, 300 and 301 of the Companies Act, 1956.

The contract cannot be entered into unless it is approved in the meeting of the Board of Directors of PQR Ltd. Specific Board resolution is required (Section 297). However, in case of urgent necessity such consent of the Board may be obtained within 3 months of the date on which the contract was entered into (Section 297(3))

P, the interested director must disclose his interest at the Board meeting at which the question of entering into the contract has been taken up for consideration (Section 299(1) & (2)). P, the interested director should not have taken part in the discussion at the said board meeting and he should not have voted on the resolution in respect of that contract (Section 300)

Prescribed particulars of the contract must be entered into the Registrar of Contract maintained under Section 301 within 7 working days of the Board meeting (Section 301).

In the given case the contract was entered into on 1.9.2005 for supply of components for a period of 3 years. As the paid-up share capital was only Rs. 70 lakhs (i.e. less than Rs.1 crore) on 1.9.2005 proviso to Section 297(1) requiring prior approval of the Central Government is not attracted. Subsequent increase in the paid up share capital beyond Rs. 1 crore will not make it necessary to get the approval of the Central Government for continuation of the contract for the remaining period. Hence, there is no additional requirement.

If MN Forgings is a private company the provisions of Section 297 are not attracted as the director of PQR Ltd. is a director or member of MN Forgings Private Ltd.

Section 299 is also not attracted for the reasons given below:

If the contract or arrangement is between companies, a director is deemed to be interested only if he singly or along with other directors hold 2% or more shares in other company (Section 299(6)). While calculating the 2% shares in other company, only investment of directors is considered. Here P, a director of PQR Ltd. is not holding any shares in MN forgings Pvt. Ltd. Shares held by P's wife are not to be considered. Hence the provisions of Section 299 are not attracted. Sections 300 and 301 are also not applicable.

Question 26

LMB Ltd., Kolkata is a multiproduct manufacturing company having paid up capital of Rs. 5.00 crores. In order to increase the product portfolio, the said company intends to procure certain machines and equipments worth Rs. 1.00 crore from a partnership firm, namely, M/s MLPK, in which the son of managing director of LMB Ltd. is a partner. The contract for purchase of said machines and equipments is to be placed before the board of directors of the company for its consideration.

In view of above facts, you are required to explain briefly the procedure under the provisions of the Companies Act, 1956 to be followed by the LMB Ltd., to enter into the said contract.

(May 2008)

Answer

As per provisions of section 297 of the Companies Act, 1956, when a Company enters into a contract in which some of the directors are interested, then consent of the Board of Directors of the Company is required to be obtained. In the present case since the Managing Director of LMB Ltd. is interested in the contract for the purchase of machines and equipments because of his son's partnership in the supplier firm, the same should be approved by the board of directors of the company.

Proviso to Section 297(1) states that in the case of a company having a paid-up capital of not less than rupees one crore, no such contract shall be entered into except with the previous approval of the Central Government. Since the paid up capital of LMB Ltd. is Rs. 5 crore, the company is required to take over prior approval of the Central Government.

For this purpose, following steps are required to be taken:

- (i) Hold a board meeting and place the terms of the contract for consideration. The managing director should disclose the nature of his interest as required under Section 299 of the Companies Act, 1956.
- (ii) The managing director should not participate in discussion when in the board meeting, the matter in respect of the abovementioned contract is being discussed. He must not also vote on the relevant resolution. Moreover, his presence shall also not be counted for determining the quorum of the board meeting. [Section 300 of the Companies Act, 1956]
- (iii) The consent of the board of directors must be accorded by way of a resolution and not otherwise.
- (iv) An application to the Central Government (by delegation to Regional Director) should be made in prescribed form (Form No. 24A). Following enclosures should be made with the said form:
 - (a) a certified true copy of the board resolution approving the contract
 - (b) a copy of the proposed agreement
 - (c) a copy of the Memorandum and Articles of Association of the company
 - (d) a copy of latest audited annual accounts with directors' and auditors' reports thereon.
 - (e) bank draft or treasury challan evidencing the payment of prescribed fees.
- (v) Necessary entries are to be made in the Register of Contracts (Section 301)

On receiving the approval from the Central Government (Regional Director), the company can proceed to enter into the contract for supply of machines and equipments with the firm M/s MLPK in which the son of Managing Director is a partner.

Question 27

A & Co. Ltd. wants to sell its products to its following customers: (a) A partnership firm in which two of the directors of the company are partners; (b) A private company in which one of the directors of the company is a member; (c) A public company in which one of the directors of the company is a director. In these three cases what steps are required to be taken by A & Co. Ltd.?

Answer

(a) & (b) According to Section 297, except with the consent of the Board of Directors of a company, *firm* in which the director or directors of the company is/are partners or a *private company* of which such director or directors is or are a member or members shall not enter into any contract with the company for the sale, purchase or supply of any goods, materials or services. Therefore, the public company in the instant two cases should obtain the consent of its Board of Directors. This consent shall have to be taken by a resolution passed at the Board meeting and not otherwise. The resolution according the consent must be passed before the contract to sell the product is entered into or within 5 months of the date on which it was entered into; otherwise consent shall not be deemed to have been given. If the consent is not accorded, anything done in pursuance of the contract shall be voidable at the option of the Board. Care should be taken to ensure that the interested directors do not vote on the motions and their presence is not counted for the purpose of quorum for the meeting. Also it is to be seen that such directors have disclosed their interests in the contract pursuant to Section 299 of the Companies Act unless any of them is enjoying the exemption under sub-section (6) of the above section.

The consent contemplated above is not a general consent but consent referable to each particular or specific contract or contracts. Consent requires knowledge of the necessary facts and material, which lead to the consent and cannot be given in general or abstract manner (*Watchand Nagar Industries Ltd. vs. Ratanchand, A.I.R. Bom. 256*). Therefore, the Board of the public company should take appropriate steps in this regard.

(c) The point of the case in question relates to disclosure of interest by directors. According to Section 299(6), nothing in Section 299 shall apply to any contracts entered into or to be entered between two companies where one of the directors of the one company or two or more of them together holds or hold not more than 2% of the paid up share capital in the other company. This point is not clear from the facts in the problem. This is a contract to be entered into between two companies. And if the director of the first company holds 2% or less of the paid-up share capital in the second public company, the provisions of Section 299 will not apply to this case.

If, however, the said director holds more than the aforesaid 2% then the Board of Directors should see that the director, pursuant to Section 299, discloses his interest or concern at the meeting of the Board. This disclosure has to be made at the Board meeting at which the contract is considered. If the interest is acquired subsequent to the meeting then it is to be disclosed at the immediately next meeting.

The Board of the first-mentioned public company should ascertain whether the interest of director aforesaid consists solely (i) in his being a director of such company and the holder of not more shares of such number and value therein as is requisite to qualify him for appointment as a director thereof, he having been nominated as such director by the company or (ii) in his being a member holding not more than 2% of its paid-up share capital. Also, there is no restriction on voting, etc. by an interested director if a notification had been issued by the Central Government under Section 300(3) exempting the company from the purview of Section 300. If, on such assertion, the interest is not found to be so consisting as aforesaid, the Board of the company should see that interested director does not participate in the discussion or vote on the contract and that his presence is excluded from the computation of quorum.

PROCEDURE, ETC., WHERE DIRECTOR INTERESTED (SECTIONS 299 – 302)

Question 1

A Limited had four directors. At one of its convened Board meeting only two of them attended and they appointed two additional directors who were their relatives. Is the appointment of those additional directors valid?

Answer

Section 300 provides that a director shall not take part in the discussion of or vote on any contract or arrangement entered into or to be entered into by or on behalf of the company if he is in anyway whether directly or in directly concerned or interested in the contract or arrangement. The Department of Company Affairs has clarified that the word interested as used in the section should be given a restrictive interpretation and thus excludes a director who has no pecuniary interest. Accordingly, the relationship of the director with the contracting party will not per se make the director concerned or interested in the contract or arrangement.

The scope of the expression 'contract' or 'arrangement' was examined by the Madras High Court in *Madras Tube Co. Ltd. vs. Hari Krishan Somani*, (1985) 1 Comp LJ 195 (Mad). The question before the court was whether the appointment of an additional director would come within the scope of the word 'contract' or 'arrangement'. The company had four directors. Only two of them attended the meeting. They appointed two additional directors who were related to them as brother and wife, respectively. The court came to the conclusion that although appointment as director does not come within the scope of the expression 'contract' because the position of a director may be conferred on a person by any method other than contract, became interested directors. Without them there was no independent quorum. Consequently the appointments were a nullity.

The Bombay High Court re-examined the matter in *Shailesh Harilal Shah vs. Matushree Textiles Ltd.*, (1994) and after giving due consideration to the authorities which influenced the Madras decision nevertheless came to the conclusion that the appointment as an additional director of a person who is related to a director does not violate the requirement of Section 300(1) because the position of a director may be conferred on a person by any method other than contract but that it would amount to an arrangement. The attending

directors, therefore, became interested directors. Without them there was no independent quorum. Consequently the appointments were nullity.

Disclosure of interests by director (Section 299)

Question 2

Company Y with a paid-up capital of Rs.50 lakhs entered into a contract with company Z in which a director of Y is holding equity shares of the nominal value of Rs.50,000. The director did not disclose his interest at the Board meeting under section 299 of the Companies Act, 1956. Is the director liable for his act?

Answer

As per Section 299, the disclosure of interest by directors do not apply to any contract or arrangement within two companies where any of the directors of one company or two or more of them together holds or hold not more than 2% of the paid up share capital in the other company. In the present case, if the holding is less than 2%, the director is not liable.

Question 3

X Ltd. entered into a contract with M & Co. Ltd. for the purchase of raw materials for Rs. 2,50,000, at the prevailing market rate. The Director, of X Ltd. Mr. B was holding shares of the value of 1% of the paid up capital of M & Co. Ltd. Another Director, of X Ltd. Mr. C was holding shares of the value of 1.5% of the paid up capital of M & Co. Ltd. Mr. B at the beginning of the year, gave a general notice to X Ltd., that he was interested in M & Co. Ltd., but did not disclose the nature of interest. Mr. B claims that he had give notice to X :Ltd. as required under the Companies Act and that his holding being only 1% is within the limit prescribed under the Companies Act.

(November, 2000)

Answer

In the problem given the contract was entered between two public companies for the purchase of raw materials for Rs.2,50,000 at the prevailing market rate. Therefore, transaction of this type, which too between two public limited companies will be hit by Section 299 and not by Section 297 as it may apparently appear to be. Though Section 299 to some extent overlaps Section 297, it is wider in scope and covers all kinds of contracts and arrangements as proposed in Section 297. In the problem given, contract between X Limited and M & Co. Limited was entered into wherein the concerned directors of X Ltd namely Mr. B (holding 1% of paid up capital of M & Co. Limited) and Mr. C (holding 1.5% of the paid up capital of M & Co. Limited) have given a general notice to X Limited but did not disclose the nature of their interest. The consequences of non-disclosure of interest are that it will cause vacation of the office of director under Section 283[1(i)] and will also subject to penalty under sub-section 4 of Section 299. However, in the opinion of the Department of Company affairs, (Company News & Notes dated 1.7.63) if a director has given a general notice in terms of sub-section 3 of Section 299, he will not be liable for prosecution provided the general notice covers the relevant contract in question. However, sub-section (6) of Section 299 provides

that nothing contained in this section shall apply to any contract or arrangement entered into or to be entered into between two companies where any of the directors of the one company or two or more of them holds or hold not more than 2% of the paid up share capital in the other company. By necessary implications it also means that where a director or two or more or all the directors hold more than 2% of the paid up share capital of another company, any contract or arrangement with that other company (in the instant case X LTD) will come within the purview of Section 299. In keeping with the spirit of Section 299 and in view of their occupying fiduciary position in the company, the concerned directors (namely Mr. B & Mr. C) should disclose their interest even if their individual holding is less than 2% of the paid up capital of the M & Co. Ltd and they should take steps to see that the disclosure is made at the next meeting of the Board of Directors. Hence the argument of Mr. B is not valid.

Question 4

Mr. Nanavati holding 3% shares in OPQ Ltd., became a director of this company on 1.5.2000. The company, prior to his appointment as director, had commenced transactions with A Ltd. In the next Board Meeting to be held on 10.5.2000, the Board proposes to discuss about price revisions sought for by A Ltd. Briefly explain:

- (i) *Whether Mr. Nanavati should make a disclosure of his interest in A Ltd., assuming that the company is going to have transactions with A Ltd. on a continuous basis; if yes, when and how? When should it be renewed?*
- (ii) *Can he vote in the price revision resolution in the Board Meeting?*

You are informed that Mr. Nanavati holds 1.5% of the share capital of A Ltd and that his wife holds another 3% of the share capital of a Ltd. **(November, 2000)**

Answer

OPQ Ltd. entered into certain transactions (arrangement/contract) with A Ltd. in which Mr. Nanavati is interested before his appointment as a director in OPQ Ltd. The issue is whether Mr. Nanavati should disclose his interest in A Ltd.

Section 299(2)(b) of the Companies Act, 1956 applies to a case of contract or arrangement in which a person was concerned or interested before he becomes a director and also to a case of a contract or arrangement in which he becomes concerned or interest after he becomes a director. The words 'becomes concerned or interested' occurring in the provision denotes a present state of thing. In the case of a person who was actually concerned or interested in the contract or arrangement, the liability for disclosure arises the moment he accepts office as director (*M.O. Varghese v. Thomas Stephen & Co. Ltd. (1970) 40 CC 1131 Kerala*).

Further, in this case, the Board proposes to discuss in the Board meeting to be held on 10.5.2000 the price revision sought by A Ltd.

In view of the above, Mr. Nanavati should make a disclosure of his interest in the first meeting to be held on 10.5.2000 after he became a director. Such disclosure may be made by a general notice under section 299(3) to the effect that he is a member or a director of a specified body corporate. Such notice is valid only for the financial year in which it is given and therefore, it should be renewed in the last month of every year, where necessary.

Another issue is whether Mr. Nanavati can vote in the price revision resolution in the Board Meeting. As per section 300(1), no director of a company shall, as a director, take any part in the discussion of, or vote on, any contract or arrangement entered into, or to be entered into, by or on behalf of the company, if he is in any way, whether directly or indirectly, concerned or interested in the contract or arrangement. As per sub-section (2) the provision of sub-section (1) shall not apply to any contract or arrangement entered into or to be entered into with a public company, in which the interest of the director aforesaid consists solely in his being a member holding not more than two percent of its paid-up share capital.

In the given case, Mr. Nanavati is holding 1.5% of the share capital of A Ltd., and his wife is holding another 3% in the share capital of A Ltd. and, therefore, it cannot be said he is interested only to the extent of less than 2% of the paid-up share capital of A Ltd. [The word 'solely' is used in section 300(2)(d)]. Hence Mr. Nanavati should not participate and vote in the Board Meeting to be held on 10.5.2000.

Question 5

The Articles of Association of a company states that a director shall not vote in respect of a contract in which he is interested. In a resolution put up for approval of the shareholders, can a director exercise his voting right in favour of a contract in which he is interested?
(November, 2001)

Answer

When a director exercises his voting right as a shareholder, he is free to vote in his own best interests like any other shareholder.

A provision in the articles of association of a company stating that a director shall not vote in respect of a contract in which he is interested does not preclude him from voting thereon as a shareholder in the general meeting of the company. A shareholder may vote as he pleases even when his interests are different from or opposed to those of the company. Shareholders are not trustees for the company or for one another.

However, in *Cooks vs. Deeks*, it was held that if directors use their position as directors to obtain for themselves the property of the company, as for example, by means of a beneficial contract, they cannot, by using their voting power as shareholders in general meeting, prevent the company from claiming the benefit of it.

Further section 182 makes it clear that a public company or a private company which is subsidiary of a public company shall not put any restriction on voting right of members

except the one specified in section 181 (i.e. restriction on exercise of voting right of members who have not paid calls).

Hence the director can exercise his voting right at a general meeting in favour of a contract in which he is interested.

Question 6

PQR Machines Ltd. Entered into a contract with MN forgings, in which wife of P, a director of the company is a partner. The contract is for supply of certain components by the firm for a period of three years with effect from 1st September, 2005 on credit basis. The paid-up Share Capital was increased from Rs. 70 lakhs to Rs. 140 lakhs on 1st March, 2006. Explain the requirements under the Companies Act, 1956, which should have been complied with by PQR Machines Ltd. before entering into contract with MN Forgings. Whether there is any additional requirement which is required to be complied with by PQR Machines Ltd. in view of the increased paid-up Share Capital on 1st March, 2006.

What would be your answer in case MN forgings is a Private Company in which P's wife is holding substantial shares?
(May 2006)

Answer

The contract for supply of components entered into between PQR Ltd. and MN Forgings, a partnership firm (on which wife of P, a director of the company is a partner) attracts Sections 297, 299, 300 and 301 of the Companies Act, 1956.

The contract cannot be entered into unless it is approved in the meeting of the Board of Directors of PQR Ltd. Specific Board resolution is required (Section 297). However, in case of urgent necessity such consent of the Board may be obtained within 3 months of the date on which the contract was entered into (Section 297(3))

P, the interested director must disclose his interest at the Board meeting at which the question of entering into the contract has been taken up for consideration (Section 299(1) & (2)). P, the interested director should not have taken part in the discussion at the said board meeting and he should not have noted on the resolution in respect of that contract (Section 300)

Prescribed particulars of the contract must be entered into the Registrar of Contract maintained under Section 301 within 7 working days of the Board meeting (Section 301).

In the given case the contract was entered into on 1.9.2005 for supply of components for a period of 3 years. As the paid-up share capital was only Rs. 70 lakhs (i.e. less than Rs. 1 crore) on 1.9.2005 proviso to Section 297(1) requiring prior approval of the Central Government is not attracted. Subsequent increase in the paid up share capital beyond Rs. 1 crore will not make it necessary to get the approval of the Central Government for continuation of the contract for the remaining period. Hence, there is no additional requirement.

If MN Forgings is a private company the provisions of Section 297 are not attracted as the director of PQR Ltd. is a director or member of MN Forgings Private Ltd.

Section 299 is also not attracted for the reasons given below:

If the contract or arrangement is between companies, a director is deemed to be interested only if he singly or along with other directors hold 2% or more shares in other company (Section 299(6)). While calculating the 2% shares in other company, only investment of directors is considered. Here P, a director of PQR Ltd. is not holding any shares in MN forgings Pvt. Ltd. Shares held by P's wife are not to be considered. Hence the provisions of Section 299 are not attracted. Sections 300 and 301 are also not applicable.

Question 7

P, son of A, who is the Managing Director of ABC Limited, proposes to give his flat on lease to the company. The paid-up share capital of ABC Limited is Rs.10 crores. Advise the company explaining the restrictions, if any, under the Companies Act, 1956.

(CA Final, New Course, November, 2008)

Answer

Lease of flat: Section 297 of the Companies Act, 1956 requires certain contracts on which the directors of a company are interested to be sanctioned by the Board of Directors of the Company and in certain cases (i.e. where the paid up share capital of the company is Rs.1 crore or more) it is also required to be approved with the previous approval of Central Government. Section 297 applies only to contracts of sale, purchase or supply of goods, materials and services or for underwriting the subscription of any shares in, or debentures of the company. Providing premises on a rental or lease basis by a director or his relative to company is not covered by Section 297. Since this Section does not apply to transactions in immovable properties, hence the proposed lease does not require either board resolution or approval of the Central Government.

However it is an arrangement in which the Managing Director is interested and as such he is required to make a disclosure under Section 299 of the said act and he should not participate or vote in the Board's proceedings (Section 300) and the lease arrangement must be entered in the Register of Contract maintained under Section 301 of the said Act.

Question 8

M/s. Raman Limited having a paid up share capital of Rs. 5 crores owns an agency of Cement Corportion of India Ltd. and proposes to supply cement, on credit, to M/s. Raman Enterprises Private Limited. Mr. Raman is a common Director in both the companies.

State the requirements of the Companies Act, 1956, if any, to be complied with by the company on the facts of this case.

Will it make any difference, if -

- (i) *M/s. Raman Enterprises Private Limited were a public company;*
 - (ii) *M/s. Raman Limited were carrying on real estate business and it proposes to sell a flat to M/s. Raman Enterprises Private Ltd. for Rs. 50 lakhs?*
- (November 2006)**

Answer

Under Section 297 of the Companies Act, 1956 except with the consent of the board of directors of a company, a director of the company or his relative; a firm in which such director or relative is a partner; or a private company of which the director is a member or director, shall not enter into any contract with the company for the sale, purchase or supply of any goods, materials or services. Where the paid up capital of the company is not less than Rs. 1 crore, it will also require previous approval of the Central Government. Exemption from the said provisions are available in the following circumstances -

- (i) the purchase of goods and materials from the company or sale of goods and materials to the company is for cash at prevailing market prices;
- (ii) any contract for sale, purchase or supply of goods, materials and services in which the company, or director etc. regularly trades the cost of which does not exceed Rs. 5,000 in any year.

In the present case, Mr. Raman is a common director in both the contractee companies. Accordingly, apart from the approval of the Board, previous approval of the Central Government (power delegated to Regional Director) is also required for entering into the proposed contract of supply of cement on credit. The provisions of Section 299 and 300 of the Companies Act, 1956 have also to be complied with and

in the Board meeting Mr. Raman shall disclose his interest in the contract and shall not participate in the discussions on this item and shall not vote for the same. The particulars of the contract be also recorded in the Register of Contracts.

- (i) Section 297 does not apply to a contract where both the contractee companies are public companies. If Ram Enterprises happens to be a public company, section 297 will have no applicability.
- (ii) Section 297 does not apply to a contract relating to immovable properties being the sale of flat in case of Raman Ltd. is a real estate company. The expression 'goods' used in the section has been defined in the Sale of Goods Act, 1930 according to which it means every kind of movable property. Hence, sale of flat will not amount to sale of 'goods' for purposes of section 297 of the section.

Question 9

Premier Machineries Limited having a paid-up share capital of Rs.90 lakhs proposes to enter into a contract with the following parties for supply of components with effect from 1st January, 2008 for a period of 3 years:

- (a) *XYZ Metal Forging Private Limited in which Mr. John, a Director of Premier Machineries Limited, is a Director and member.*

- (b) *ABC Casting Limited in which Mr. Philips, a Director of Premier Machineries Limited, holds 30% of the paid-up share capital.*
- (c) *The capital of Premier Machineries Limited was increased to Rs.1.50 crores on 1st January, 2009 by issue of further shares.*

Briefly discuss the legal requirements to be complied with under the Companies Act, 1956 to give effect to the above proposals taking into account the increase in the paid-up share capital as on 1st January, 2009.

(CA Final, New Course, November 2009)

Answer

Under section 297 of the Companies Act, 1956 as Mr. John, a director of Premier Machineries Ltd. Is interested in XYZ metal Forging Private Ltd. as a director and a member of the Company, a resolution in the meeting of the Board of Directors is required to be passed before entering into a contract with XYZ Metal Forging Private Ltd. If due to urgency it is not possible to pass a Board resolution before entering into the contract, the requisite consent of the Board shall be obtained within three months of the date on which the contract was entered into under Section 299, Mr. John must disclose his interest to the Board and not participate in the said meeting/deliberations.

Since the paid up capital of the Company is Rs.90. lakhs, approval of the Central Government is not necessary. In this case, the paid up capital was increased to Rs.1.50. crore subsequent to the date of entering the contract. No approval of the Central Government will be required as on the material date of entering into the contract, the paid up capital was less than Rs 1 crore.

Section 297 does not cover cases of Public Limited Companies, hence aforesaid approvals will not be necessary. In both the cases the interested directors must make disclosure of interest as required under section 299 and also comply with section 300. Entries are also required to be made in the Register of Contract under section 301.

Interested director not to participate or vote in Board's proceedings (Section 300)

Question 10

A Limited had four directors. At one of its convened Board meeting only two of them attended and they appointed two additional directors who were their relatives. Is the appointment of those additional directors valid?

Answer

Section 300 provides that a director shall not take part in the discussion of or vote on any contract or arrangement entered into or to be entered into by or on behalf of the company if he is in anyway whether directly or in directly concerned or interested in the contract or arrangement. The Department of Company Affairs has clarified that the word interested as used in the section should be given a restrictive interpretation and thus excludes a

director who has no pecuniary interest. Accordingly, the relationship of the director with the contracting party will not per se make the director concerned or interested in the contract or arrangement.

The scope of the expression 'contract' or 'arrangement' was examined by the Madras High Court in *Madras Tube Co. Ltd. vs. Hari Krishan Somani*, (1985) 1 Comp LJ 195 (Mad). The question before the court was whether the appointment of an additional director would come within the scope of the word 'contract' or 'arrangement'. The company had four directors. Only two of them attended the meeting. They appointed two additional directors who were related to them as brother and wife, respectively. The court came to the conclusion that although appointment as director does not come within the scope of the expression 'contract' because the position of a director may be conferred on a person by any method other than contract, became interested directors. Without them there was no independent quorum. Consequently the appointments were a nullity.

The Bombay High Court re-examined the matter in *Shailesh Harilal Shah vs. Matushree Textiles Ltd.*, (1994) and after giving due consideration to the authorities which influenced the Madras decision nevertheless came to the conclusion that the appointment as an additional director of a person who is related to a director does not violate the requirement of Section 300(1) because the position of a director may be conferred on a person by any method other than contract but that it would amount to an arrangement. The attending directors, therefore, became interested directors. Without them there was no independent quorum. Consequently the appointments were nullity.

The provisions mentioned above shall not apply to:

- (i) a private company, which is neither a subsidiary nor a holding company of a public company
- (ii) a private company, which is a subsidiary of a public company in respect of a contract or an arrangement, entered into by the private company with the holding company;
- (iii) any contract of indemnity against any loss, which the director may suffer by reason of becoming surety for the company;
- (iv) any contract or arrangement entered into (or proposed contract or arrangement) with a public company or a private company which is subsidiary of a public company in which the interest of the director consists a) in his being a director of such company and the holder of not more than the requisite qualification shares and he having been nominated as such director, or (b) in his being member holding of more than 2% of its paid up-share capital
- (v) a public company or a private company which is subsidiary of a public company in

respect of which the Central Government in the public interest issues a notification thereof having regard to the desirability of establishing or promoting any industry, business or trade. However, the Central Government may direct that the provision of Section 300(1) shall apply to these companies subject to such exceptions, modifications and conditions as it may specify in the notification in the foregoing circumstances. [Sections 300(2) and (3)].

According to Section 297, a director of the company or his relative, a firm in which such a director or relative is a partner, any other partner in such a firm or a private company of which the director is a member or director, must not enter into contracts with company for the sale, purchase, or supply of goods, materials or services or for underwriting shares or debentures except with the consent of the Board of Directors [sub-section (1)]. According to the provision to sub-section (1) in the case of a company having a paid-up capital of Rs.1 crore or more no such contract shall be entered into *except with previous approval of the Central Government*. The consent of the Board is deemed to have been given only if it is accorded by a resolution of the Board and not otherwise, either before or within three months of the date of entering into the contract [sub-section (4)].

If the consent is not accorded to any contract under Section 297, anything done in pursuance of the contract shall be voidable at the option of the Board. [sub-section (5)]. Before we proceed on to discuss the other provisions contained in Sections 297(2) and (3) let us examine a situation.

Question 11

With the knowledge of all the Directors of a Public Limited Company, a mortgage was created over the property of the company in respect of a loan given by the brother of one of the Directors of the company. But the interested Director neither disclosed his interest nor abstained from voting at the Board Meeting, when the loan transaction was approved.

Examine with reference of the provisions of the Companies Act, 1956 whether there is any ban on such contracts and whether non-disclosure of interest and voting by the interested Director would make the contract void. **(November, 2003)**

Answer

Section 299 of the Companies Act, 1956 requires the disclosure of interest by a director while Section 300 prohibits an interested director to participate or vote on Boards' proceedings. But where a whole body of directors is aware of the facts relating to an interest of a director, a formal disclosure is not necessary. [Venkatachalapathy V.S. Guntur Collton Mills, AIR 1929 Mad. 353].

- (i) The mere voting by an interested director will not render the contract void or voidable unless with the absence of that vote, there would have been no quorum. The mere fact that voting under such situation is an offence punishable with fine under Section 299(4) and 300(4) of the Act, does not *ipso facto* render the contract void or violable. In this

case, there is no allegation of earning secret profits. Thus the action of the company will fail as the contract of mortgage is fair and in the interest of the company.

- (ii) Under Section 299 and 300 of the Act, there is no ban on a contract in which a director is interested. The only requirement is that the interest should be disclosed, bonafide and fair [*P. Leslie & Co. vs. V.O. Wapshare AIR 1969 SC 843*].

Even where the interest is not disclosed the transaction is only voidable against the interested director, and not void. [*Narayan Das Shreeram Somani vs. Sangli Bank AIR 1966 SC 170*].

Question 12

A Mortgage was created over the property of a public company. The loan was advanced by the son of the director. All the directors already knew this fact. Thus the director was interested in the transaction. But he has neither disclosed his interest nor abstained from voting while approving the said transaction. Later on a suit was filed for setting aside the mortgage on the ground that since the interested director voted on the matter, the contract was void. Advise with reasons.

- (i) *Whether the contract became void due to non-disclosure of interest by the concerned director?*
- (ii) *Is there any ban on such a contract under the Companies Act, 1956? (June 2009)*

Answer

Section 299 of the Companies Act, 1956 requires the disclosure of interest by a director while section 300 prohibits an interested director to participate or vote in respect of that particular transaction at the Board meeting. Further his presence will not be counted for quorum also. But where a whole body of directors is aware of the facts relating to an interest of a director, a formal disclosure is not necessary. (*Ramakrishna Rao vs. Bangalore Race Club*).

The mere voting by an interested director will not render the contract void or voidable unless with the absence of that vote, there would have been no quorum. The mere fact that voting under such situation is an offence punishable with fine under section 299(4) and 300(4) of the Act does not *ipso facto* render the contract void or voidable. In this case, there is no allegation of earning secret profits. Thus the action against the company will fail as the contract of mortgage is fair and in the interest of the company.

Under section 299 and 300 of the Act,, there is no ban on contract in which a director is interested. The only requirement is that the interest should be disclosed, bonafide and fair. (*P. Leslie & co. vs. Vo Wapshare*)

Even where the interest is not disclosed the transaction is only voidable against the interested director, and not void. (*Narayan Das Shreeram Somani vs Sangli Bank*).

REMUNERATION OF DIRECTORS (SECTIONS 309 – 311)

Remuneration of Directors (Section 309)

Question 1

Examine whether the payment of following remuneration to Non-executive Directors (Directors who are neither in the whole-time employment of the company nor Managing Director) is in accordance with the provisions of the Companies Act, 1956:

- (i) *Sitting fee payable to Directors is increased from Rs.3,000 to Rs.6,000 per meeting by amending the Articles of Association.*
- (ii) *Commission payable to Non-executive Directors is calculated on the basis of book profits arrived at after providing for depreciation as per straight line method.*
- (iii) *Guarantee commission has been paid to one of the Non-executive Directors for having guaranteed the term loans obtained from a Financial Institution. (November, 2003)*

Answer

Non-Executive Directors Remuneration

Sitting Fees: Sitting fees are payable to directors at the rates prescribed in the Articles of Association of the company [Section 309(2) Companies Act, 1956]. No approval of the Central Government will be necessary for an increase in the amount of sitting fees so long as such increase is within the prescribed limits (Proviso 1 to Section 310) - The present prescribed limit is Rs.5,000 per meeting [Rule 10B of the Companies (Central Governments) General Rules and Forms 1956]. Since the sitting fee of Rs.6,000/- is above the prescribed limit, the amendment shall not have effect unless approved by the Central Government under Section 310.

Depreciation: Section 350, as amended by the Companies (Amendment) Act, 2000 specifies the manner of ascertainment of depreciation. The amount of depreciation to be deducted is the amount of depreciation as appearing in the books i.e. as shown in the profit and loss account of the relevant financial year, at the rates specified on Schedule XIV to the Companies Act. Schedule-XIV specifies different rates of depreciation applicable to the two methods of depreciation, namely, written-down value method and straight-line method. Thus after the Companies (Amendment) Act, 2000, depreciation as per written-down value need not

be recalculated where depreciation is charged in the books as per straight-line method. Hence, the computation of commission payable is in order.

Guarantee Commission: Section 309(1) provides that the remuneration payable to any director shall be inclusive of the remuneration payable for services rendered by him in any other capacity. The question is whether the guarantee commission is a remuneration within the meaning of Section 309. It was held in *Suessen Textile Bearings Ltd v. Union of India* [(1984) 55 (Comp. Cases 492, 496, 497)] that the guarantee commission paid to directors for giving surety against loans or credit facilities taken by the company from financial institution is not a remuneration for any professional services within the meaning of section 309 and therefore, approval of the Central Government is not necessary. The director giving guarantee does not render manual, clerical, technical supervisory or administrative service. He gets the commission for the risk which he bears and that has nothing to do with his directorship. In view of this judgement, the Department of Company Affairs has withdrawn the earlier circular dated 16.12.1969, where the department has clarified that guarantee commission is 'remuneration' within the meaning of Section 309 (Circular No.3 dated 16.2.1994). Hence the payment of guarantee commission is in order.

Question 2

Mr. Weldon was appointed as a Director of Esquire Engineering Ltd., with effect from 1st October, 2002. Since the Company, namely, Esquire Engineering Ltd. wanted to take full advantage of the wisdom and expertise of Mr. Weldon, it offered him remuneration payable on monthly basis and made an application to the Central Government for approval for payment of such remuneration. Anticipating the approval of the Central Government, Esquire Engineering Ltd. started paying such remuneration from the date of appointment and continued to do so till 31st March, 2003. The Central Government did not fully approve the remuneration proposed by the company and restricted the same to a lower amount. On scrutiny of the accounts, it was established that the company, till 31st March, 2003, has paid to Mr. Weldon a total sum of Rs.1.20 Lacs in excess of the remuneration sanctioned by the Central Government.

You are required to:

- (i) State with reference to the provisions of the Companies Act, 1956 in respect of recovery and waiver of recovery of the excess remuneration so paid, whether Mr. Weldon can keep the excess remuneration so received and under what conditions.*
- (ii) Draft a resolution for waiver of recovery of the excess remuneration so paid by the Company.* **(November, 2004)**

Answer

- (i) Mr. Weldon was appointed as a non-executive director. The services to be rendered by him are not stated to be of a professional nature. Hence, the provisions of Section 309*

(4) are attracted in this case. According to Section 309(4) of the Companies Act, 1956 a non-executive director may be paid remuneration by way of monthly, quarterly or annual payment basis with the approval of the Central Government.

Section 309(5A) of the Companies Act, 1956 states that if any director draws or receives, directly or indirectly, by way of remuneration any sum in excess of the limits prescribed by section 309 of the Companies Act, 1956 or without the prior approval of the Central Government, wherever required, then such director shall refund such excess remuneration to the company and until such refund is made, he shall hold such sum in trust for the company.

Section 309(5B) of the Companies Act, 1956 states that the company shall not waive the recover of any sum refundable under section 309(5A) of the Companies Act, 1956 unless permitted by the Central Government.

In light of the above mentioned provisions of the Companies Act, 1956, Mr. Weldon is under obligation to refund the excess remuneration of Rs.1.20 Lakhs received by him from the company and till the same is refunded, he shall hold the said sum in trust for the company. Similarly, the company is also not eligible to waive the recovery of such excess sum. However, the company can waive the recovery and Mr. Weldon can keep such excess sum, if the permission from the Central Government as envisaged in section 309(5B) of the Companies Act, 1956 is obtained.

- (ii) Board Resolution for waiver of recovery of excess remuneration paid to a director:

"RESOLVED that subject to the approval of the Central Government, the Board does hereby decides to waive the recovery of a sum of Rs.1.20 Lacs paid to Mr. Weldon, a director of the company during the period from 1st October, 2002 to 31st March, 2003 in excess of the remuneration sanctioned by the Central Government in terms of section 309 of the Companies Act 1956."

"RESOLVED FURTHER that an appropriate application under section 309(5B) of the Companies Act, 1956 be made to the Central Government and that Mr, the Secretary of the company be and is hereby authorized to take necessary action in this regard."

Question 3

M/s Star Health Specialities Ltd. owns a Multi-specialty Hospital in Chennai. Dr. Hamilton, a practising Heart Surgeon, has been appointed by the company as its non-executive ordinary director and it wants to pay him fee, on case to case basis, for surgery performed on the patients at the hospital. A question has arisen whether payment of such fee to him would amount to payment of managerial remuneration to a director subject to any restriction under the Companies Act, 1956.

Advise the company, which seeks to ensure that the same does not contravene any provision of the Companies Act, 1956 **(November 2006)**

Answer

Under the proviso to sub-section (1) or section 309 of the Companies Act, 1956, in case—

- (i) the services rendered are of a professional nature; and
- (ii) in the opinion of the Central Government, the director possesses the requisite qualifications for the practice of the profession,

the remuneration paid for these services shall be outside the scope of Section 309 of the Act and shall not be a part of managerial remuneration. It is then not open to the Central Government to put any restriction on the amount of remuneration payable to him for his approach work. The company is, accordingly, advised to approach the Ministry of Company Affairs to seek an affirmative expression of opinion that Dr. Hamilton who is a qualified surgeon, possesses the requisite qualification to practice the profession of surgery.

Question 4

Mr. X appointed as the Managing Director of XYZ Ltd. w.e.f. 1st October, 2006. The company made an application to the Central Government for approval, as the remuneration proposed to be paid to Mr. X was beyond the limits laid down in schedule XIII to the Companies Act, 1956. The company started paying remuneration from the date of appointment and continued to do so till 31st March, 2007. The Central Government did not approve the remuneration as proposed by the company and restricted the same to a lower amount. On scrutiny of the accounts, it was noticed that the company till 31st March, 2007 has paid to Mr. X, a total sum of Rs. 1.20 lakhs in excess of the remuneration sanctioned by the Central Government. Explain with reference to the provisions of the Act whether Mr. X can keep the excess remuneration. Draft a resolution for waiver of recovery of the excess remuneration so paid by the company. **(November 2007)**

Answer

According to Section 309(5A) of the Companies Act, 1956, if any director draws any remuneration in excess of the remuneration sanctioned by the Central Government, he shall refund such excess remuneration to the company. The company shall not waive the recovery of any sum refundable to it unless permitted by the Central Government.

In the present case Mr. X cannot keep remuneration drawn by him which is in excess of the remuneration sanctioned by the Central Government, the Central Government permit the waiver of recovery of excess remuneration, the company may waive the recover of excess remuneration, and then Mr. X will have a right to retain the excess remuneration drawn by him.

Draft resolution for waiver of recovery of the excess remuneration:

“Resolved that subject to the approval of the central Government, consent of the company be and is hereby given waiving the recovery of an amount of Rs. 120,000 paid to Mr. X the director of the company, during the period 1st October, 2006 to 31st March, 2007 being in excess of the remuneration sanctioned by the Central Government vide letter no. dated

Resolved further than an application be made to the Central Government and the company secretary be and is hereby authorized to take the necessary steps in this regard.”

Provision for increase in remuneration to require Government sanction (Section 310)

Question 5

An article of Association of a listed company has fixed payment of sitting fee for each Meeting of Directors subject to maximum of Rs. 10,000. In view of increased responsibilities of independent directors of listed companies, the company proposes to increase the sitting fee to Rs. 25,000 per meeting. Advise the company about the requirement under Companies Act, 1956 to give effect
(May 2004, May 2007, November 2006, June 2007)

Answer

Under Section 310 of the Companies Act, 1956 approval of the Central Government shall not be required where sitting fee for each meeting of the Board of a Committee thereof does not exceed the prescribed sum under Rule 10-B of the Central Government's (General Rules & Forms, 1956) as under:

1.	Companies with paid up capital of Rs. 10 crores and above or turnover of Rs. 50 crores and above	Sitting fee not to exceed Rs. 20,000
2.	Other companies	Sitting fee not to exceed Rs. 10,000

Any increase in the sitting fee will require amendment of relevant provision of the Articles of Association. In the given case, the proposed sitting fee of Rs. 25,000 will require approval of the Central Government as the same exceeds the prescribed limits. The company can pay the sitting fee upto Rs. 20,000 depending upon the aforesaid parameters laid down in Rule 10-B.

Question 6

A company wants to include the following clause in its Articles of Association:

“Each director shall be entitled to be paid out of the funds of the company for attending meetings of the Board or a Committee thereof including adjourned meeting such sum as sitting fees as shall be determined from time to time by the Directors but not exceeding a sum of Rs.30,000 for each such meeting to be attended by the Director.”

You are required to advise the company as to the validity of such a clause and the correct legal position under the provisions of the Companies Act, 1956.

(CA Final, New Course, June 2009)

Answer

The payment of sitting fee to a Director is governed by the provisions of Section 310 of the Companies Act, 1956 read with Rule 10B of the companies (Central Government's) General Rules and Forms, 1956. According to the said provisions, a Company with a paid up share capital and free reserves of Rs.10 crores and above or a turnover of Rs.50 Crores and above can pay to its director by way of sitting fee for each meeting of the board of directors or a committee thereof an amount not exceeding Rs.20,000/- and in case of other companies, the limit has been set at Rs.10,000/-.

In view of the above legal provisions, the company cannot have a clause in its Articles of Association which exceeds the limit prescribed by law. The company is advised to check whether the aggregate of its paid up capital and free reserves exceeds Rs. 10 crores or whether its turnover exceeds Rs. 50 crores and accordingly it can have a clause in its Articles of Association. In case the company keeps the clause as given in the question, it shall be ultra vires the Companies Act, 1956 as Section 9 states that any provision contained in Memorandum of Association, Articles of Association, Agreements or Resolutions to the extent it is repugnant to the provisions to the provisions of the Companies Act, 1956 shall be void.

Question 7

Mr. X appointed as the Managing Director of XYZ Ltd. w.e.f. 1st October, 2006. The company made an application to the Central Government for approval, as the remuneration proposed to be paid to Mr. X was beyond the limits laid down in schedule XIII to the Companies Act, 1956. The company started paying remuneration from the date of appointment and continued to do so till 31st March, 2007. The Central Government did not approve the remuneration as proposed by the company and restricted the same to a lower amount. On scrutiny of the accounts, it was noticed that the company till 31st March, 2007 has paid to Mr. X, a total sum of Rs. 1.20 lakhs in excess of the remuneration sanctioned by the Central Government. Explain with reference to the provisions of the Act whether Mr. X can keep the excess remuneration. Draft a resolution for waiver of recovery of the excess remuneration so paid by the company.

(November 2007)

Answer

According to Section 309(5A) of the Companies Act, 1956, if any director draws any remuneration in excess of the remuneration sanctioned by the Central Government, he shall refund such excess remuneration to the company. The company shall not waive the recovery of any sum refundable to it unless permitted by the Central Government.

In the present case Mr. X cannot keep remuneration drawn by him which is in excess of the remuneration sanctioned by the Central Government, the Central Government permit the waiver of recovery of excess remuneration, the company may waive the recover of excess remuneration, and then Mr. X will have a right to retain the excess remuneration drawn by him.

Draft resolution for waiver of recovery of the excess remuneration:

“Resolved that subject to the approval of the central Government, consent of the company be and is hereby given waiving the recovery of an amount of Rs. 120,000 paid to Mr. X the director of the company, during the period 1st October, 2006 to 31st March, 2007 being in excess of the remuneration sanctioned by the Central Government vide letter no. dated

Resolved further that an application be made to the Central Government and the company secretary be and is hereby authorized to take the necessary steps in this regard.”

Question 8

Non-executive Directors of ABC Limited, who are neither in the whole time employment of the company nor Managing Directors have been given the following remuneration --

- (i) *Guarantee Commission has been paid to them for having guaranteed the term loans obtained from a financial institution.*
- (ii) *Commission payable to them is calculated on the basis of book-profits arrived at after providing for depreciation as per straight line method,*

Examine the validity of these payments in the light of the provisions of the Companies Act, 1956.
(CA, Final, New Course, May, 2010)

Answer

Remuneration to Non-Executive Directors:

- (i) **Guarantee Commission:** Section 309(i) of the Companies Act, 1956 provides that the remuneration payable to any director shall be inclusive of the remuneration payable for services rendered by him in any other capacity. The question is whether guarantee commission is remuneration within the meaning of Section 309 of the said Act. In the case of *Suesses Textile Bearings Ltd. Vs. Union of India (1984)* it has been decided that the guarantee commission paid to the directors for giving surety against loan taken by the company from financial institutions is not a remuneration for any professional services within the meaning of Section 309 and therefore approval of the Central Government is not necessary.
- (ii) **Depreciation:** Section 350 of the Companies Act, 1956 specifies the manner of ascertainment of depreciation. The amount of depreciation to be deducted is the amount of depreciation as appearing in the books i.e. as shown in the profit and loss account of the relevant financial year at the rates specified in Schedule XIV of the Companies Act, 1956. Thus, the payment of commission calculated on the basis of book profits arrived at after providing for depreciation as per straight-line method is not in order.

Question 9

Mr. Weldon was appointed as a director of Esquire Engineering Ltd. with effect from 1st October, 2008. Since the Company wanted to take full advantage of the wisdom and experience of Mr. Weldon, it offered him attractive remuneration payable on monthly basis and made an application to the Central Government for approval to pay such remuneration. Anticipating the approval of the Central Government, Esquire Engineering Ltd. started paying such remuneration from the date of appointment and continued to do so till 31st March, 2009. The Central Government did not fully approve the remuneration proposed by the Company and restricted the same to a lower amount. On scrutiny of accounts, the Company noticed that till 31st March, 2009 it has paid to Mr. Weldon a total sum of Rs.5.50 lakhs in excess of the remuneration sanctioned by the Central Government. Explain the relevant provisions of the Companies Act, 1956, in respect of recovery and waiver of recovery of the excess remuneration so paid. Draft a resolution for recovery/waiver of recovery of the excess remuneration paid by the Company.

(November 2009)

Answer

- (a) A director who is not a Managing Director or Whole Time Director can draw remuneration by way of monthly, quarterly or annual payment only if so authorized by the Central Government (Section 309). The Central Government may while sanctioning the payment of remuneration under Section 309, fix remuneration at such amount as it may deem fit (Section 637AA). If any director draws any remuneration in excess of the remuneration sanctioned by the Central Government, he shall refund such excess remuneration to the Company. Until such excess remuneration is refunded he shall hold it in trust for the Company. The Company shall not waive the recovery of any sum refundable to it unless permitted by the Central Government.
- (b) In the present case, Mr. Weldon cannot keep remuneration drawn by him which is in excess of the remuneration sanctioned by the Central Government. Accordingly he shall refund to the Company Rs.5.50 lakhs. Until such refund is made he shall hold the excess amount in trust for the Company. Further the Company cannot waive the recovery of excess remuneration.

However, if on an application made to the Central Government, the Central Government may permit, the waiver of recovery of excess remuneration. The Company can waive the recovery of excess remuneration and then Mr. Weldon shall have a right to retain the excess remuneration drawn by him. For recovery of the excess remuneration paid to Mr. Weldon, there is no need to pass any resolution. However, for waiver of recovery a resolution is required to be passed by the Company in a general meeting and approval of the Central Government in necessary.

Resolution

- (c) "Resolved that subject to the approval of the Central Government, consent of the Company be and is hereby given waiving the recovery of an amount of Rs.5.50 lakhs paid to Mr. Weldon, the director of the Company, during the period 1st October, 2008 to 31st march 2009 being in excess of the remuneration sanctioned by the Central Government vide letter no date
- (d) Resolved further that an application to be made to the Central Government and the Company Secretary be and is here by authorized to take the necessary steps in this regard."

Question 10

Advise M/s Super Specialities Ltd. in respect of the following proposals under consideration of its Board of Directors:

- (i) *Appointment of Managing Director who is more than 70 years of age;*
- (ii) *Payment of commission of 4% of the net profits per annum to the ordinary directors of the company;*
- (iii) *Payment of remuneration to an ordinary director for rendering professional services; and*
- (iv) *Payment of remuneration of Rs.40,000 per month to the whole time director of the company running in loss and having an effective capital of Rs.95.00 lacs. (May 2005)*

Answer

- (i) Under Schedule XIII, Part I, Paragraph (c) of the Companies Act, 1956, a person shall be eligible for appointment as Managing Director who has attained the age of 70 years where his appointment is approved by a Special resolution passed by the company in the general meeting. In that case, approval of the Central Government is not required.
- (ii) Under Section 309(4)(b) of the Companies Act, 1956 ordinary directors may be paid commission if the company by special resolution authorise such payment not exceeding 1% of net profit, if the company has MD/MTD/Manager or upto 3% of the net profits in any other case. Further, under section 309(7) of the Act, Special resolution shall not remain in force for a period of more than 5 years at a time.

Second proviso to section 309(4) states that a company in general meeting may, with the approval of the Central Government, authorise the payment of such remuneration at a rate exceeding one per cent or, as the case may be, three per cent of its net profits.

Thus, in the present case, commission of 4% of net profits of the company per annum can only be paid to the ordinary directors with the approval of the Central Government

- (iii) Under proviso to section 309(1) of the Act, any remuneration for services rendered to any director in any other capacity shall not be so included if-
- (a) the services rendered are of a professional nature, and
 - (b) in the opinion of the Central Government, the director possesses the requisite qualification for the practice of the profession.

In that case, approval of the Central Government will not be required for payment of any remuneration to the concerned director.

- (iv) In terms of section II of Part II of Schedule XIII of the Act, approval of the Central Government is not required for payment of monthly remuneration upto Rs.75,000/- in case of a company with effective capital of less than Rs.1 crore and having no profit or its profits are inadequate, to its managerial persons, provided -
- (1) the payment of remuneration is approved by the Remuneration Committee;
 - (2) the company has not defaulted in repayment of its debts, including public deposits or debentures or interest payable thereon for a continuous period of 30 days in the preceding year before the date of such appointment.

Thus, in the given case, the company may pay the remuneration of Rs.40,000 P.M. to its WTD without approval of the Central Government subject to the above restrictions.

Question 11

EF Chemicals Ltd. proposes to appoint one whole-time technical Director on a consolidated monthly remuneration of Rs. 30,000 and one whole-time Marketing Director on a consolidated salary of Rs. 25,000 per month for a period for three years with effect from 1st September, 2005. The company has got a Managing Director and he is getting Rs. 40,000 per month. Explain the requirements under the Companies Act to be complied with by the company in connection with the proposed appointment of whole-time Directors taking into account the following data collected from the Balance Sheet of the company as on 31st March, 2005:

	Rs.
1. Paid-up Share Capital	80,00,000
2. Debentures redeemable after three years	90,00,000
3. Investments	20,00,000
4. Accumulated Loss	70,00,000
5. Preliminary Expenses not written off	15,00,000
	(May 2006)

Answer

Appointment of whole time directors: In the given case two whole time directors are proposed to be appointed with effect from 1st September, 2005. The remuneration payable to these directors depends on the effective capital of the company on the last day of the preceding financial year i.e. 31.3.2005. The effective capital is Rs. 65 lakhs (Rs. 80 lakhs + 90 lakhs – Rs. 20 lakhs – Rs. 70 lakhs – Rs. 15 lakhs) on 31.3.2005.

The ceiling on minimum remuneration has been prescribed in Part II of Schedule XIII of the Companies Act, 1956. Here the Managing Director is already getting a minimum monthly remuneration of Rs. 40,000. The proposed minimum remuneration to the whole-time technical director is Rs. 30,000 p.m. and to the whole time marketing director is Rs. 25,000 p.m. If a company has more than one managing director and / or whole-time director, the company may pay to each of them minimum remuneration within the prescribed ceiling. As the effective capital is less than Rs.1crore, the company may pay to each of the Managing Director/whole time director minimum remuneration upto Rs. 75,000 p.m. Hence the proposed minimum remuneration is within the prescribed limits.

The remuneration payable to the whole-time directors must be approved by Remuneration Committee of the Board of Directors, and thereafter the appointments of the Technical Director and Marketing Director shall be approved at a Board meeting.

Abstract of terms of appointment of whole-time directors must be sent to every member within 21 days as required under section 302(2). Nature of concern or interest of each director must be disclosed.

Copy of Board resolution, Form No. 32 must be filed with the Registrar of Companies.

Return in Form No. 25C must also be filed within 90 days from appointment as required under section 269(2). The return must contain a certificate from the auditor or the Secretary of the company or a Secretary in Whole-Time Practice that the requirements under Schedule XIII have been complied with Part III of Schedule XIII – Para 2)

The appointment and remuneration of the whole-time marketing and technical directors must be approved in next annual general meeting by ordinary resolution (Section 305(1) and part III of Schedule XIII).

The company has to comply with the above requirements under the Companies Act, 1956 with regard to the proposed appointment of two whole-time directors.

MISCELLANEOUS PROVISIONS (SECTIONS 312 – 314)

Prohibition of assignment of office by director (Section 312)

Question 1

'X' was appointed as Managing Director for life by the Articles of Association of a private company incorporated on 1st June, 1970. The articles also empowered 'X' to appoint a successor. 'X' appointed by will 'G' to succeed him after his death. Examine in this connection

- (a) *Can 'G' succeed 'X' as Managing Director after the death of 'X'?*
- (b) *Is it possible for the company in general meeting to remove 'X' from his office of directorship during his life time?*

Answer

- (a) Section 312 prohibits assignment of his office by a director and such assignment shall be void. It was held in *Oriental Metal Pressing Works Private Ltd. vs. B.K. Thakoor (A.I.R. 1960 Bom. 167)* that the appointment of one as managing director by the will of one D was void in view of the provisions contained in Section 312, since, according to the High Court, the words 'any assignment' were comprehensive enough to include every assignment to transfer of a director or of the appointment by a director of a person to the office of a director in his place, whether by a deed *inter vivos* or by will. But this ruling has been reversed by the Supreme Court (*vide A.I.R. 1961 S.C. 573*). The Court considers that the word 'assignment' in Section 312 does not mean or include 'appointment'. From its every nature transfer inevitably imports the passing of a thing from one person to another. A transfer without the passage of the thing, even when that is an office is inconceivable. On the other hand, an 'appointment' has nothing to do with passing from one person to another; it connotes the putting in of someone in a vacancy. So transfer and appointment are dissimilar. It would be an unusual statute, which by using a single word intended to prohibit at the same time, two wholly different acts. A construction leading to such a result cannot be permitted. The Court observed that 'the section talks of assignment of his office by the director. The word 'his' would indicate that the office contemplated was one held by the director at the time of assignment. An appointment to an office can be made only if the office is vacant. It is legitimate, therefore it infer that by using the word 'his' the legislature

indicated that an appointment by a director to the office which he previously held but did not hold at the date of appointment was not to be included 'assignment'. In view of the Supreme Court decision, 'X' has not made any assignment of his office prohibited by section 312 and 'G' can succeed 'X' as Managing Director after the death of 'X'.

- (b) Section 284 empowers the company to remove a director, by ordinary resolution before the expiry of his period of office. This section applies to both public and private companies. It applies to permanent directors or life directors and directors appointed for a fixed term even though they might have been appointed by the Articles of Association or otherwise. But directors appointed by the Central Government under section 408 cannot be removed by the company under this section. Proviso 1 to sub-section (1) of section 408 exempts life directors who were holding office in private companies on 1st April, 1952. As the private company in this case was incorporated on 1st June, 1970, it is not entitled to this exemption. Hence 'X' can be removed as a director under section 284 even though he is a permanent director and once he is removed as a director, he also ceases to be a Managing Director.

Director, etc not to hold office or place of profit (Section 314)

Question 2

Mr. X is serving in a company in the dual capacity of a director and an employee? Referring to the provisions of the Companies Act, 1956. State:

- (a) *Whether there is any prohibition/restriction serving in the dual capacity?*
- (b) *If so whether a director serving as an employee would amount to holding an office or place of profit?*
- (c) *Whether the remuneration drawn by the director as an employee of the company would be governed by the provisions relating to managerial remuneration?*
- (d) *What would be your answer if the said director is rendering services of a professional nature?*

Answer

There is no prohibition is contained in the Companies Act for a director acting in the dual capacity of a director and an employee. However, Section 314 puts a restriction for a director while accepting office or place of profit in the company. For this purpose, the director appointment in the office or place of profit need to be approved by the shareholders in the general meeting. A director however, without recourse to Section 314 can render services to the company in his professional capacity on one time basis.

Question 3

A is proposed to be appointed as a marketing executive on a monthly salary of Rs.60,000 in a company in which his father is a director.

Answer

As per Section 314(1B) no relative of a director of a company shall hold any office or place of profit which carries a total monthly remuneration of not less than such sum as may be prescribed except with the prior consent of the company by a special resolution and the approval of the Government. The limit of monthly remuneration prescribed by the Central Government presently is Rs.50,000/-, therefore, the company is required to pass a special resolution and get approved by Central Government before Mr. A is appointed.

Question 4

Mr. Smart is a director of ABC Ltd., accepts the offer of employment as “Chief Executive-Technical Operations” of the same company on a monthly remuneration of Rs.15,000. Can he be an employee at the same time being the director of the company? In case his son is appointed to the same post, does it attract any provisions of the Companies Act?

Answer

Ordinarily, the shareholders in general meeting elect a director, and once so elected, he enjoys well-defined rights and powers under the Act. An employee is appointed by the company under a contract of service is a servant of the company and the company can always direct his actions and interfere with his work. *In Lee Behrens & Co. (Re [1932] 2 com cas. 588* it was observed that directors are elected representatives of the shareholders engaged in directing the affairs of the company on its behalf. However, there is nothing in law to prevent a director from accepting employment under the company under a special contract, which he may enter into with the company. *(R.R. Kothandaraman vs. Commr. of I.Tax (1957)*. Section 314 provide for a director holding an office or place of profit under a company.

Except with the consent of the company accorded by a special resolution no director shall hold any office or place of profit and no partner or relative of his, no firm in which he or his relative is a partner, no private company of which he is a director or member and no director or manager of such a private company shall hold any office or place of profit carrying a monthly remuneration of Rs. 10,000 or more. The special resolution may be passed before or a general meeting of the company held for the first time after the holding of such an office or profit. If it is done without the knowledge of the director, the consent of the company may be obtained either in the general meeting held for the first time after the holding of such an office or within 3 months from the date of appointment whichever is later.

If a partner or a relative of a director or manager, a firm in which such director or manager or relative of either is a partner or a private company of which such a director or manager or relative of either is director or member can not hold any office or place of profit which carries a total monthly remuneration of Rs.20,000 or more except with the prior consent of the company by special resolution and the approval of the Central Government.

Thus, in the instance case, Mr. Smart can accept the offer of employment as Chief Executive-Technical Operations. If his son is appointed to the said post, it requires the consent of the company.³

Question 5

Mr. True is a director of a company and also a chartered accountant by profession and one of the partners in M/s True & Fair Co. The company appointed the said firm as chartered accountant of the company on a regular basis. Does Mr. True holds any office or place of profit in the company. Would your answer be different if his appointment is on a case-to-case basis?

Answer

Chartered Accountants appointed by a company on a regular basis are hit by a restrictive provisions of sub-sections I and I(b) of Section 314 if he is a director receiving remuneration over and above to which he is entitled. In case the office or place of profit is held by an individual other than a director or by any firm, private company or other body corporate, if it obtains from the company anything by way of remuneration whether as salary, fees, commission perquisite or otherwise, approval of the company is not required where the monthly remuneration is less than Rs. 10,000/-. Accordingly, if a director is holding the place of chartered accountants for the company he would be covered by Section 314(3) irrespective of the fact that office or place of profit carries a total monthly remuneration less than Rs.10,000/-.

Question 6

Mr. V, a Chartered Accountant is a Director in PQR Limited. The company proposes to appoint/engage the firm V & Co. in which Mr. V is a partner in one or more of the following capacities:

- (i) *Consultants on regular retainer basis.*
- (ii) *Authorised representatives to appear before tribunals.*

Discuss whether the provisions of Section 314 of the Companies Act are attracted in the above situations.

(May, 2000)

Answer

Apparently the prohibition under Sub-section (1) & (1B) of the Section 314 of the Companies Act, 1956 is not applicable to remuneration/compensation given to concerned persons (i.e. directors) for the services of a professional nature rendered by them to the company in their professional capacity such as advocate, chartered accountant, solicitor etc. However, prohibition will apply to them if they bind themselves on regular retainer ship basis. Therefore,

- (i) Chartered Accountants appointed by a company on a regular retainer basis as advisers, consultants, internal auditors, etc., also hold the position or place of consultant or adviser and accordingly such appointments are hit by the restrictive provisions of Sub-sections (1) and (1B) of Section 314.

- (ii) Based on the above analogy as contained above the bare engagement of a Chartered Accountant in a particular case and the payment to him of his professional fees in that case would not attract the provisions of Sub-sections (1) and (1B) of Section 314 of the Companies Act. Engaging a person in his professional capacity for performing a particular function, say, for attending to a particular case or for undertaking a particular assignment of consultancy, or rendering advice on a specific matter, would not by itself constitute appointment to an office or place of profit in or under the company. But if the terms of engagement of a Chartered Accountant are that he should attend to all the tax cases or act as adviser in all connected matters, whether generally or in a particular city or town, then even though he may be paid on a case by case basis, it would amount to appointment to a "place of profit" under the company.

Question 7

Examine the validity of the following:

Mr. Q, a Director of PQR Limited proceeding on a long foreign tour, appointed Mr. Y as an alternate director to act for him during his absence. The articles of the company provide for appointment of alternate directors. Mr. Q claims that he has a right to appoint alternate director.

(May, 2002)

Answer

Section 313 of the Companies Act, 1956 provides that the Board of Directors of a company may, if authorised by its articles or by resolution passed by the company in general meeting, appoint an alternate director to act for a director during his absence for a period of not less than 3 months from the State in which the meetings of the Board are ordinarily held. The alternate director can be appointed only by the Board of Directors and only in cases where the Board is authorised by Articles or by the company in general meeting. Hence Mr. Q, the director in question, is not competent to appoint alternate director and the appointment of Mr. Y as alternate director is not valid.

Question 8

M/s Kith and Kin Consultants Private Limited seeks your legal advice regarding the following appointments relating to directors and their relatives:

- (i) *Mr. Nephew, who is a relative of one of the directors, is to be appointed as the Managing Director on a monthly salary of Rs.30,000 plus other perquisites as applicable to other executives of the company.*
- (ii) *Miss Niece, a relative of a director, is to be appointed as Chief Executive Officer on a consolidated salary of Rs.25,000 per month.*

Advise explaining the relevant provisions of the Companies Act, 1956.

(May, 2002)

Answer

According to the provisions of section 314 of the Companies Act, 1956, except with the consent of the company accorded by a special resolution, no director of a company or relative shall hold any office or place of profit except that of Managing Director or manager of the company. Thus Mr. Nephew, if he is appointed as the Managing Director of the company, the provision of section 314 are not attracted, even though he is related to one of the directors of the company. This is because the appointment of Managing Director or manager is outside the purview of the provisions of Section 314.

Further according to section 314 (1B) no relative of director can be appointed to any office or place of profit under the company which carries a monthly remuneration of not less than Rs.50,000/- (previously Rs. 20,000/-) except with the prior consent of the company by a special resolution and the approval of the central Government. Thus in the case of Mr. Wellconnected who is related to the managing director, his appointment requires not only the passing of a special resolution by the company but also the approval of the Central Government. The special resolution is required to be passed before the appointment. However in the case of Miss Niece, her appointment requires only prior passing of the special resolution and not the approval of Central Government because the remuneration proposed to be paid is less than Rs. 50,000/- per month.

Question 9

Mr. A, an Advocate, is a Director of M/s ABC Limited and he is proposed to be engaged by the company as an Advocate to appear before the court in connection with a case, on a remuneration of Rs.10,000.

Will it amount to an 'Office' or Place of Profit' attracting Section 314 of the Companies Act, 1956?

Will your answer be different, if he is proposed to be appointed on a regular retainer basis for rendering legal advice on a retainer fee of Rs.5,000 per month either by ABC Limited or its subsidiary?

State also whether the proposed appointments can be made by the Board of Directors of the Companies.

(May, 2004)

Answer

Office or place of profit means in the case of a director, if the director obtains remuneration over and above the remuneration to which he is entitled as a director. Such remuneration may be as salary, fees, commission, perquisites, right to occupy any premises free of rent or in any other way [Section 314(3)(a)Companies Act, 1956].

An advocate who renders professional services as and when called upon to do so cannot be

said to be holding an office or place of profit under the company or in the company. An advocate who cannot by reasons of his status at the Bar held any direct contractual relations with his clients in regard to the performance of his professional work and duties and he acts essentially as an officer of the court when he appears before the court. Hence A cannot be said to be holding an office or place of profit under Section 314 and the appointment can be made by the Board.

But if Mr. A. is appointed on a regular retainer basis for rendering legal advice, other than appearance in courts, the provisions of Section 314(1) will be applicable. (DCA's Circular No. 14 of 1975 dated 5th June, 1975) and A will be said to be holding an office or place of profit. For the same reason, A will be considered as holding an office or place of profit if he gets the retainer fee from the subsidiary of ABC Ltd.

The exemption from Section 314(1) in respect of offices of profit carrying remuneration of less than Rs.10,000 per month applies only to the partners relatives, etc of a director and not to the director himself. In the case of a director, the section will hit any office of profit, however small the remuneration attached to it may be.

Hence A cannot be appointed on a regular retainer basis on a retainer fee of Rs.5,000 per month without obtaining the consent of the company (ABC Ltd.) by a special resolution.

If A receives retainer fee from the subsidiary of ABC Ltd., special resolution must be passed by both the holding company and the subsidiary company unless A remits the retainer fee received from the subsidiary company to the holding company.

Question 10

Excellent Technical Consultants Ltd. has approached you seeking your opinion on the following appointments relating to directors and their relatives

- (i) *Appointment of Mr. Sonata (relative of one of the directors) as the Managing Director of the Company on a monthly remuneration of Rs.40,000 and other perquisites as are currently being allowed to other executives of the Company.*
- (ii) *Appointment of Mr. Romesh (relative of one of the directors) as the General Manager – Marketing of the Company on a consolidated monthly remuneration of Rs.30,000.*
- (iii) *Appointment of Mr. Kamal (relative of one of the directors) as an Accounts Manager of the Company on a consolidated monthly remuneration of Rs.18,000.*

Express your opinion explaining the relevant provisions of the Companies Act, 1956?

(November, 2004, November, 2006)

Answer

As per provisions of section 314(1) of the Companies Act, 1956, except with the consent of the company accorded by way of a special resolution, no director or relative of a

director shall hold any office or place of profit except that of Managing Director or Manager of the Company.

Further, as per the provisions of Section 314(1B) of the Companies Act, 1956, no relative of a director can be appointed to any office or place of profit under the company which carries a monthly remuneration of not less than Rs.50,000/- (as per Notification vide 5th February, 2003) except with the prior consent of the company by way of a special resolution and the approval of the Central Government.

In the light of above legal provisions the opinion on the appointments of various persons as stated in the question can be expressed as follows:

Mr. Sonata is being appointed as the Managing Director of the Company, the provisions of section 314(1) are not attracted even though he is a relative of a director. This is because the appointment of Managing Director or Manager is outside the provisions of section 314 of the Companies Act, 1956. If Mr. Sonata is not already a director of the company, steps must be taken to appoint him first as an additional director/director. Thereafter he may be appointed as Managing Director by complying with the requirements under section 269 read with Schedule XIII to the Companies Act. The appointment can be made by the Board subject to the approval the company in general meeting as the proposed remuneration is within the limits laid down in Schedule XIII.

Since the remuneration proposed to be paid to Mr. Romesh does exceed Rs.50,000/- per month, his appointment does not require the passing of special resolution by the company and also the approval of the Central Government is not required. However, as the proposed remuneration exceeds Rs.10,000/- his appointment shall require the passing of special resolution by the company. The special resolution is required to be passed at a general meeting of the company held for the first time after such appointment.

In case of Mr. Kamal, since the remuneration proposed to be paid to him exceeds Rs.10,000/- but does not exceed Rs.50,000/- per month, his appointment shall require the passing of special resolution by the company only and the no approval of the Central Government is required. The special resolution according the consent may be passed at a general meeting of the members of the company held for the first time after such appointment.

Question 11

Mr. Kamlesh, son of Managing Director of a Public Company, is proposed to be appointed as Chief Executive of the Company on a Monthly remuneration of Rs.75,000. State the provisions of the Companies Act, 1956 which are required to be complied with by the company in this regard?

Will it make any difference if Mr. Kamlesh is appointed as Whole-Time Director on the same remuneration?
(CA Final, New Course, November 2009)

Answer

Under Section 314(1B) of the Companies Act, 1956, in case relative of a Director holds office or place of profit under the Company on a monthly remuneration of Rs.50,000 or more, the Company is required to obtain prior consent of the company by special resolution and approval of Central Government. In the present case, the Company is accordingly required to pass a special resolution and obtain approval of the Central Government.

In case Mr. Kamlesh is appointed as Whole Time Director in the Company, Section 314 will not be attracted in view of sub-section (3) thereof, as he will be drawing remuneration in his capacity as a Director. He will be governed by the provisions of Section 269 read with Schedule XIII of the Act, according to which approval of Central Government is not required as the proposed remuneration of Rs.75,000. per month is within the ceiling provide in Part II of Schedule XIII provided the conditions prescribed in Part I of the Schedule have been complied with by the Company and the appointee.

COMPENSATION FOR LOSS OF OFFICE (SECTIONS 318 – 321)

Compensation for loss of office not permissible except to managing or whole-time directors or to directors who are manager (Section 318)

Question 1

Can a company pay compensation to its directors for loss of office? Explain briefly the relevant provisions of the Companies Act, 1956 in this regard? (May, 2000)

Answer

A company can pay compensation to its directors for loss of office as provided in Sections 318 to 321 of the Companies Act 1956. Under Section 318, such compensation can be paid only to managing director, director holding the office of the manager and to a whole time director but not to others. The compensation payable shall be on the basis of average remuneration actually earned by such director for three years, or such shorter period as the case may be, immediately preceding the ceasing of holding of such office and shall be for the unexpired portion of his term or for three years whichever is shorter. No such payment can be made, if winding up of the company is commenced before or commences within 12 months after he ceases to hold office if the assets of the company on the winding up, after deducting expenses thereof, are not sufficient to repay to the shareholders the capital (including the premium, if any) contributed by them. However, no payment of compensation can be made in the following cases:

- (a) where a director resigns excepting on the ground of amalgamation or reconstruction and holding the office of managing director or manager or other officer of such reconstructed or amalgamated company.
- (b) where the director vacates office under section 203 or section 283(1).
- (c) where the winding up of the company is due to the negligence of the director concerned.
- (d) where the director has been guilty of any fraud or breach of trust.
- (e) where the director has instigated or has taken part directly or indirectly in bringing about, the termination of his office.

Question 2

Mr. Doubtful was appointed as Managing Director of Carefree Industries Ltd. for a period of five years with effect from 1.4.2000 on a salary of Rs.12 lakhs per annum with other perquisites. The Board of Directors of the company on coming to know of certain questionable transactions, terminated the services of the Managing Director from 1.3.2003. Mr. Doubtful termed his removal as illegal and claimed compensation from the company. Meanwhile the company paid a sum of Rs.5 lakhs on ad hoc basis to Mr. Doubtful pending settlement of his dues. Discuss whether:

- (i) The company is bound to pay compensation to Mr. Doubtful and, if so, how much.*
- (ii) The company can recover the amount of Rs. 5 lakhs paid on the ground that Mr. Doubtful is not entitled to any compensation, because he is guilty of corrupt practice.*
(November, 2004, November, 2007)

Answer

According to Section 318 of the Companies Act, 1956, compensation can be paid only to a Managing or Whole-time Director. Amount of compensation cannot exceed the remuneration which he would have earned if he would have been in the office for the unexpired term of his office or for 3 years whichever is shorter. No compensation shall be paid, if the director has been found guilty of fraud or breach of trust or gross negligence in the conduct of the affairs of the company.

In light of the above provisions of law, the company is not liable to pay any compensation to Mr. Doubtful, if he has been found guilty of fraud or breach of trust or gross negligence in the conduct of affairs of the company. But, it is not proper on the part of the company to withhold the payment of compensation on the basis of mere allegations. The compensation payable by the company to Mr. Doubtful would be Rs.25 Lacs calculated at the rate of Rs.12 Lacs per annum for unexpired term of 25 months.

Regarding adhoc payment of Rs.5 Lacs, it will not be possible for the company to recover the amount from Mr. Doubtful in view of the decision in case of *Bell vs. Lever Bros. (1932) AC 161* where it was observed that a director was not legally bound to disclose any breach of his fiduciary obligations so as to give the company an opportunity to dismiss him. In that case the Managing Director was initially removed by paying him compensation and later on it was discovered that he had been guilty of breaches of duty and corrupt practices and that he could have been removed without compensation.

Question 3

A Managing Director was removed during the tenure of office and certain compensation was paid to him. It was later on found that during the tenure of his office that he was guilty of

corrupt practices and the company felt that no compensation should have paid to him and therefore wants to recover the compensation so paid to him. Can the company succeed?

Answer

In *Bell vs. Lever Brothers*, (1932), Lever Brothers removed their managing director of a subsidiary by paying him compensation. It was afterwards discovered that during his tenure of office he had been guilty of so many breaches of duty and corrupt practices that he could have been removed without compensation. An action was then commenced to recover back the compensation money. It was held that Bell was not bound to refund the compensation money and to disclose any breach of his fiduciary obligation so as to give the company an opportunity to dismiss him.

DIRECTORS WITH LIMITED LIABILITY (SECTIONS 322 – 323)

Special resolution of limited company making liability of directors, etc., unlimited (Section 323)

Question 1

BHP Ltd. wants to make the liability to its directors unlimited. You are required to state with reference to the provisions of the Companies Act, 1956 whether this can be done.

Answer

Section 323(1) of the Companies Act, 1956 states that a limited company may, if so authorized by its Articles of Association, by special resolution, alter its memorandum of association so as to render unlimited the liability of its directors or of any director or manager. Hence, by amending the Memorandum of Association of the company by way of passing a special resolution in a general meeting, BHP Ltd. can make the liability of directors unlimited.

POWERS OF CG UNDER (SECTIONS 388B – 388E)

Powers of Central Government to remove managerial personnel from office on the recommendations of the Tribunal (Section 388B – 388E)

Reference to Tribunal of cases against managerial personnel (Section 388B)

Question 1

The Central Government came into possession of certain facts and documents, which indicated that some of the managerial personnel of a Company concerned with the management of the affairs thereof are acting in a manner, which is not desirable and if allowed to carry on, it is likely to cause serious injury to the interest of the trade, industry and business to which the company pertains. You are required to state the circumstances and manner in which the Central Government can initiate the process of removal of managerial personnel under the provisions of the Companies Act, 1956.

(November 2005)

Answer

As per provisions of Section 388B of the Companies Act, 1956, if in the opinion of the Central Government, there are circumstances suggesting:

- (a) that any person concerned in the conduct and management of the affairs of a company is or has been in connection therewith guilty of fraud, misfeasance, persistent negligence or default in carrying out his obligations and functions under the law, or breach of trust; or
- (b) that the business of a company is not or has not been conducted and managed by such person in accordance with sound business principles or prudent commercial practices, or
- (c) that a company is or has been conducted and managed by such person in a manner which is likely to cause or has caused, serious injury or damage to the interest of the trade, industry or business to which such company pertains; or

- (d) that the business of a company is or has been conducted and managed by such person with intent to defraud its creditors, members or any other persons or otherwise for a fraudulent or unlawful purpose or in a manner prejudicial to public interest.

Then, in any of the above circumstances the Central Government may state a case in the form of an application against the such person and refer the same to the Company Law Tribunal with a request that the Company Law Tribunal may enquire into the case and record a decision as to whether or not such person is a fit and proper person to hold the office of Director or any other office connected with the conduct and management of any company.

The Company Law Tribunal is empowered to record its decision under the provisions of Section 388D of the Companies Act, 1956 and such decision shall be recorded by it after concluding the hearing of the case in which such person shall join as the respondent.

Section 388E of the Companies Act, 1956 states that the Central Government shall, by order, remove from office any director or any other person concerned in the conduct and management of the affairs of a company, against whom a decision of the Company Law Tribunal under Section 388D has been recorded.

NOTE: Powers of the Company Law Board has been transferred to the National Company Law Tribunal by the Companies (Second Amendment) Act, 2002 and assented by the President of India on 13.01.2003. This will take effect from the date of full enforcement. Till then, powers being currently exercised by the Company Law Board shall continue to be exercised.

Power of CG to remove managerial personnel on the basis of Tribunal's decision (Section 388E)

Question 2

X Ltd. is being managed by Mr. Clever as the Managing Director. Serious allegations have been made by some shareholders and creditors of the company that the Managing Director has misused his position and caused enormous loss to the company. The said shareholders and creditors of the company make a complaint to the Central Government to intervene and provide relief to them. Their main prayer is that the Managing Director should be removed from the post. Explain the powers of the Central Government in this regard. (May, 2001)

Answer

On receipt of the complaint from some of the shareholders and creditors of X Ltd., that its managing director Mr. Clever has misused his office and thereby caused loss to the company, the Central Government, if satisfied with the contents of the complaint may make a reference to the Company Law Board with a request to inquire into the case and record a finding whether or not Mr. Clever is a fit and proper person to hold the office of Managing Director. The application made to CLB must contain a concise statement of the

circumstances and material as the central Government may consider necessary for the purpose of the enquiry. The Company Law Board will hear both the parties viz. (1) The Central Government and (2) The Respondent Mr. Clever as well as the company. The CLB has powers to pass any interim order to the effect that the respondent Mr. Clever shall not discharge any of the duties of his office until further orders and appoint a suitable person in place of the respondent. At the conclusion of the hearing the CLB will record its finding. If the finding of the CLB is against the respondent, the Central Government, by order, shall remove him from office, as provided in Section 388E(1) of the Companies Act, 1956. The person against whom such an order is passed is debarred from holding the post of director etc., for a period of 5 years from the date of order of removal. Also no compensation is payable to him for termination of office.

ARBITRATION, COMPROMISES, ARRANGEMENTS AND RECONSTRUCTIONS (SECTIONS 389 – 396 A)

Power to compromise or make arrangements with creditors and members (Section 391)

Question 1

Alpha Ltd. and Beta Ltd. entered into a scheme of amalgamation by which Alpha Ltd. would transfer its entire undertaking to Beta Ltd. However, the Central Government raised an objection that unless the objects clause of the companies are similar, and memorandum empowers to do so, the scheme of amalgamation cannot be permitted. Is the contention of the Central Government correct?

Answer

The power to amalgamate may flow from the memorandum or it may be acquired by resorting to the statute. Section 17 of the Companies Act, 1956 indicates that a company which desires to amalgamate with another company will take necessary steps to come before a court for alteration of its memorandum in aid of such amalgamation. The statute confers a right on a company to alter its memorandum in aid of amalgamation with another company. The provisions contained in sections 391 to 396 and 494, illustrate instances of statutory power of amalgamating a company with another company without any specific power in the memorandum. [*Hari Krishna Lokia (v) Hoolungooree Tea Co. Ltd*, 1996].

Section 391 is not only a complete code, but it is in the nature of a single window clearance system to ensure that parties are not put to avoidable, unnecessary and cumbersome procedure for making repeated applications to court for various alterations and changes. What is to be seen is the overall fairness and feasibility of scheme of amalgamation and there need not be any 'unison of objects of both transferor and the transferee company. [*R Morarjee Gokuldas spg. & wrg. Co.*, 1995].

To amalgamate with another company is the power of the company and not an object of the company. [*Re. Hari Krishna Lohia*, 1996]. Irrespective of the objects clause, the court is empowered to sanction scheme of amalgamation provided it does not prejudice the interest of the public. Therefore, based on the above judicial rulings, the contention of the central government is not correct. [*Golkunda Engg. Enterprises Ltd (v) the G. V. Ltd*, 1997J].

Question 2

Overambitious Limited became sick. The shareholders and creditors of the company passed resolutions in meetings convened by the company approving a scheme of reconstruction of the company. The scheme provides for sale of vacant land and utilisation of the sale proceeds for payment of outstanding wages, sales tax dues and repayment of part of the loan taken from the bank. The unsecured creditors will have to forego 50% of their claims against the company and receive debentures for the balance amount. Advise the directors about the steps to be taken to give effect to the proposed scheme inspite of objections raised by a few shareholders and creditors.

(May, 2003)

Answer

Scheme of compromise or arrangement: The scheme provides for sacrifice on the part of creditors as they have to forego 50% of the amount due to them and accept debentures for the balance amount. The scheme also provides for sacrifice by members but the nature of sacrifice has not been stated in the problem. The company is sick and therefore it can be considered as a company liable to be wound up within the meaning of section 390(a) of the Companies Act, 1956. The proposed scheme involves as a compromise or arrangement with members and creditors and it attracts section 391.

While the company or any creditor or member can make application to the court under section 391, it is usual for the company to make an application. On such application, the court may order that a meeting of creditors and/or members be called and held as per directions of the court (Section 391(1)).

Company must arrange to send notice of meeting to every creditor/member containing a statement setting forth the terms of compromise or arrangement explaining its effect. Material interest of directors, M.D, or manager of the company in the scheme and the effect of scheme on their interest should be fully disclosed (Section 393(1)(a)). Advertisement issued by the company must comply with the requirements of Section 393(2). At the meetings convened as per directions of the court majority in number representing at least $\frac{3}{4}$ in value of creditors/members present and voting (either in person or proxy if allowed) must agree to compromise or arrangement.

Thereafter the company must present a petition to the court for confirmation of the compromise or arrangement [Companies (Court) Rules-79].

The notice of application made by the company will be served on the Central Government and the Court will take into consideration representation, if, any made by the Central Government (Section 394A). The Court will sanction the scheme, if it is satisfied that the company has disclosed all material facts relating to the company e.g. latest financial position, auditor's report on accounts of the company, pendency of investigation of company, etc.

Copy of Court order must be filed with the Registrar of Companies and then only the order will come into effect (Section 391(3)). Copy of court order must be annexed to every Memorandum of Association issued thereafter. (Section 391(4)).

If the court sanctions the scheme, it will be binding on all members and creditors even those who were dissenting (Section 391(2)). (*S.K. Gupta vs K.P. Jain A/R 1979 SC 374*).

Question 3

A scheme of reconstruction of Southern Stone Company Limited was, approved by its shareholders and creditors in their meeting and resolutions to that effect were passed. Afterwards a few shareholders and creditors of the company raised objections against the said arrangements of reconstruction. The entire paid up capital of the company was wiped out by the accumulated losses. Advise the Directors of the said company about the steps to be taken, to give effect to the proposed scheme under the Companies Act, 1956.

(CA Final, New Course, May 2010)

Answer

Scheme of reconstruction: The Company is a sick company and therefore can be considered as a company liable to be wound up with the meaning of Section 390 of the companies Act, 1956. The proposed scheme involves a compromise or arrangement with members and creditors and attracts Section 391 of the said Act. An application be submitted before the High Court under Section 391 of the said Act. On such application the court may order that a meeting of creditors and/or members be called and held as per the directions of the court.

The company must send notice of meeting to every creditor/member containing a statement setting forth the terms of compromise explaining its effects. At the meetings convened as per directions of the court majority in number representing at least $\frac{3}{4}$ in value of creditors/members present and voting must agree in compromise or arrangements. Thereafter the company must present a petition to the court for confirmation of the compromise or arrangement.

The notice of application made by the company will be served on the Central Government and the court will take into consideration representation, if any, made by the Central Government (Section 394A). The court will sanction the scheme, if satisfied, after consideration of all relevant matters. Copy of order issued by the court must be filed with the Registrar of Companies and then only the order will come into effect. Copy of the said order must be annexed to memorandum of Association issued thereafter. The scheme sanctioned by the court shall be binding on all members and creditors even on those who were dissenting.

Provisions facilitating reconstruction and amalgamation of companies (Section 394)

Question 4

HPC Ltd. for a number of years was in various types of business. In order to exit from its non core business, its management decided to hive off the business of Food Processing by

demerging the said business with an associate company, namely, BCD Ltd. You are required to advise briefly, with reference to the provisions of the Companies Act, 1956, the steps the management should take to give effect to the proposed demerger **(November 2005)**

Answer

HPC Ltd. can demerge its food processing business with an associate company, BCD Ltd. By obtaining the approval of Company Law Tribunal (CLT earlier such power was vested in High Court and the High Court can continue to exercise such power till the CLT becomes fully functional) as provided in section 394 of the Companies Act, 1956 for this purpose, HPC Ltd. is required to take the following steps:

- (1) HPC Ltd., known as "Transferor Company" for this purpose, has to prepare a scheme under which its properties and liabilities in respect of food processing business will be transferred to BCD Ltd., known as "Transferee Company" for this purpose. Such scheme must contain the consideration for transfer, known as "Exchange Ratio".
- (2) An application under Section 391(1) of the said Act must be made to CLT for an order convening meetings of creditors and/or members.
- (3) Notice(s) of the meeting(s) must be sent to members/creditors as per the direction of CLT. Such notice must be accompanied by a statement under Section 393(1) of the said Act setting forth the terms of the compromise or arrangement and explaining its effect in general and in particular, the effect on the interests of Managerial Personnel.
- (4) To hold the said meetings and pass necessary resolution approving the scheme subject to the confirmation of CLT. It may be noted that the resolution must be passed by a majority in number representing $\frac{3}{4}$ in value of the members/creditors as required under Section 391(2) of the said Act.
- (5) Thereafter, HPC Ltd. is required to move to CLT jointly with BCD Ltd. for approval of the scheme disclosing all material facts relating to the Company. (Proviso to section 391(2). CLT as required under section 394A shall give notice to the Central Government and shall take into consideration any representation received from Central Government before passing any order on the application made to it for approval of the scheme.
- (6) On receipt of CLT's order, HPC Ltd. is required to file a certified copy of the order with the Registrar of Companies (ROC) for registration within 30 days after making of the order by CLT. [(Section 394(3)]. This is very important since the non-filing of the order with ROC would make the approval order ineffective.
- (7) Lastly, to proceed to give effect to the scheme as approved by CLT in the manner as directed by it.

Question 5

Answer the following with reference to a scheme of amalgamation of companies explaining the relevant provisions of the Companies Act, 1956:

- (i) *Whether companies being amalgamated must be companies registered in India.*
- (ii) *What is the majority required for approving the scheme of amalgamation in a meeting of members of a company called as per directions of the court? Is the scheme to be approved by preference shareholders?*
- (iii) *When will the court order dissolution of the transferor company?* **(May, 2000)**

Answer

- (i) A scheme of compromise or arrangement may provide for amalgamation of companies under Section 394 of the Companies Act, 1956. Section 394(4)(b) defines the 'transferee' and 'transferor' companies. While the 'transferee company' does not include any company other than a company within the meaning of the Companies Act, 1956 the transferor company includes any body corporate whether a company within the meaning of the Companies Act or not. Hence the scheme of amalgamation may provide for transfer of foreign companies to Indian companies.
- (ii) Majority in number representing three-fourths in value of members or class of members, as the case may be, present and voting either in person or by proxy, where proxies are allowed under the rules made under Section 643 must approve the scheme or arrangement providing for amalgamation of companies [Section 391(2)]. Any member who though present at the meeting, does not vote for or against, but remains neutral, is not to be taken into consideration.

As the expression used is 'member', not only holders of equity shares but also preference shareholders will have to be taken into account and the value of their shares be included or, if the meeting of holders of preference shares and equity shares are ordered by the court to be held separately, the three-fourths majority of each class will have to be ascertained separately.
- (iii) The scheme may provide for the dissolution, without winding up, of any transferor company [Section 394(1)]. The Court shall not order dissolution of any transferor company unless the official liquidator has, on scrutiny of the books and papers of the company, made a report to the court that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest [Second proviso to Section 394(2)].

Question 6

M/s Over-ambitions Consultants Ltd. had, in course of its operations over the years, acquired various other ventures like plantations and tourism businesses. With a view to consolidate its

core business activities, the management decided to hive off its non-core activities by demerging them with an associate company. Advise briefly the steps the management should take to achieve the purpose of demerger. **(November, 2001)**

Answer

M/s Over Ambitions Constructions Ltd. can achieve its purpose of hiving off its plantations and tourism business activity by demerger process by obtaining the approval of the High Court as provided in Section 394 of the Companies Act, 1956.

The following steps are to be taken by M/s Over Ambitions Consultants Ltd.,

- (1) Prepare a draft scheme under which the properties and liabilities of the company comprising of plantations and tourism will be transferred to the associate company known as the transferee company. The consideration for the transfer must be stated in the scheme. (exchange ratio).
- (2) An application under section 391(1) must be made to the Court for an order convening meetings of creditors and/or members.
- (3) Notice of the meeting must be sent to members/creditors as per the court's directions, The notice must be accompanied by a statement under section 393(1) setting forth the terms of the compromise or arrangement and explaining its effects etc.
- (4) To hold the general meeting and pass that resolution approving the draft scheme of amalgamation subject to confirmation of the high court. Resolution must be passed by a majority in number representing 3/4th in value of the members as required under section 391.
- (5) To move the High Court jointly with transferee company for approval of the scheme and for the purpose to supply it with material facts [proviso to section 391(2)]. The court shall give notice of the application to the Central Government and shall take into consideration the representation, if any, made by the Government before passing any order. (Section 394A).
- (6) On receipt of the court's order, file the certified copy of the order, with the Registrar of Companies within 30 days after the making of the order [Section 394(3)]. Otherwise, it would not be effective.
- (7) To proceed to effect the scheme as per the scheme of amalgamation approved and the directions given by the High Court.

Question 7

M/s FMCG Ltd. proposes to acquire the majority shares of M/s Slow Industries Ltd. by way of Amalgamation. Briefly enumerate the steps that should be taken by the Transferee Company to achieve the objective under the Companies Act, 1956. **(November, 2002)**

Answer

FMCG LTD., the transferee company should take the following steps to achieve the objective of acquiring the majority shares of Show Industries Ltd. They are:

- (i) to check up whether the memorandum of association of the transferee company contains the power of amalgamation. If not, to take steps to alter the objects clauses suitably to acquire the said power.
- (ii) to prepare the draft scheme of amalgamation including the exchange ratio and get it approved by a meeting of the Board of Directors.
- (iii) to apply to the High Court for direction to convene the general meeting by way of Judges' summons as provided in Companies (Court) Rules 1959.
- (iv) to send notice of general meeting to every member alongwith the details of the scheme of amalgamation.
- (v) to hold the general meeting and to pass the resolution approving the draft scheme of amalgamation subject to the confirmation of the High Court. The resolution is to be passed by a majority in number representing 3/4th in value of the members as required by Section 391.
- (vi) to move the High Court for approval of the scheme.
- (vii) on receipt of the court order, to file the certified copy thereof to the Registrar of Companies within 30 days after making the order. [Section 394(3)].
- (viii) A copy of the order of the court to be annexed to every copy of the memorandum issued after the certified copy of the order has been filed with the Registrar.
- (ix) To effect the scheme of amalgamation as per the scheme approved and the directions given by the High Court and to allot shares of the transferee company to the shareholders of transferor company i.e., Slow Industries Ltd.

Question 8

ABC Company Limited was amalgamated with and merged in XYZ Company Limited. Some workers of ABC Company Limited refuse to join as workers of XYZ Company Limited and claim compensation for premature termination of service. XYZ Company Limited resists the claim on the ground that their services are transferred to XYZ Company Limited by the order of amalgamation and merger and, therefore, the workers must join service of XYZ Company Limited and cannot claim any compensation. Examine whether the workers' contention is correct.

(November, 2003)

Answer

An order under Section 394 of the Companies Act, 1956 transferring the property, rights and liabilities of one company to another does not automatically transfer contracts of

personal service, which are in their nature, incapable of being transferred and no contract of service is thereby created between an employee of the transferor company on the one hand and the transferee company on the other. In *Nokes vs. Doucaster Amalgamated Collieries Ltd.* [(1940) 3All 2k 549], the House of Lords categorically stated that the workers are not furniture and their services can not be transferred without their consent. Therefore, the workers of ABC Co. Ltd will succeed against XYZ Co. Ltd.

Question 9

Examine with reference to the provisions of the Companies Act, 1956 the validity of the following:

- (i) *A scheme provides for Amalgamation of a 'Foreign Company' with a Company Registered under the Companies Act, 1956.*
- (ii) *The statement forwarded with the notice convening a meeting of its members pursuant to Court's Direction Under Section 391 contains only 'Exchange Ratio' without details of its calculation.*
- (iii) *At the time of filing of the petition for Amalgamation, the object clause of both the transferor and Transferee Companies does not contain power to Amalgamate.*
(May, 2004)

Answer

Amalgamation of a foreign company with a company registered under the Companies Act

According to Section 394(4)(b), 'transferor company' does not include any company, other than a company within the meaning of this Act. But transferor company includes any body corporate whether a company within the meaning of this Act or not. According to the definition of 'body corporate' in Section 2(7), it includes a company incorporated outside India.

Further, as per Section 390(a), for purposes of Section 391, 'Company' means 'any company liable to be wound up'. A foreign company having a place of business in India (i.e. a 'foreign company' within the meaning of Section 591) can be wound up as an 'unregistered company' under Section 582(b) read with Section 583 and 584.

Hence, a scheme providing for amalgamation of a foreign company as a transferor company can be sanctioned by the court (NCLT).

Statement under section 393: Every notice sent to members or creditors to convene a meeting pursuant to High Court's (NCLT) directions under Section 391 must be accompanied by a statement setting forth the terms of compromise or arrangement and explaining its effects and material interests of directors and effect thereof on the scheme (Section 393(1)). But the statement required under Section 393 is different from one required.

The 'statement' required under Section 393 is different from the 'explanatory statement' required under Section 173. The former does not ordain disclosure of all material facts [*Re. Tata Gil Mills Co. Ltd (1994) 14 CLA 13 (Bom.)*]. The statement should contain the exchange ratio. But it is not necessary to give details thereof, nor is it necessary to circulate the valuation report to shareholders (*Hindustan Lever Employees' Union v. Hindustan Lever Ltd (1995) 83 Comp. Cas. 30(SC)*). Hence the statement containing only exchange ratio without giving details of calculation of exchange ratio is valid.

Paper to amalgamate: It has been held in various cases that where there is a statutory provision dealing with the amalgamation of companies, no special power in the object clause of the memorandum of association of a company is necessary for its amalgamating with its company [*Hari Krishna Lohia v. Hoolungoree Tea Company (1970) 47 Comp. Cases 458*]. Hence the objects in the memorandum of association of the transferor company or transferee company need not contain power to amalgamate.

Question 10

Answer the following explaining the relevant provisions of the Companies Act, 1956:

- (1) *Whether the Companies being amalgamated must be Companies registered under the Companies Act, 1956.*
 - (2) *Whether the Companies seeking sanction of the court for a scheme of amalgamation must have specific power to amalgamate in the object clause of their Memorandum of Association.*
- (CA Final, New Course, November 2009)**

Answer

Amalgamation: A scheme of compromise or arrangement may provide for amalgamation of companies under section 394 of the Companies Act, 1956. Section 394(4)(b) defines the 'transferor' and 'transferee' companies. While the 'transferee' company does not include any company other than a company within the meaning of the Companies Act, 1956, the transferor company includes any body corporate, whether a company within the meaning of the Companies Act or not. 'Body Corporate' includes a company incorporated outside India [(section 2(7))]. Hence transferor company may be a company incorporated outside India, but transferee company must be a company incorporated under the Companies Act, 1956.

Usually the Memorandum of Association of a company contains in its object clause the power to amalgamate. But, in a number of cases it has been held that it is not necessary to have in the memorandum of association a specific power to amalgamate with another company. The provisions of Section 391/394 of the Companies Act, 1956 indicate the scope of the statutory power for amalgamating a company with another company despite the absence of any specific enabling provision in their memoranda. (*Aimco Pesticides Ltd, Feedback Reach Consultancy Pvt Ltd., Sir Matturdas Vissaiji Foundation in re*). Hence even companies not having specific power to amalgamate in their Memoranda can seek sanction of the Court for a scheme of amalgamation.

Question 11

The shareholders and creditors of Wagonbound Company Limited, in meeting convened for approval of a scheme of reconstruction of the company, passed resolutions. The scheme of reconstruction provided for the following:

- (i) *Sale of vacant land and appropriation of proceeds for payment of outstanding wages, tax dues and repayment of loan.*
- (ii) *Unsecured creditors to forego 40% of their claims against the company and receive debentures for the balance amount.*

A few share holders and creditors raised objections against the said arrangements. Advise the directors about the steps to be taken to give effect to the proposed scheme under the Companies Act, 1956.
(May 2009)

Answer

RECONSTRUCTION SCHEME OF COMPANY: The provisions contained in sections 391 to 394 of the Companies Act, 1956 are applicable to Wagonbound Company Limited as it can be considered as a company liable to be wound up within the meaning of Section 390 of the Companies Act, 1956. The proposed scheme involves a compromise or arrangement with members and creditors and it attracts section 391 of the said Act.

While the company or any creditor or member can make application to the Court/Tribunal under Section 391, it is usual for the company to make an application. On such application the Court/Tribunal may order that a meeting of creditors and/or members be called and held as per the directions of the Court/Tribunal.

The company must send notice of meeting to every creditor/member containing a statement setting forth the terms of compromise or arrangement explaining its effect. Material interest of directors, Managing Director or manager of the company in the scheme and the effect of scheme on their interest should be fully disclosed (Section 393). At the meetings convened as per directions of the Court/Tribunal majority in number representing at least $\frac{3}{4}$ in value of creditors/members present and voting must agree to compromise or arrangement. Thereafter the company must present a petition to the Court/Tribunal for confirmation of the compromise or arrangement.

The notice of application made by the company will be served on the Central Government and the Tribunal will take into consideration representation, if any, made by the Central Government (Section 394A). The Court/Tribunal will sanction the scheme, if satisfied, after considering all relevant matters.

Copy of order issued by the Court/Tribunal must be filed with the Registrar of Companies and then only the order will come into effect. Copy of the said order must be annexed to every

Memorandum of Association issued thereafter. The scheme sanctioned by the Court/Tribunal shall be binding on all members and creditors even those who were dissenting.

Note: The power under the scheme of reconstruction etc. is still with the High Courts pending constitution of the National Company Law Tribunal.

Question 12

Sunrise Company Limited was merged with Moonlight Company Limited on account of amalgamation. Some workers of sunrise Company Limited refused to join as workers of Moonlight Company Limited and claimed compensation on the ground of premature termination of their services. Moonlight Company Limited resists the claim of the workers on the ground that their services have been transferred to Moonlight Company Limited in view of the order of amalgamation and merger and hence the workers must join the service of Moonlight Company Limited and cannot claim any compensation.

State the powers of the court about the matters that would be considered while sanctioning the scheme of amalgamation under the provisions of the Companies Act, 1956. Decide whether the contention of the workers is justified.

(November 2008)

Answer

While sanctioning the scheme of amalgamation, the Court under Section 394 of the Companies Act, 1956 may make provision for all or any of the following matters:

- (i) The transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of the transferor company.
- (ii) The allotment by the transferee company of any shares, debenture etc, in that company which under the scheme are to be allotted by that company to any person.
- (iii) The continuation of any legal proceedings by or against any transferor and transferee company.
- (iv) The dissolution, without winding up of any transferor company.
- (v) The provisions to be made for any persons who within such time and in such manner as the court directs, dissent from the scheme of amalgamation.
- (vi) Such incidental matters as are necessary to secure that the amalgamation shall be fully and effectively carried out.

An order under Section 394 of the Companies Act, 1956 transferring the property, rights and liabilities of one company to another does not automatically transfer contracts of personal service which are in their nature incapable of being transferred and no contract of service is thereby created between an employee of the transferor company on the one hand and the transferee company on the other.

In *Nokes vs. Doucaster Amalgamated collieries Ltd.* (1940 (3) all 2k 549) the House of Lords clearly stated that the workers are not furniture and their services can not be transferred without their consent. Thus the contention of the workers of Sunrise Company Limited against the Moonlight Company Limited is correct and justified.

Question 13

HPC Ltd. for a number of years was in various types of business. In order to exit from its non-core business, its management decided to hive off the business of food processing by demerging the said business with an associate company, namely BCD Ltd. You are required to advise briefly, with reference to the provisions of the Companies Act, 1956, the steps the management should take to give effect to the proposed demerger. (May 2008)

Answer

HPC Ltd. can demerge its food processing business with an associate company, BCD Ltd. by obtaining the approval of National Company Law Tribunal (NCLT) [earlier such power was vested in High Court and the High Court can continue to exercise such power till the CLT becomes fully functional] as provided in Section 394 of the Companies Act, 1956. For this purpose, HPC Ltd. is required to take the following steps:

1. HPC Ltd., known as “transferor Company” for this purpose, has to prepare a scheme under which its properties and liabilities in respect of food processing business will be transferred to BCD Ltd., known as “Transferee Company” for this purpose. Such scheme must contain the consideration for transfer, known as “Exchange Ratio”.
2. An application under Section 391(1) of the said Act must be made to NCLT / High Court for an order convening meetings of creditors and / or members.
3. Notice(s) of the meeting(s) must be sent to members/creditors as per the direction of NCLT/ High Court. Such notice must be accompanied by a statement under Section 393(1) of the said Act setting forth the terms of the compromise or arrangement and explaining its effect in general and in particular, the effect on the interests of Managerial Personnel.
4. To hold the said meetings and pass necessary resolution approving the scheme subject to the conformation of NCLT/ High Court. It may be noted that the resolution must be passed by a majority in number representing 3/4th in value of the members / creditors as required under Section 391(2) of the said Act.
5. Thereafter, HPC Ltd. is required to move to NCLT / High Court jointly with BCD Ltd. for approval of the scheme disclosing all material facts relating to the Company. [Proviso to Section 391(2)], the High Court as required under Section 394A shall give notice to the Central Government and shall take into consideration any representation received from Central Government before passing any order on the application made to it for approval of the scheme.

6. On receipt of NCLT's / High Court's order, HPC Ltd. is required to file a certified copy of the order with the Registrar of Companies (ROC) for registration within 30 days after making of the order by NCLT / High Court [Section 394(3)]. This is very important since the non-filing of the order with ROC would make the approval order ineffective.
7. Lastly, to proceed to give effect to the scheme as approved by NCLT / High Court in the manner as directed by it.

Notice to be given to Central Government for application under section 391 and 394 (Section 394A)

Question 14

A scheme of amalgamation was approved by overwhelming majority of members of both the merging companies. The exchange ratio was fixed by a firm of reputed Chartered Accountants. When the scheme of amalgamation was awaiting sanction of the court, a small group of members of one of the merging companies raised objection on the ground that the exchange ratio was unfair. Examine with reference to decided case law whether the objection is likely to be sustained. What would be your answer in case similar objection was raised by the Central Government?

(CA Final, New Course, November, 2008)

Answer

Exchange Ratio: Courts leave the aspect of share valuation to expert valuers and shareholders. Unless the person who challenges the valuation satisfies the court that the valuation is grossly unfair, the court will not disturb the scheme (*Piramal Spg Vs Weaving Mills Ltd*). In this case the valuation is confirmed to be fair by eminent firm of auditors and is also confirmed by majority of members. The objection of the some by small group of shareholders cannot be sustained as held in *Hindustan Lever Employees. Union Vs Hindustan Lever Ltd*.

Section 394A of the Companies Act, 1956 requires the Court (Tribunal) to give notice of every application made to it under Section 391 or 394 to the Central Government. The Court (tribunal) should take into consideration the representations if any made to it by that Government before passing any order. The role played by the Central Government is that of an impartial observer who acts in public interest and advises the Court (tribunal) whether it is or it is not feasible for the two companies to amalgamate (*Ucal Fuel Systems Ltd Sure*). But the court is not bound to accept the views of the Central Government. Thus objection of the Central Government as regards valuation of shares was rejected by the Court (Tribunal), in the face of views expressed by two independent chartered accountants (*M.G Investments & Industrial Co. Ltd Vs New Shorrock spinning & Mgf Co. Ltd*). Hence even in the case of representation bay Central Government, unless that Government establishes that the exchange ratio was unfair and not in public interest, the court will refuse to interfere.

Power of Central Government to provide for amalgamation of companies in national interest (Section 396)

Question 15

With a view to boost the share values, the Central Government wants to amalgamate two Public Limited Companies into a single company. The Government and Public Financial Institutions have substantial interest in both the companies. The two companies are in the business of tourism and running several hotels which are not making good profits and consequently the share prices are depressed. Examine the powers of the Central Government to amalgamate the two companies in public interest. (May, 2002)

Answer

According to section 396 (1) of the Companies Act, 1956 where the Central Government is satisfied that it is essential in public interest that the two public limited companies should amalgamate the said Government may be order notified in the Official Gazette, provide for the amalgamation of the said two companies into a single company with such constitution; with such property, powers, rights interest, authorities and privileges and with such liabilities duties and obligations as may be specified in the order. This power of Central Government is notwithstanding anything contained in sections 394 and 395 of the Act that deal with amalgamation and reconstruction of companies. The Central Government has also the power to pass and provide for any consequential incidental and supplementary provisions in connection with the amalgamation including the confirmation by or against the transferee company of any legal proceedings pending by or against any transferor company. Any member or creditor who is aggrieved by the order of the amalgamation resulting in any financial loss is entitled to compensation which will be assessed by such authority as may be prescribed. Any person aggrieved by the order of compensation can file an appeal to the Company Law Board within 30 days of the publication of the order of compensation. Any order passed by the Central Government under this section can be made only where the draft copy thereof is sent to both the companies who have right to make an appeal and the same has been either disposed of or no appeal has been filed within the time provided thereof. The Central Government has duty to make such modifications in the light of any suggestions and objections received. All copies of the orders made under this section shall be laid before both the Houses of Parliament as soon as the same has been made.

Question 16

X Ltd. and Y Ltd. are two listed companies engaged in the business of telecommunication. The companies are not making profits and as such their share's market prices have gone down. A substantial portion of their share capital is held by Central Government as well as some Public Financial Corporations. In order to increase the share value, the Central Government wants to amalgamate the aforesaid two companies into a single company.

Examine the powers of Central Government to amalgamate the two companies in public interest as per the provisions of the Companies Act, 1956. (May 2007)

Answer

According to section 396 (1) of the Companies Act 1956 where the Central Government is satisfied that it is essential in public interest that two public limited companies should amalgamate the said Government may, by order notified in the Official Gazette, provide for the amalgamation of the said two companies into a single company with such constitution, with such property, powers, rights, interests, authorities and privileges and with such liabilities, duties and obligations as may be specified in the order. This power of Central Government is notwithstanding anything contained in section 394 and 395 of the Act that deal with amalgamation and reconstruction of companies. The Central Government has also the power to pass and provide for any consequential, incidental and supplementary provisions in connection with the amalgamation including the continuation by or against the transferee company of any legal proceedings pending by or against the transferor company. Any member or creditor who is aggrieved by the order of the amalgamation resulting in any financial loss is entitled to compensation, which will be assessed by such authority as, may be prescribed. Any person aggrieved by the order of compensation can file an appeal to the Company Law Board (now tribunal) within 30 days of the publication of the order of compensation. Any order passed by the central government under this section can be made only where the draft copy thereof is sent to both the companies who have right to make an appeal and the same has been either disposed of or no appeal has been filed within the time provided thereof. The Central Government has duty to make such modifications in the light of any suggestions and objections received. All copies of the orders made under this section shall be laid before both the houses of parliament as soon as the same has been made. ABC Ltd has made an offer to acquire all the equity shares of XYZ Ltd at a certain price. Members of the company who hold 90% of the shares of XYZ Ltd have accepted the offer. The remaining shares are held by 2 persons who do not agree to the deal. Explain the procedure to finalize the deal. State the steps to be taken to acquire the shares of dissenting shareholders? Also, state whether ABC Ltd can acquire all the shares in XYZ Ltd?

Question 17

ABC Ltd has made an offer to acquire all the equity shares of XYZ Ltd at a certain price. Members of the company who hold 90% of the shares of XYZ Ltd have accepted the offer. The remaining shares are held by 2 persons who do not agree to the deal. Explain the procedure to finalize the deal. State the steps to be taken to acquire the shares of dissenting shareholders? Also, state whether ABC Ltd can acquire all the shares in XYZ Ltd?

Answer

Applying the provisions of section 395 of the Companies Act, 1956, ABC Ltd., can acquire all the shares of XYZ Ltd. including those held by 2 persons. It can acquire the shares held by 2

persons if no application is made to the court for avoiding the sale of their shares or if the court refused it accordingly. In *Bombay Gas Company (P) Ltd., vs. Central Government* (1997) (CC) 89, the Bombay High Court held that Section 394(4)(b) provides for amalgamation of a foreign country with the Indian company. The transferee company, however, cannot be a foreign country. The expression member is not only holders of equity shares but also preference shareholders who had to be taken into account and value of their shares be included. The scheme may provide for the dissolution without winding up of any transferor company [Section 394(i)].

Question 18

A scheme of merger of DJA Company Limited with MRN Company Limited with approved by the shareholders at an extraordinary general meeting and the exchange ratio of 3 shares of MRN Company Limited for 20 shares in DJA Company Limited was approved. The proposal was also okayed by a lending financial institution which held 45% shares in DJA Company Limited. The valuation was carried out by one of the directors of DJA Company Limited, who was also a senior member of the Institute of Chartered Accountants of India. The valuation was affirmed by three independent valuers nominated by the shareholders in general meeting. However, certain leasehold properties, under license, which were not transferable, were not taken into account in the valuation. While the scheme was awaiting the Court's sanction, it was challenged by certain shareholders on the ground that the exclusion of leasehold assets in the valuation, made the scheme Unfair. Decide giving reasons :

- (i) *Whether the contention of the shareholders is tenable ?*
- (ii) *What factors would the court take into account in approving the exchange ratio?*

Answer

Merger And Scheme of Valuation:

- (i) The contention of the shareholders in this case shall not be tenable. The court is not to disturb a scheme unless the person who challenges the valuation satisfies the court that the valuation arrived at was grossly unfair. Valuation in this case was approved by the shareholders and also okayed by the lending institution(s) which are usually well-informed and scrutinize the scheme with expert's eye and which are also presumed to act bonafide. In the similar case of *Tata Oil Mills Ltd. Re* (1994), the court held that the presumption of fairness was writ large on the face of the Scheme. The Court did not attach importance to the fact that certain leasehold assets and properties held under license were excluded from valuation. Such assets, the court said, were neither transferable nor heritable. They are in the nature of a personal privilege. The Supreme Court affirmed this decision in *Hindustan Lever Employees Union v, Hindustan Lever Ltd.,* (1994) and accepted the exchange ratio proposed. The Supreme Court found no objection to the valuation being done by one of the directors of TOMCO (DJA Co. in this case). His report did not show any prejudice and was

also affirmed by the independent valuers. Supreme Court also enumerated all the possible methods of valuation such as, market price, book value and yield basis and pointed out that a combination of all or some of the methods, may have to be adopted in circumstances of a particular case. Thus based on the above explanation and the decisions given by the Supreme Court, it can be concluded that the contention of the shareholders that the exclusion of certain leasehold assets in the valuation has made the scheme unfair, shall not be tenable.

- (ii) The court would take into account the following factors in determining the final share exchange ratio:
1. The stock exchange prices of the shares of the two companies before the commencement of negotiations or the announcement of the bid.
 2. The dividends presently paid on the shares of the two companies.
 3. The relative growth prospects of the two companies.
 4. The cover for the present dividends of the two companies.
 5. The relative gearing of the shares of the two companies.
 6. The values of the net assets of the two companies.
 7. The voting strength in the merged enterprise of the shareholders of the two companies.
 8. The past history of the prices of the shares of the companies.

PREVENTION OF OPPRESSION AND MISMANAGEMENT (SECTIONS 397 – 407)

Application to Tribunal for relief in cases of oppression (Section 397)

Question 1

The group of requisite shareholders under Section 399 filed a petition before the Company Law Board for relief against oppression. Meanwhile, a secured creditor filed a civil suit for winding up for non-payment of his debt. The shareholders contended that winding up proceeding should not be heard as the Company Law Board is seized of the petition under Section 397. Is there contention tenable?

What would be your answer, if in the said situation a composite petition (petition praying for relief against oppression as well petition for winding up) is filed in the Court of Law?

Answer

In *A.K. Puri vs. Devi Dass Gopal Kishan Ltd.*, (1995) 17CLA, the J&K High Court held that there was no conflict of jurisdiction with respect to Sections 397, 398 and Section 433. The court observed that there is no statutory provisions in the Companies Act which provides for stay of the winding up proceedings under Section 433 when the CLB was seized of a petition between the same parties under Section 397/398. In other words, there is neither explicit nor implicit to carry on the winding up proceedings even when the CLB was seized of the matter.

The question whether shareholders can file a writ petition for relief against oppression and mismanagement during pendency of proceedings before the CLB, the Supreme Court in *World-wide Agencies Pvt. Ltd., vs. Mrs. M.T. Desor* (1990) 67 CC. 607 held against such filing as a shareholder cannot be allowed to bypass the express provisions of the Companies Act.

Winding up petition as a creditor on ground of inability to pay debts is not a bar to admission of a composite petition under Section 397 and 398 by the same party in the capacity of a member. [*MMTC Ltd. vs. Indo French Biotech Enterprise Ltd* (2000)] 23 SCL 192 (CLB).

Question 2

What is meant by 'oppression'? State whether the aggrieved party would succeed in obtaining relief from Company Law Board on the ground of oppression in the following cases:

- (i) *The majority of the Board of Directors override the minority directors and the minority directors apply to Company Law Board complaining oppression by majority directors.*
- (ii) *A petition by majority shareholders complaining oppression by minority shareholders.*

Answer

Oppression: The term 'oppression' is not defined in the Companies Act. Oppression, according to the Dictionary meaning of the word, is any act exercised in a manner burdensome, harsh and wrongful. The meaning of the term 'oppression' was explained by Lord Cooper in the Scottish case of *Elder v. Elder and Watson Ltd*, as given below:

"The conduct complained of should be at the lowest involve or visible departure from the standards of fair dealing and a violation of the conditions of fair play or which every shareholder who entrusts his money to a company is entitled to rely.

- (i) **Oppression of a member as a director:** The oppression dealt with by section 397 is only oppression of members in their character as such; and it is only in that character they can involve section 397. The harsh treatment, for instance, of a member who is a director or other officer or employee, by the Board of Directors or management does not come within (section 397). It has been held in *Re. Bellador Silk Ltd.* that if the majority of the Board of Directors override the minority directors the latter cannot resort to section 397 and hence the minority directors will not succeed in getting relief from CLB on the ground of oppression.
- (ii) **Right not confined to minority:** According to section 399, the right to apply for relief under section 397/398 is given to 100 members or 1/10th of the total number of members or any member or members holding not less than 1/10th of the issued share capital of the company. There is nothing in this section which suggests even indirectly that unless the application is made by minority shareholders it is not maintainable. The right to apply is, therefore, not confined to oppressed minority of the shareholders alone. It was held by Calcutta High Court in *Re. Sindhri Iron Foundry (P) Ltd.* that the oppressed majority also might apply for relief under section 397. Therefore, the petitioners are likely to succeed in getting relief provided the other condition laid down in section 397 (i.e. that to wind up the company would unfairly prejudice such members, but that otherwise the facts would justify the making of a winding-up order on just and equitable ground) is satisfied, even though the Delhi High Court held a contrary view in *Suresh Kumar Sanghi v. Supreme Motors Ltd*,

Question 3

Messrs Ahimsa Private Limited was incorporated in the year 2001 under the Companies Act, 1956 by 3 brothers, namely, Amit, Anil and Akhlesh. All the three were Promoter-directors named in the Articles of Association and subscribed for 100 shares each in the company

through Memorandum of Association. Thereafter, from time to time, further shares were allotted in proportion of one-third to each of them and in due course, the company started earning substantial profits. Due to greed of money, the two brothers, namely, Amit and Anil, joined hands together to assume complete control of the company, leaving their brother, Akhlesh in lurch. Both the brothers got further shares allotted to themselves, thereby their joint shareholding increased from 66 2/3% to 90%, while the shareholding of Akhelesh got reduced from the erstwhile 33% to 10%. No notice of any Board Meeting was sent to Akhlesh, who was sidelined and was also removed as a Director.

Aggrieved by the decisions taken by his two brothers at his back, Akhlesh seeks your advice for taking out appropriate proceedings before the court or judicial authority of competent jurisdiction. Also suggest the nature of reliefs he may claim while filing his case.

(November 2006)

Answer

Under Section 397 of the Companies Act, 1956 on an application by any member of a company, the Company Law Board (Tribunal as per amended provision which has not come into force) is of the opinion that –

- (i) the company's affairs are being conducted in a manner which is prejudicial to public interest or in a manner oppressive to any member(s); and
- (ii) to wind up the company would unfairly prejudice such member(s), but that otherwise the facts justify winding up of the company on just and equitable ground,

The CLB may, with a view to bringing to an end the matters complained of, make such order as it thinks fit.

As per section 399, a member holding 10% shares is entitled to file such a petition.

In the present case, Mr. Akhlesh was holding 33 % shares in the company which is nothing but a quasi partnership and was participating in the management. By further allotment of shares in a clandestine manner and without the consent of Mr. Akhlesh, his shareholding was reduced to 10% while the shareholding of his brothers stood at 90%. This is a serious act of oppression of Akhlesh, a minority shareholder. On similar facts, it was held by Supreme Court in *Dale & Carrington Inv't. Private Ltd. Vs. P.K. Prathpan*, (2004) 122 Comp cases 175(SC) that assuming meetings of board of directors did take place, the manner in which the shares were issued in favour of R without informing other shareholders about it and without offering them to any other shareholder, was totally mala fide and the sole object of R in this was to gain control of the company by becoming a majority shareholder. This was clearly an act of oppression on the part of R. The only relief that has to be granted in the present case was to undo the advantage gained by R through his manipulation and fraud. The allotment of all the additional shares in favour of R had to be set aside.

Section 397 protects the rights of shareholders and not as a director. It has, however, been held by CLB in a number of cases that in a family company like the present one, removal of the promoter-director is also an act of oppression.

In the facts and circumstances of this case, Akhlesh is advised to file a petition under Section 397 of the Act. Being a 10% shareholder he is entitled to file the petition, before the Principal Bench of Company Law Board at New Delhi. He may seek the following reliefs:

- (i) the alleged allotment of further shares be declared null and void and set aside;
- (ii) the alleged removal of the petitioner, Mr. Akhlesh be declared as null and void and set aside;
- (iii) The Board of Directors be re-constituted with the petitioner and his two brothers and an independent person, as the Chairman of the board of directors to be appointed by the Company Law Board with casting vote;
- (iv) the petitioner may be appointed as Managing director of the company having substantial powers of management.

Question 4

State the conditions which must be satisfied before filing a petition under Section 397 of the Companies Act, 1956 for prevention of oppression. (CA Final, New Course, May, 2009)

Answer

The conditions which are required to be satisfied before filing a petition under Section 397 of the Companies Act, 1956 can be enumerated as follows:

- (i) An application under the said Section 397 can be made only by the members. In the case of a company having share capital minimum one hundred members or one-tenth of total number of member of the company, whichever is less; or a member or members holding not less than 10% of the paid up capital of the company can file such petition. In case of a company not having share capital, minimum one-fifth of the total number of members of the company is required for the purpose. However, Central Government may authorise any lesser number of members to file such petition.
- (ii) It must be established that the affairs of the company are being conducted in a manner (a) oppressive to any member/members of the company or (b) prejudicial to public interest.
- (iii) The oppression complained of must affect a person in his capacity as a member of the company. Rights and interests as a member of a company can only be agitated and not in relation to any commercial relation that a member has with the company as was decided by the Company Law Board in the case of *Anil Gupta vs. Mirai Auto Industores Ltd.* [(2003) 113 COMP. CAS.63].

- (iv) The acts complained of must be continuing acts of oppression. The acts constituting oppression must continue till the date of making the application.
- (v) The applicant must make out a prima facie case that the degree of oppression is so severe that there is just and equitable ground for winding up of the company. But at the same time, it must also be established that the winding up of the company would not unfairly prejudice the applicant.
- (vi) It may be noted that expression “issued share capital” in section 399(1) includes both the preference and equity share capital.

Question 5

The profits of MJR Company Limited for the financial year 2009-2010 fell considerably due to recession. The Board of Directors of the company, therefore, bonafide did not recommend any dividend for the year. At the Annual General Meeting of the company, a group of shareholders/members objected to the Board's decision and wanted the Board to make recommendation for dividend.

On refusal by the Board, the members, who feel oppressed by the Board's decision to skip the dividend, move to the Company Law Board/Tribunal and complain against the Board on the ground of oppression and mismanagement.

Examining the provisions of the Companies Act, 1956, decide:

- (1) *Whether the members contention shall be tenable?*
- (2) *Whether the act of Board of Directors not to recommend any dividend shall amount to oppression and mismanagement?* **(May, 2010)**

Question 6

60% shares of Indo-French Ltd. are held by French Group and balance by an Indian Group. As per articles of association of the company both groups had equal managerial powers. The relationship between the two groups soured and the operations of the company reached a deadlock. The Indian Group approached the Company Law Tribunal (Company Law Board till Company Law Tribunal becomes functional, referred to as CLB hereinafter) for action against the French Group for oppression. Based on these facts, you are required to decide, with reference to the provisions of the Companies Act, 1956 and/or the decided case laws, the following issues:

- (i) *Whether the contention of oppression against the French Group by the Indian Group is tenable?*
- (ii) *What are the powers of the CLB in this regard?* **(May 2007)**

Answer

- (i) Section 397 of the Companies Act, 1956 deals with the remedy in a situation when the affairs of the company are being conducted in a manner oppressive to a shareholder or

shareholders. This means that some of the shareholders must be in such a position that they can be oppressed by other shareholders or the management. In the present case as given in the question, both the Indian Group and the French Group are equally strong and none is able to oppress the other. The situation stated in the question is a deadlock but it can not be termed as oppression. Since it is not a case of winding up of the company, the relief under the said section 397 is not available to the Indian Group. [*Gnanasambandam v. Tamilnad Transporters (Coimbatore) p. Ltd. (1971) 41 Comp. Cas. 26*] In view of the position discussed, the contention of the Indian Group is not tenable.

- (ii) The powers of the Company Law Tribunal (Company Law Board till National Company Law Tribunal becomes functional) referred to as CLB hereinafter) under the provisions of section 397 of the Companies Act 1956, are discretionary in character. Apart from the general powers envisaged therein, the CLB under section 402 (b) of the said Act, may order the purchase of the shares of one group by the other group. In the case of *Yashovardhan Saboo Vs. Groz Beckert Saboo Ltd. 1933 1 Comp. L.J. 20*, the presiding officer ordered the foreign group to buy out the shares of the minority group at the fair price with deadlock and the matters are not sorted out by any other means, an order for winding up of the company may also be made under the just and equitable clause, [*Kishan Kumar Ahuja Vs. Suresh Kumar Ahuja*]. Thus, if the Indian Group of the French Group fail to buy out the shares of the other group, the CLB may order the winding up of the company.

Right to apply under sections 397 and 398 (Section 399)

Question 7

- (i) *ABC Private Limited is a company in which there are eight shareholders. Can a member holding less than one-tenth of the share capital of the company apply to the Company Law Board for relief against oppression and mismanagement?*
- (ii) *It is alleged by said member that the Directors of the Company have misused their position in making certain inter-corporate deposits which are against the interests of the company. Will the Company Law Board entertain application containing such allegation in the case of a private company?* **(May, 2000)**

Answer

- (i) Under Section 399(1)(a) of the Companies Act, 1956, in the case of a company having share capital, the following member(s) have the right to apply to the Company Law Board under Section 397 or 398:
- (i) Not less than 100 members of the company or not less than one-tenth of the total number of members, whichever is less; or

- (ii) Any member or members holding not less than one-tenth of the issued share capital of the company provided the applicant(s) have paid all the calls and other sums due on the shares.

In the given case, since there are eight shareholders. As per (i) above, 10% of 8 i.e. 1 satisfies the condition. Therefore a single member can present a petition to the Company Law Board (CLB), regardless of the fact that he holds less than one-tenth of the company's share capital.

- (ii) As regards the proprietary rights in inter-corporate loans by a private company, they are not closely regulated by Company Law as in the case of public companies. Though the Board of Directors are the best to judge and to take a commercial decision in this regard, if it is *mala fide*, it should be looked into. Therefore the CLB can look into the allegation lodged by the member.

Question 8

A group of shareholders of Deceptive Duplicating Machines Ltd. filed an application before the Company Law Board alleging various acts of fraud and mismanagement by Mr. Unscrupulous, the Managing Director, and his associates. During the course of hearings before the CLB, it was contended on behalf of the company that the alleged transactions had taken place long ago and that the Managing Director, who was responsible for such actions had already been removed and that there is no case before the CLB to interfere in the working of the company. The contention of the Applicants on the other hand is that though the fraudulent nature of the transactions is a thing of the past and though the Managing Director had been removed, yet the management of the company is still controlled by the henchmen of Mr. Unscrupulous. Discuss the powers of the Company Law Board in support of your answer. (May, 2001)

Answer

The power available to the shareholders to seek relief or remedy from the acts of oppression and mismanagement as stated in Sections 397 and 398 of the Companies Act, 1956 can be invoked only when the affairs of the company are being conducted in a manner oppressive to shareholders or prejudicial to the interest of the company. Thus at the time of making an application, there must be a continuing course or conduct of the affairs of the company, which is oppressive to any shareholder or shareholders or prejudicial to the interest of the company. It is this course of oppressive or prejudicial conduct which can be made the subject matter of a complaint in the application to CLB. The forgoing provisions of law (Section 397 & 398) do not confer any power on the Company Law Board to set aside or interfere with past and concluded transactions between the company and the shareholders or third parties which are no longer continuing wrongs or to award a compensation in respect of such concluded transactions. (*Seth Ganpatram Vs. Shri Satyaji Jubilee Cotton and Jute Mills Company Ltd. (1964) 34 comp. Case 777*). However, there are two exceptions to the above said general rule. The first one is

provided in Section 402(f) which enables CLB to set at naught transactions amounting to fraudulent preference effected within 3 months before the date of application under Sections 397 and 398, even though they are no long continuing wrongs. The second one is provided in Section 406 which enables the CLB, on an application under Sections 397 and 398, to book delinquent directors, managers and other office bearers of the company and to enforce the company's claim against them if they have misapplied or retained the company's money or have committed any misfeasance or breach of trust in relation to the company. It is necessary for the petitioners to establish that the matter complained falls under either of these exceptions and mere statement that the management of the Company still controlled by the Hechmen of Mr. Unscrupulous is not enough.

Question 9

M/s Continuous Conflicts Ltd. is a company controlled by two family groups. The first family group has four directors, namely, Mr. A, Mr. B, Mr. C and Mr. D on the board of directors. The second family group has two representatives Mr. X and Mr. Y on the board. Because of internal family troubles, the first group, by virtue of its majority shareholding removed both Mr. X and Mr. Y as the directors of the company. Aggrieved by this action the second group is planning to move an application before the Company Law Board. You have been approached for advice. Advise as to the eligibility restrictions regarding filing the application and the chances of getting relief from the Company Law Board, assuming that there is no other material on record in support of oppression of the minority group (May, 2002)

Answer

The management of any company registered under the Companies Act, 1956 is based on the principle of majority rule and the voting power of every member depends upon the number of shares held by them. Thus one single individual holding the majority shares can overrule the views of the other members who may be more in numerical numbers but not in voting power. However, certain rights have been given to minority shareholders who complain that the affairs of the company are being conducted in a manner oppressive to any member or members. In such an event, the minority shareholders can apply to the Company Law Board for relief against oppression and mismanagement. The eligibility restriction for filing an application to the Company Law Board is contained in Section 399 of the Companies Act. According to the said section, the application to CLB can be made in the case of a company having share capital, by not less than one hundred members or not less than one-tenth of the total number of members whichever is less or members holding not less than one-tenth of the issued share capital provided, the applicants have paid all calls and other dues on their respective shares. In the case of a company not having the share capital, the application can be filed by members holding not less than one-fifth of the total number of members.

In the present case the majority group have removed the minority directors from the board. The election and removal of directors is the prerogative of the members and such an act cannot be per se treated as oppressive to the minority shareholders, unless there is an allegation of mismanagement to the detriment of the shareholders. The application under section 397/398 requires to prove oppressive conduct to their members in their capacity as members. Thus the minority group consisting of two directors Mr. X and Mr. Y will not be able to successfully prosecute the case against the majority directors in the absence of any material or record in support of oppression and mismanagement of the minority group.

Question 10

There are eight shareholders in M/s Supra Private Ltd. Mr. Shyam who is holding less than one-tenth of the Share Capital of the company seeks your advice whether he can apply to the Company Law Board for relief against oppression and Mismanagement. Advise.
(November, 2002)

Answer

Petition to Company Law Board

Under Section 399 (1) (a) of the Companies Act, 1956, in the case of a company having share capital, the following members have right to apply to the Company Law Board under Section 397 or 398.

- (a) Not less than 100 members of the company or less than one-tenth of the total number of members, whichever is less; or
- (b) Any number of members holding not less than one-tenth of the issued share capital of the company provided that the applicants have paid all calls and other sums due on their respective shares.

In the instant case, since there are eight share holders, as per (b) above, 10% of 8, i.e. 1 satisfies the condition laid down in section 399 mentioned above. In view of this Mr. Shyam can present a petition to the Company Law Board, regardless of the fact that he hold less than one-tenth of the Company's share capital.

Further, a single member can present a petition to the Company Law Board under section 401 of the Act, if authorised by the Central Government.

Question 11

A group of shareholders of Badwill Machineries Ltd. filed an application before the Company Law Board (CLB) alleging various acts of fraud and mismanagement by Mr. Bigfish, the Managing Director of his associates. During the course of hearing before the CLB, the authorised representative of the said company contended that the alleged transactions had taken place several years ago and the company has already removed the Managing Director, who was responsible for such transactions and hence there is no case before the CLB to interfere in the working of the company. Against the submissions on behalf of the company,

the applicants submitted that although the fraudulent transactions were done in past and the Managing Director has been removed, but the company is still controlled by the persons, who are in league with the erstwhile Managing Director and are working as his henchmen.

State the merits of the applicants' arguments and the powers of the CLB. (November, 2003)

Answer

The power available to the shareholder to seek relief or remedy from acts of oppression and mismanagement as stated in section 397 and 398 of the Companies Act, 1956 can be invoked only when the affairs of the company are being conducted in a manner oppressive to the shareholders or prejudicial to the interest of the company. Thus at the time of making an application, there must be a continuing course or conduct of the affairs of the company, which is oppressive to the shareholders or prejudicial to the interest of the company.

It is this course of oppressive or prejudicial conduct which can be made subject matter of a complaint in the application to the Company Law Board (CLB). The provisions of sections 397 and 398 of the Companies Act, 1956 do not confer any power on the CLB to set aside or interfere with the past and concluded transactions between the Company and the shareholders or third parties which are no longer continuing wrongs or to award a compensation in respect of such concluded transactions [*Seth Ganpatram vs. Shri Satyaji Jubilee Cotton and Jute Mills Co. Ltd. (1964) 34 Company Cases 777*].

However, the above mentioned general rule is subject to following exceptions:

- (i) As per clause (f) of section 402 of the Companies Act, 1956, the CLB can set aside any transfer, delivery of goods, payment, execution or other act relating to property made or done by or against the company within three months before the date of the application under sections 397 and 398 of the said Act, even though they are no longer continuing wrongs.
- (ii) As per provisions of section 406 read with Schedule XI to the Companies Act, 1956, the CLB, on an application made to it under sections 397 and 398 of the said Act, has power to book the delinquent directors, managers and other office bearers of the company and to enforce the company's claim against them if they have misplaced or retained the company's money or have committed any misfeasance or breach of trust in relation to the company.

In the light of the above legal position, it is necessary for the petitioning shareholders to establish that the subject matter of the complaint falls within the scope of any of the above mentioned exceptions and a mere allegation that the affairs of the company is still controlled by the persons who are in league with the erstwhile Managing Director and are working as his henchmen is not sufficient.

Question 12

Messrs Ahimsa Private Limited was incorporated in the year 2001 under the Companies Act, 1956 by 3 brothers, namely, Amit, Anil and Akhlesh. All the three were Promoter-directors named in the Articles of Association and subscribed for 100 shares each in the company through Memorandum of Association. Thereafter, from time to time, further shares were allotted in proportion of one-third to each of them and in due course, the company started earning substantial profits. Due to greed of money, the two brothers, namely, Amit and Anil, joined hands together to assume complete control of the company, leaving their brother, Akhlesh in lurch. Both the brothers got further shares allotted to themselves, thereby their joint shareholding increased from 66 2/3% to 90%, while the shareholding of Akhelesh got reduced from the erstwhile 33% to 10%. No notice of any Board Meeting was sent to Akhlesh, who was sidelined and was also removed as a Director.

Aggrieved by the decisions taken by; his two brothers at his back, Akhlesh seeks your advice for taking out appropriate proceedings before the court or judicial authority of competent jurisdiction. Also suggest the nature of reliefs he may claim while filing his case.

(November, 2006)

Answer

Under Section 397 of the Companies Act, 1956 on an application by any member of a company, the Company Law Board (Tribunal as per amended provision which has not come into force) is of the opinion that –

- (i) the company's affairs are being conducted in a manner which is prejudicial to public interest or in a manner oppressive to any member(s); and
- (ii) to wind up the company would unfairly prejudice such member(s), but that otherwise the facts justify winding up of the company on just and equitable ground,

The CLB may, with a view to bringing to and end the mattes complained of, make such order as it thinks fit.

As per section 399, a member holding 10% shares is entitled to file such a petition.

In the present case, Mr. Akhlesh was holding 33 % shares in the company which is nothing but a quasi partnership and was participating in the management. By further allotment of shares in a clandestine manner and without the consent of Mr. Akhlesh, his shareholding was reduced to 10% while the shareholding of his brothers stood at 90%. This is a serious act of oppression of Akhlesh, a minority shareholder. On similar facts, it was held by Supreme Court in *Dale & Carrington Invt. Private Ltd. Vs. P.K. Prathpan*, (2004) 122 Comp cases 175(SC) that assuming meetings of board of directors did take place, the manner in which the shares were issued in favour of R without informing other shareholders about it and without offering them to any other shareholder, was totally mala fide and the sole object of R in this was to

gain control of the company by becoming a majority shareholder. This was clearly an act of oppression on the part of R. The only relief that has to be granted in the present case was to undo the advantage gained by R through his manipulation and fraud. The allotment of all the additional shares in favour of R had to be set aside.

Section 397 protects the rights of shareholders and not as a director. It has, however, been held by CLB in a number of cases that in a family company like the present one, removal of the promoter-director is also an act of oppression.

In the facts and circumstances of this case, Akhlesh is advised to file a petition under Section 397 of the Act. Being a 10% shareholder he is entitled to file the petition, before the Principal Bench of Company Law Board at New Delhi. He may seek the following reliefs:

- (i) the alleged allotment of further shares be declared null and void and set aside;
- (ii) the alleged removal of the petitioner, Mr. Akhlesh be declared as null and void and set aside;
- (iii) The Board of Directors be re-constituted with the petitioner and his two brothers and an independent person, as the Chairman of the board of directors to be appointed by the Company Law Board with casting vote;
- (iv) the petitioner may be appointed as Managing director of the company having substantial powers of management.

Question 13

M/s. City Hospital Private Ltd. has two groups of Directors. A dispute arose between the two groups out of which one group controlled the majority of shares. A very serious situation arose in the administration of the company's affairs when the minority group ousted the lawful Board of Directors from the possession and control of the management of the company's factory and workshop. Books of account and statutory records were held by the minority group and consequently the annual accounts could not be prepared for two years. The majority group applied to the company law board for relief under sections 397 and 398 of the Companies Act. You are required to decide with reference to the provisions of the said Act, the following issues:

- (i) *Can majority of shareholders apply to the Company Law Board for relief against the oppression by the minority shareholders?*
- (ii) *Whether Company Law Board can grant relief in such circumstances. (November 2007)*

Answer

- (i) The case started in the question relates to the provisions of sections 397 and 398 of the companies Act, 1956 with regard to remedy available to majority shareholders.

Where the majority is prevented from protecting itself by controlling the directors at general body meetings, the majority becomes an artificial minority entitled to claim protection under Section 397 and 398 (*V. Sebastean, Dr V City Hospital (Pvt.) Ltd. (1985) 57 Comp. case 453 (Ker)*). Thus the remedy under Section 397 and 398 is confined not to an oppressed minority of the shareholders alone; an oppressed majority may also apply to the Company Law Board against their oppression from the side minority shareholders. In *Sindhri Iron Foundry (Pvt.) Ltd. Re (1963) 78 E. to N. 118*, issue and allotment of a number of shares in a company whereby an admitted majority of shareholders was reduced to a minority was struck down. While granting relief to a majority group, Mitra J observed in their case;

“If the Court (now the Company Law Board) finds that the company's interest is being seriously prejudiced by the activities of one or the other group of shareholders, that two different registered offices at two different addresses have been set up, that two rival boards are holding meetings, that the company's business property and assets have passed into hands of unauthorized persons who have taken wrongful possession and who claim to be the shareholders and directors, there is no reason why the Court (now the company Law Board) should not make appropriate orders to put an end to such matters”.

- (ii) **Relief by the Company Law Board:** The Company Law Board may give relief if it is of opinion:
1. that the company's affairs are being conducted (a) in a manner prejudicial to public interest, or (b) in a manner oppressive to any member or members;
 2. that the facts justify the compulsory winding up order on the ground that it is just and equitable that the company should be wound up;
 3. that to wind up the company would unfairly prejudice the applicants.

On being satisfied about the above requirements, the Company Law Board may pass such order as it thinks fit with a view to bring an end to the matters complained of this provision would help salvage an otherwise sound concern which would have been, but for this principle, forced to into winding up.

Question 14

The issued, subscribed and paid-up share capital of ABC Company Limited is Rs.10 lakhs consisting of 90,000 equity shares of Rs.10 each fully paid up and 10,000 preference shares of Rs.10 each fully paid up. Out of the members of company, 400 members holding one preference share each and 50 members holding 500 equity shares applied for relief under Sections 397 and 398 of the Companies Act, 1956. As on the date of petition, the company had 600 equity shareholders and 5,000 preference shareholders.

State with details whether the above petition under Section 397 and 398 is maintainable. Will your answer be different, if preference shareholders have subsequently withdrawn their consent?
(May, 2004, May 2009)

Answer

As per section 399 of the Companies Act, 1956, in the case of a company having a share capital, members eligible to apply for oppression and mismanagement shall be lowest of the following:

100 members; or

$\frac{1}{10}$ th of the total number of members; or

Members (including equity shareholder as well as preference shareholder) holding not less than $\frac{1}{10}$ th of the issued share capital of the company.

The consent to be given by shareholder is reckoned at the beginning of the proceedings. The withdrawal of consent by shareholder during the course of proceedings does not affect the maintainability of the application.

In the question above, the shareholding pattern of the company is as follows:

Rs. 9,00,000 equity share capital held by 600 members.

Rs. 1,00,000 preference share capital held by 5,000 members.

Rs. 10,00,000 total share capital held by 5,600 members.

The application alleging oppression and mismanagement has been made by the members as follows:

(a) Number of members making the application:

- Preference shareholders 400
- Equity shareholders 50
- Total members 450

(b) Amount of share capital held by members making the application:

- Preference share capital Rs. 4,000 (400 preference shares of Rs.10 each)
- Equity share capital Rs. 5,000 (500 equity shares of Rs.10 each)
- Total capital Rs. 9,000

The application shall be valid if it has been made by the lowest of the following:

100 members

560 members (being 1/10th of 5,600)

Members holding Rs.1,00,000 share capital (being 1/10th of Rs.10,00,000)

As it is evident, the application made by 450 members meets the eligibility criteria specified u/s 399; therefore, the application is maintainable.

Such application shall remain valid despite the fact that some of the applicants have withdrawn their consent.

Question 15

A group of members of XYZ Limited has filed a petition before the Company Law Board alleging various acts of oppression and mismanagement by the majority shareholders of the Company. The Petitioner group holds 12% of the issued share capital of the Company. During the pendency of the petition, some of the petitioner group holding about 5% of the issued share capital of the Company wish to disassociate themselves from the petition and they along with the other majority shareholders have submitted before the Company Law Board that the petition may be dismissed on the ground of non-maintainability. Examine their contention having regard to the provisions of the Companies Act, 1956. **(November, 2009)**

Answer

The argument of the majority share holders that the petition may be dismissed on the ground of non-maintability is not correct. The proceedings shall continue irrespective of withdrawal of consent by some petitioners. It has been held by the Supreme Court in *Rajmundhry Electric Corporation vs. V. Nageswar Rao*, AIR (1956) SC 213 that if some of the consenting members have subsequent to the presentation of the petition withdraw their consent, it would not affect the right of the applicant to proceed with the petition. Thus, the validity of the petition must be judged on the facts as they were at the time of presentation. Neither the right of the applicants to proceed with the petition nor the jurisdiction of Company Law Board to dispose of on its merits can be affected by events happening subsequent to the presentation of the petition.

Oppression & Mismanagement: Under Sections 397 and 398 of the Companies Act, 1956, members may apply to the Company Law Board/Tribunal in cases of oppression and mismanagement. However, bona fide decisions consistent with the company's memorandum and articles are not to be equated with mismanagement even if they turn out to be wrong in the circumstances or these cause temporary losses. The Court will not permit the machinery created by the sections to be used by the minority for compelling the majority to come to terms, where the company is honestly managed. Directors' bona fide decision not to declare dividend and to accumulate available profits into reserves is not mismanagement. (*Thomas Vettom (V.J.) vs. Kuttanad Rubber Co. Ltd.* (1984) 56 Com. Cases 284 (Ker).

Thus in the given case, the group of shareholders/members who complain to CLB/Tribunal against the decision of the Board not to declare any dividend and to

accumulate available profits into reserves, would not succeed, as the act of directors does not amount to mismanagement. Furthermore, the shareholders cannot compel the Board to recommend a dividend. The Board's recommendations are placed in the general meeting. The general meeting can reduce the dividend, but cannot even increase the dividend as recommended by the Board. Therefore, the shareholders/members cannot compel the company to declare dividend and cannot charge the directors with oppression or mismanagement.

Applying the above, answers to the question shall be as under:

- (1) The contention of shareholders/members shall not be tenable.
- (2) The act of the Board of Directors who acted bona fide, not to recommend any dividend shall not amount to oppression or mismanagement.

Question 16

A group of shareholders holding more than 15% of the issued capital of M/S Defraud Ltd. have filed a petition before the Company Law Board alleging various acts of illegal, invalid and irregular transactions entered into in the name of the Company. Examine the merits of the petition in the light of the judicial pronouncements made in this regard. (November 2009)

Answer

A group of shareholders of M/s Defraud Ltd. must hold more than 15% of the issued share capital of the Company or satisfy other requirements under Section 399(1) of the Companies Act, 1956. Since the group holds 15% of the issue capital they are entitled to file a petition before the Company Law Board under sections 397 and 398 of the Companies Act, 1956 by alleging that the affairs of the Company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members of the Company. There are however, several judicial pronouncements according to which mere illegal, invalid or irregular acts by themselves do not constitute a ground for invoking the provisions of Section 397 unless it is proved that they are oppressive to any shareholder or prejudicial to the interest of the Company or to the public interest. [*Sheth Mohanlal Ganpatram vs Shri Savaji Jubilee Cotton and Jute Mills Company Ltd.*] Thus in the present case, the petition filed by the group of shareholders will fail unless they can prove to the satisfaction of the Company Law Board that the acts complained of in the petition are oppressive and prejudicial to the interest of the Company and the public interest. And that to wind up the Company would unfairly prejudice such member or members, but that otherwise those facts would justify the making of a winding up order on the ground that it was just and equitable that the Company should be wound up.

Question 17

A group of shareholders consisting of 25 members decide to file a petition before the Company Law Board for relief against oppression and mismanagement by the Board of

Directors of M/s Fly By Night Operators Ltd. The company has a total of 300 members and the group of 25 members holds one –tenth of the total paid –up share capital accounting for one-fifteenth of the issued share capital. The main grievance of the group is the due to mismanagement by the board of directors, the company is incurring losses and the company has no declared any dividends even when profits were available in the past years for declaration of dividend. Advise the group of shareholders regarding the success of (i) getting the petition admitted and (II) obtaining relief from the Company Law Board.

Answer

Section 399 of the Companies Act, 1956 provides the right to apply to the Company Law Board for relief against oppression and mis-management. This right is available only when the petitioners hold the prescribed limit of shares as indicated below:

- (i) In the case of company having a share capital, not less than 100 members of the Company or not less than one tenth of the total number of its members whichever is less or any member or members holding not less than one tenth of the issued share capital of the company, provided that the applicant(s) have paid all calls and other dues on the shares.
- (ii) In the case of company not having share capital not less than one-fifth of the total number of its members.

Since the group of shareholders do not number 100 or hold 1/10th of the issued share capital or constitute 1/10th of the total number of members, they have no right to approach the CLB for relief. However, the Central Government, if it is of the view that circumstances exist which make it just and equitable so to do, may authorize any member(s) to apply to the CLB (Section 399(4)). So, members any approach Central Government to authorize them to approach CLB in spite of deficiency in numbers.

As regards obtaining relief from CLB, continuous losses cannot, by itself, be regarded as Oppression (*Ashok Betelnut Co. P. Ltd. vs. M.K. Chandrakanth*).

Similarly, failure to declare dividends or payment of low dividends also does not amount to oppression. (*Thomas Veddon V.J. (v) Kuttanad Robber Co. Ltd*).

Thus the shareholders may not succeed in getting any relief from CLB.

MISCELLANEOUS PROVISIONS (SECTIONS 416 – 424)

Employees' securities and provident funds (417 – 419)

Employees' securities to be deposited in post office savings bank or Scheduled Bank (Section 417)

Question 1

M/s Flyover Constructions Ltd. has to recruit 2,000 Civil Engineers on contract basis for a period of 5 years. The company entered into an agreement with the employees that each employee will have to deposit Rs. 50,000 as security which sum will be returned on completion of 3 years of contract of service. The company wants to utilize the fund so collected in their business. Advise the company with reference to Companies Act in the matter of collection and utilization of money received from employees as security deposit. **(November 2007)**

Answer

Section 417 of the Companies Act, 1956 provides that

- (1) any money or security deposited with a company by any of its employee in pursuance of his contract of service with the company shall be kept or deposited by the company within fifteen days from the date of deposit.
 - (i) in a post office savings bank account, or
 - (ii) in a special account to be opened by the company for the purpose in the state bank of India or in a scheduled bank, or
 - (iii) where the company itself is a scheduled bank, in a special account to be opened by the company for the purpose either in itself or in the state bank of India or in any other scheduled bank.
- (2) No portion of such moneys or securities shall be utilized by the company except for the purposes agreed to in the contracts of service.
- (3) A receipt for moneys deposited with a company by its employee shall not be deemed to be security within the meaning of this section; and the moneys themselves shall accordingly be deposited as provided in sub-section (1).

So the company cannot utilize the money so collected. It will have to deposit the money in the special accounts as referred in the section.

Provisions applicable to provident funds of employees (Section 418)

Question 2

As per the terms of the agreement of service between NOC Ltd. and its employees, an amount equal to 12.5% of the salary shall be transferred to the recognized Provident Fund and shall be payable to the employee either on retirement or termination, as the case may be. An amount equal to 12.5% of the salary shall be contributed by the company to the recognized provident fund.

Mr. A earning Rs. 3000 p.m. has been working with the company since the last four years. Due to some personal reasons Mr. A is in need of Rs. 100,000 and wants to obtain as advance the amount standing to the credit in the fund. With reference to the provisions of the Companies Act, 1956. advice as regards the following:

- (i) When and where should the money so collected by the company be deposited?*
 - (ii) Can Mr. A obtain the advance from his accumulated contribution to recognized Provident Fund?*
- (November 2008)**

Answer

Section 418 of the Companies Act, 1956 dealing with the provident fund of the employees provides that:

- (1) Where a provident fund has been constituted by a company for its employees or any class of its employees, all moneys contributed to such fund (whether by the company or by the employees) or received or accruing by way of interest or otherwise to such fund shall, within fifteen days from the date of contribution, receipt or accrual, as the case may be either-
 - (a) *be deposited-*
 - (i) in a post office saving bank account, or*
 - (ii) in a special account to be opened by the company for the purpose in the State Bank of India or in a Scheduled Bank, or*
 - (iii) Where the company itself is a Scheduled Bank, in a special account to be opened by the company for the purpose either in itself or in the State Bank of India or in any other Scheduled Bank; or*
 - (b) be invested in the securities mentioned or referred to in clauses (a) to (e) of Section 20 of the Indian Trusts Act, 1882 (2 of 1882).*
- (2) Notwithstanding anything to the contrary in the rules of any provident fund to which sub-section (1) applies or in any contract between a company and its employees, no

employee shall be entitled to receive, in respect of such portion of the amount to is credit in such fund as is invested in accordance with the provisions of sub-section (1), interest at a rate exceeding the rate of interest yielded by such investment.

- (3) Nothing in sub-section (1) shall affect any rights of an employee under the rules of a provident fund to obtain advances from or to withdraw money standing to his credit in the fund, where the fund is a recognized provident fund.
- (i) *So the money collected by NOC Ltd. from its employees will have to be deposited in any of the following:*
- (a) *in a post office saving bank account, or*
 - (b) *in a special account to be opened by the company for the purpose in the State Bank of India or in a Scheduled Bank, or*
 - (c) *be invested in securities mentioned or referred to in clauses (a) to (e) of Section 20 of the Indian Trusts Act, 1882 (2 of 1882).*
- (ii) *As per the provision of Section 418 (3), Mr. A can obtain advances from or withdraw money standing to his credit in the fund provided the fund is a recognized provident fund.*

WINDING-UP (SECTIONS 425 – 560)

Contributories

Liability as contributories of present and past members (Section 426)

Question 1

By an order of the Court M/s ABC Limited was wound up with effect from 15.3.2002. Mr. Gupta, who ceased to be a member of the Company from 1.6.2001 received a notice from the liquidator to deposit a sum of Rs.15,000 as his contribution towards the liability on the shares previously held by him. Mr. Gupta seeks your opinion about his liability. (November, 2002)

Answer

Liability of Contributory

'Contributory' is a term used in the case of winding up of a company. A Contributory can be past or present member and is liable to contribute to the assets of the company in the event of winding up.

In the instant case, Mr. Gupta ceased to be a member of the Company when it went into liquidation from 15.3.2002. Thus, Mr. Gupta will be treated as a past member. He will not be required to contribute to the assets of the company if the following conditions are fulfilled:

- (1) If Mr. Gupta had ceased to be a member of the company for a period of one year or upwards before the commencement of the winding up. In this case, since one year has not elapsed, Mr. Gupta will be liable to contribute to the assets of the company.
- (2) If the debt or liability of the company was contracted or incurred after he ceased to be a member.
- (3) If the present members are able to satisfy the contributions required to be made by them under the Act.

In any case, the liability of the past or present member cannot exceed the unpaid amount on the shares and if the shares are fully paid up, no contribution is required to be made by the members past or present.

Question 2

M/s XYZ Limited was wound up with effect from 15.3.2000 by an order of the court. Mr.A, who ceases to be a member of the company from 1.6.1999, has received a notice from the

liquidator that he should deposit a sum of Rs. 5,000 as his contribution towards the liability on the shares previously held by him. In this context explain whether Mr. A can be called a contributory and whether he can be made liable and whether there is any limitation on his liability.
(May, 2000)

Answer

Contributory is a term used in the case of winding up of a company. A contributory can be a past or present member and is liable to contribute to the assets of the company in the event of winding up. In the present case Mr. A ceased to be a member of the company when it went into liquidation from 15.3.2000. Thus Mr. A will be treated as a past member. He will not be required to contribute to the assets of the company if the following conditions are fulfilled:

- (a) If Mr. A had ceased to be a member of the company for a period of one year or upwards before the commencement of the winding up. In this case since one year has not elapsed, Mr. A will liable to contribute to the assets of the company.
- (b) If the debt or liability of the company was contracted or incurred after he ceased to be a member.
- (c) If the present members are able to satisfy the contributions required to be made by them under the Act.

In any case, the liability of the past or present member cannot exceed the unpaid amount on the shares and if the shares are full paid up no contribution is required to be made by the members past or present [Section 426 of Companies Act, 1956].

Question 3

X Ltd. had gone into liquidation and a liquidator was appointed to administer the assets and liabilities of the Company. The liquidator of the Company finds that the assets of the Company are not sufficient to meet out the liabilities. He therefore, calls on the contributories including the part members as per List B to contribute towards the assets. The past members object to the liquidator's act on the ground that since they are no more members of the Company, they are not liable to contribute. Referring to the provisions of the Companies Act, 1956 decide:

- (i) *Whether the contention of the past member is tenable and can they be exempted from the liability to contribute?*
- (ii) *What would be your answer in case the members in question are the present members?*
(November 2009)

Answer

In accordance with the provisions of the Companies Act, 1956, as contained in Section. 426, in the event of a Company being wound up every present and past member shall be liable to contribute to the assets of the Company to an amount sufficient -

- (a) for payment of (i) its debts and liabilities, and (ii) costs, charges and expenses of the winding up, and
- (b) for the adjustment of the rights of the contributories among themselves.

The liability of the present member i.e. as per List A shall be limited

- (i) in case of a Company limited by shares, to the amount remaining unpaid on the shares; and
- (ii) in case of a Company limited by guarantee, to the amount undertaken to be contributed by him to the assets of the Company in the event of its being wound up.

However, in the winding up of a Company limited guarantee, which has a share capital, every member of the Company shall be liable, to contribute not only the amount undertaken to be contributed by him in the event of winding up but also to contribute to the extent of any sum unpaid on any shares held by him as if the company were a company limited by shares.

Liability of Past Members: (List B)

A past member shall not be liable to contribute:

- (i) if he has ceased to be a member for 1 year or more before the commencement of the winding up;
- (ii) in respect of any debt or liability of the Company contracted after he ceased to be a member;
- (iii) if it appears to the Court that the present members will be able to satisfy the contributions required to be made by them.

The past members can be called upon only after the Court has called upon the contributories in List A to pay and their contributions are found insufficient. In the case of a Company limited by shares a past member shall not be liable to contribute more than the amount unpaid on the shares in respect of which he is liable as such member:

Thus examining the above provisions, answer to the given questions shall be:

1. The past members' contention shall be tenable only:
 - (i) When they have ceased to be a member for 1 year or more before the commencement of the winding up of the Company.
 - (ii) If the liability of the Company was contracted after he ceased to be a member.
 - (iii) If it appears to the court that the present members will be able to satisfy the contributions required to be made by them.
2. In the second case, the present members shall be liable to the extent of the amount remaining unpaid on the shares in case of a Company limited by shares. In case of a Company limited by guarantee, to the amount undertaken to be contributed by him to the assets of the Company.

Winding-Up by Tribunal

(Cases in which companies may be wound up by the Tribunal)

Circumstances in which company may be wound up by Tribunal (Section 433)

Question 4

XYZ Co. Limited has its subsidiary company PRM Ltd, which is formed to carry out some of the objectives of XYZ Co. Limited. XYZ Ltd suspends one of its several businesses, by passing a resolution at the company's extraordinary general meeting, with effect from 1st January 2006. The business so suspended continues to be suspended until March 2006. On 1st April 2006, a group of shareholders of XYZ Ltd file a petition in the court for winding of the company on the ground of suspension of business by the company.

Referring to the provisions of the Companies Act, 1956, decide:

- (1) *Whether the shareholders' contention shall be tenable?*
- (2) *What would be your answer in case XYZ Ltd suspends all its business?*
- (3) *Can shareholders of PRM Ltd. File a petition in the court for winding up of their company (PRM Ltd) on the ground that the holding company viz., XYZ Ltd has suspended its entire business, though PRM Ltd. has not suspended business?*

Answer

The problem relates to suspension of business by a company. Section 433 provides that if a company does not commence its business within a year from its incorporation or suspends its business for a whole year, it may be wound up by the court. The contention of the shareholders of XYZ Ltd that the company is liable to be wound up in the ground so suspensions so business, is not tenable for the following reasons:

- (a) A company may be wound up by court if a company suspends its business for a whole year. Here the business was suspended only on 1. 1.97. Hence on 1st April, 1997 the business has not been suspended for the whole year to attract Section 433(c)
- (b) Where a company having much business discontinues one of them, it cannot be said to have suspended business within the meaning of Section 433(c).
- (c) Where a company ceases to do any business but is a holding company of subsidiaries engaged in the pursuit of the business, which it was previously doing, it cannot be said that the company has suspended its business (Ref; Eastern Telegraph Company Ltd).

Question 5

RM Limited went for a public issue of Equity Shares (Rs. 10 Crores) of Rs.10 each. The shares were subscribed to an extent of 95% of the total issue. The shares of the company were accepted for listing by Bombay Stock Exchange but subsequently the permission was

cancelled on certain grounds. On an appeal to the Central Government by the company, the decision of the Stock Exchange was held to be valid. As a result, the application money had become refundable to the allottees. The company, had no prospects of doing any business and there was a complete deadlock among the Directors. Looking at the circumstances, certain creditors filed a petition in the court for winding up of the company on the ground that the company had become commercially insolvent. The shareholders of the company object to the petition of the creditors. Decide giving reasons :

- (a) *Whether the objections of the shareholders will sustain and the court can dismiss the petition of creditors for winding up of the company?*
- (b) *State the provisions of the Companies Act, 1956 in this regard.*

Answer

- (a) Commercial Insolvency of RM Ltd.:

In this case three facts are given i.e.:

1. RM Limited went for a public issue and subsequently it was required to refund the amount received on application.
2. As a result, the company has no prospects of doing any business.
3. There was a complete dead lock among the directors.

These three circumstances may be construed as indicators of commercial insolvency of the company.

Section 433 (e) read together with Section 434 provides that a Court may order for winding up of a company if it is unable to pay its debts or deemed to be unable to pay its debts and it is proved to the satisfaction of the Court after taking into account all the liabilities including the contingent and prospective liabilities of the company. Moreover, Section 439 gives powers to the creditors for filing an application for its petition for winding up. There are no chances for the sustainment of shareholder's objection. *Deccan Farms & Distilleries Ltd. vs. Velabai Laxmidas Bhajji (1979)*. The Court has got wide discretionary powers regarding winding up. It may or may not dismiss the petition of creditors for winding up. Even if a winding up petition is a proper remedy against a company which is unable to pay its debts, the Court may in its discretion refuse to put an end to the life of the company [*Jugalkishore Banarsidas v. South India Saw Mills P. Ltd. (1975)*].

- (b) The Provisions of the Companies Act, 1956, which will apply in this case, are:
 - (a) A company may be wound up by the Court, if the company is unable to pay its debts. [Section 433(e)].

- (b) A company shall be deemed to be unable to pay its debts, if it is proved to the satisfaction of the Court that the company is unable to pay its debts, and in determining whether a company is unable to pay its debts, the Court shall take into account the contingent and prospective liabilities of the company. [Section 434 (c)].
- (c) An application to the Court for the winding up of a company shall be by petition presented, subject to the provisions of this section, by any creditor or creditors, including any contingent or prospective creditor or creditors. [Section 439 (b)].

Question 6

Mr. X is an unsecured creditor and has to recover a sum of Rs. 7 lakhs from Global Footwear Company Limited. The said company has become financially insolvent and hence unable to pay its debts. With the object of recovery of the said amount Mr. X is willing to proceed for compulsory winding up of the company. Advise the steps and procedure in this relation under the provisions of the Companies Act, 1956 **(CA, Final, New Course, May, 2010)**

Answer

Procedure in case of Compulsory Winding-Up: Mr. X has to take the following steps to put the company into compulsory winding up:

1. A petitions for winding up of the company is to be filed in the high court, where the registered office of the company is located under section 439(I)(b) read with section 433(e) and (f) of the Companies Act, 1956. A copy of the petition should be served on the company.
2. The petition should be filled along with an affidavit showing sufficient ground for the appointment of a provisional liquidator till an order is passed by the High Court appointing an official liquidator (Rule 106 of the Companies (Court) Rules 1959).
3. After obtaining the winding up order from the high court the same should be advertised within 14 days in a newspaper in English language and in the regional language of the state where the company is registered (Rule 113 of the Companies (Court) Rules, 1959).
4. A certified copy of the winding up order passed by the court should be filed with the concerned Registrar of companies along with the prescribed fees within 30 days from the date of the winding upto order (Section 445(i)).
5. The winding up proceedings will be carried out by the official liquidator till dissolution of the company.

Petition for winding up

Provisions as to applications for winding up (Section 530)

Question 7

High Value Builder Ltd. is financially insolvent and is unable to pay its debts. Mr. X an unsecured creditor has to recover a sum of Rs.5 lakhs from the company. Advise Mr. X about the steps and

the procedure to be followed to put the company into compulsory winding up, as an alternative for the recovery of his dues. **(May 2009)**

Answer

Mr. X has to take the following steps to put High Value Builders Ltd. into compulsory winding up:

- (i) A petition for winding up of the company is to be filed in the High Court where the registered office of the company is located under Section 439(1) (b) read with Section 433(e) and (f) of the Companies Act, 1956. A copy of the petition should also be served on the company.
- (ii) The petition should be filed along with an affidavit showing sufficient ground for the appointment of a provisional liquidator till an order is passed by the High Court appointing an official liquidator..
- (iii) After obtaining the winding up order from the High Court the same should be advertised within 14 days in a newspaper in English language and in the regional language of the state where the company is registered.
- (iv) A Certified copy of the winding up order passed by the court should be filed with the concerned Registrar of Companies along with the prescribed fees within 30 days from the date of the winding up order.
- (v) If the shares of the company are listed in a stock exchange, copy of the petition along with the order may be filed with the stock exchange concerned.
- (vi) The winding up proceedings will be carried out by the official liquidator till dissolution of the company.

Winding Up by Tribunal

Official Liquidators (Section 448 – 463)

Question 8

A listed Public Company was ordered to be wound up by the order of the Bombay High Court. While ordering the winding up, the Court ordered the Official Liquidator to submit a preliminary report to the Court as per the provisions contained in the Companies Act. State briefly the details to be given in the preliminary report of the Official Liquidator. **(November, 2001)**

Answer

As soon as the winding up order is received by the official Liquidator, a preliminary report is required to be submitted to the court. This report should be submitted as soon as the Liquidator receives the Statement of Affairs from the persons who were directors of the company at the time of winding up. There is a time limit of six months within which the official Liquidator is required to submit his preliminary report to the court.

The preliminary report should contain the following details:

- (i) The amount of capital issued, subscribed and paid up.
- (ii) The estimated amount of assets and liabilities giving separately (a) cash and negotiable securities; (b) debts due from contributories; (c) debts due to the company and securities, if any, available in respect thereof; (d) moveable and immovable properties belonging to the company; (e) unpaid calls.
- (iii) If the company has failed, the causes of the failure.
- (iv) The opinion of the Liquidator as to whether any further enquiry is desirable as to any matter relating to promotion, formation or failure of the company or the conduct of the business thereof.

The Official Liquidator has also the power to make a further report if in his opinion the company was formed with a view to commit a fraud or a fraud has been committed in respect of any matter which in his opinion is desirable to bring to the notice of the court.

Voluntary Winding-Up

Declaration of Solvency

Declaration of solvency in case of proposal to wind up voluntarily (Section 488)

Question 9

The Directors of M/s HIJ Company Ltd. desire to proceed for voluntary winding up of the company and hence they are required to File 'Declaration of Solvency'. Your advice is sought about the procedure to be followed for the said purpose. **(November, 2002)**

Answer

Declaration of Solvency

Chapter III of part VII of the Companies Act, 1956 deals with "Voluntary winding up" of companies and in this relation section 488 of the said Act provides for filing of "declaration of solvency" on the part of the directors of the company when there is proposal for voluntary winding up of the company.

The analysis of Section 488 of the Companies Act, 1956 discloses that a declaration of solvency contains the following features -

1. It is declaration duly supported by an affidavit, verified by a competent authority.
2. The declaration is made by the directors or where there are more than two directors, by the majority of the directors.
3. A meeting of Board of Directors is required for the purpose.

4. There is recital on the part of the Directors that they have made full inquiry into the affairs of the company and
5. That they have formed opinion that the company has no debts or that if it will be able to pay its debt in full within a period not exceeding three years from the date of commencement of winding up as may be specified in the said declaration.

In order that the above declaration in valid, it should be made within five weeks immediately preceding the date of passing the resolution for winding up of the company and must be delivered to the Registrar before that date. Further, the said declaration should be accompanied by a copy of the auditors report on the profit and loss account of the company for the period commencing from the date of the last audited accounts upto a date practicable immediately before the date of the declaration and a balance sheet on the last mentioned date and also a statement of company's assets and liabilities as on the date of the declaration made out in accordance with the requirements laid down by clause (2) of section 488 of the Companies Act, 1956.

A false declaration of a solvency makes the directors, liable under clause (3) and (4) of section 488 of the Companies Act, 1956.

Provisions applicable to a members' voluntary winding up (Section 489 – 498)

Question 10

What are the steps to be taken for up in a case, where the company is solvent, but the business for which it was formed has been completed. **(November, 2000)**

Answer

In this case the company is proposed to be wound up as the business for which it was formed has been complied. As the company is solvent, the voluntary winding up can be member's voluntary winding up and for this purpose the following steps is to be taken:

- (1) All the directors or atleast majority of directors have to make declaration at the meeting of Board of Directors that they have made full enquiry into the affairs of the company and they are of the opinion that the company has no debts at all or it will be able to pay all its debts within three years from the date of commencement of winding up proceedings [section 488(1) Companies Act, 1956]. Such declaration should be made within five weeks preceding the date of general meeting where winding up petition is proposed to be passed.
- (2) The declaration should be filed with Registrar of Companies before the date of general meeting. The declaration should be accompanied by report of auditors of the company giving profit and loss account for the period commencing from date upto which last accounts were prepared and ending with latest practicable date before the making of declaration. A balance sheet on that date should also be prepared. [Section 488(2)].

- (3) Next, the company has to pass at its general meeting a resolution called 'resolution for voluntary winding up'. Ordinary resolution will do in this case, if the articles provide that the company is to be dissolved on completion of the business (section 484). Otherwise, special resolution is required.
- (4) At this meeting or any meeting subsequent thereto, one or more liquidators are to be appointed and their remuneration should be fixed. (Section 490).
- (5) After the resolution is passed, company must give notice of such resolution by advertisement within 14 days in Official Gazette and also in some newspaper circulating in the District where the registered office is situated. (Section 485).
- (6) Under section 494, the company has to give notice of appointment of the liquidator to the Registrar of Companies.
- (7) The voluntary winding up commences at the time when the resolution for voluntary winding up is passed. (Section 486).

Official Liquidators

Audit of liquidators' accounts (Section 462)

Question 11

The High Court at Mumbai appointed the Official Liquidator as the Liquidator of Imprudent Engineering Company Ltd. Some of the creditors have brought to the notice of the Liquidator that though the company is in liquidation for the past several years, nothing worthwhile has been done to speed up the winding up and no documents have been filed to indicate the progress of Liquidation. Examine in this connection the nature and periodicity of returns required to be filed by the Liquidator in terms of the provisions contained in the Companies Act. (May, 2001)

Answer

According to Section 462(1) of the Companies Act, 1956 read with Rule 298 of the companies (Court) Rules the Official Liquidator is required to fill the accounts of M/s Imprudent Engineering Company Ltd., with the Court twice a year, one made upto 31st March and the second upto 30th September, within 3 months of closing the accounts. The accounts should be drawn up in Form No. 144 of the Rules. Further according to Rule 302, the accounts should be audited by a Chartered Accountant appointed by the Court or if the Court so directs by the Examiner of the Local Fund Accounts of the State concerned. A copy of the accounts so filed by the Official Liquidator with the court is open to inspection by any creditor, contributory or any person interested.

Where the winding up is not concluded within one year after commencement, the official liquidator is required within 2 months after the expiry of the year and thereafter until the winding up is concluded, once every year to file his statement in the prescribed form No. 148 (Rule 311) in Court. A copy thereof shall also be filed with the Registrar (Rule 511).

Provisions applicable to every voluntary winding up

Arrangement when binding on company and creditors (Section 517)

Question 12

Reckless Constructions Ltd. has gone into liquidation, because of the inability of the company to pay its debts. During the course of winding up a proposal was put forward by the previous management to revive the working of the company through a scheme of arrangement between the company and its creditors. As per the scheme, all the creditors have to forego fifty per cent of their dues. The company approaches you for advice. Discuss the steps that have to be taken by the company in this regard. **(May, 2001)**

Answer

As per the provisions contained in Section 517 of the Companies Act, 1956 M/s Reckless construction Ltd. can enter into a scheme of arrangement with the creditors, even though the company is in liquidation. According to the said section, the scheme of arrangement will be binding on the company and its creditors provided it has been approved by a special resolution of the company and agreed to by three fourths in number and value of the creditors. Any creditor or contributory may, however, within three weeks from the completion of the arrangement appeal to the court and the court may amend., vary, confirm or set aside the arrangement. The company should take the following steps in this regard:

- (i) to get the draft scheme of arrangement approved by the Board of Directors.
- (ii) to apply to the Court for directions to convene the meetings of the members/ creditors.
- (iii) to hold the general meeting and pass the required special resolution.
- (iv) to move the High Court for approval of the scheme.
- (v) on receipt of the court's order, to file the certified copy of the order with the Registrar of Companies.

Question 13

Worthless Ltd. has gone into liquidation because of the inability of the company to ay its debts. During the course of winding up, a proposal was put forward by the previous management to receive the working of the company through a scheme of arrangement between the company and its creditors. As per the scheme, all the creditors have to forego fifty percent of their dues. Some of the creditors have voiced their opposition to the said scheme. The company approaches you for advice. State the steps that have to be taken by the company in this regard. **(November 2007)**

Answer

As per Section 517

- (1) any arrangement entered into between a company about to be, or in the course of being wound up and its creditors shall, subject to the right to appeal under this section,

be binding on the company and on the creditors if it is sanctioned by a special resolution of the company and acceded to by three-fourths in number and value of the creditors.

- (2) any creditor or contributory may, within three weeks from the completion of the arrangement, appeal to the court (now Tribunal) against it and the (now tribunal) may thereupon, as it thinks just, amend, vary, confirm or set aside the arrangement.

Thus, the company may enter into a scheme of arrangement with the creditors by the procedure given below:

The draft scheme of arrangement shall be considered and approved by the board of director.

The company shall apply to the court for directions to convene the meetings of the members and creditors

A general meeting of the company shall be held and the special resolution approving the scheme of arrangement shall be passed.

A meeting of creditors shall be held whereat the scheme shall be agreed to by $\frac{3}{4}$ in number and value of the creditors. The company shall approach the court (Tribunal) for approval of the scheme.

On receipt of the courts (Tribunal) order, the company shall file a certified copy of the courts (Tribunal) order with the registrar.

Provisions applicable to every mode of winding up

Proof and ranking of claims

Question 14

The value of the security of a secured creditor of a company is Rs. 1,00,000. The total amount of the workmen's dues is Rs. 1,00,000. The amount of the debts due from the company to its secured creditors is Rs. 3,00,000. The aggregate of the amount of workmen's dues and of the amounts of debts due to secured creditors is Rs. 4,00,000.

With reference to the provisions of the Companies Act, 1956, what is the workmen's portion of the security?

If the liquidator incurs Rs. 10,000 for the preservation of the security before it is realised by the secured creditor, what is the portion of Rs. 10,000 that should be borne by the secured creditors?

Answer

- (i) The workmen portion of the security is therefore $\frac{1}{4}$ th of the value of the security, i.e. 25,000, [Sub-section (3) added to Section 529 by the Companies (Amendment) Act, 1985].

- (ii) If the liquidators incur Rs. 10,000 for the preservation of the security, it is equal to the following equation:

$$\text{Whole of expenses} - \text{Whole of expenses} \times \frac{\text{Workmen's portion}}{\text{Value of the security}}$$

$$= \text{Rs. } 10,000 \times \frac{10,000 \times 25,000}{1,00,000}$$

$$= \text{Rs. } 10,000 - 2,500$$

= Rs. 7,500. This is the amount to be borne by the secured creditors.

Overriding preferential payments (Section 529A)

Question 15

OGC Ltd. was a supplier of Raw Materials to SAM Ltd., which could not make payment to OGC Ltd. owing to huge losses and financial constraints. Ultimately, SAM Ltd. went into liquidation and Official Liquidator was appointed. OGC Ltd. filed a suit for recovery of its dues. The Court awarded a decree in favour of OGC Ltd. Armed with the Court's decree, OGC Ltd. approached the Official Liquidator to pay the amount to it in preference over dues of the workmen. The workmen protested the demand of OGC Ltd. and contended that their dues rank pari passu with the Secured Creditors and will override all other claims of other creditors even where a decree has been passed.

You are required to ascertain the validity of the argument of the workmen in the light of the provisions of the Companies Act, 1956 and the decide cases on the subject. (May 2008)

Answer

The problem given in the question is covered by the provisions of Section 529A of Companies Act, 1956 read with Sections 529 and 530 of the said Act. The effect of combined reading of these sections is that the workmen of the company become secured creditors by operation of law to the extent of the workmen's dues and are entitled to proportional payment along with other secured creditors. If there is no secured creditor then the workmen of the company become unsecured preferential creditors under the said Section 529A to the extent of workmen's dues. The purpose of the said section 529A is to ensure that the workmen should not be deprived of their legitimate claims on the event of the liquidation of the company and the assets of the company would remain charged for the payment of workmen's dues and such charge will be pari passu with the charge of other secured creditors. There is no other statutory provision overriding the claim of the secured creditors except the said Section 529A.

Thus under the said Section 529A, the dues of the workmen and debt due to the secured creditors are to be treated pari passu and have to be treated as prior to all other dues.

Thus, the law is very much clear in this respect and the Hon'ble Supreme Court of India held

in the case of UCO Bank [(1994) 81 Comp. Case 780] that the provisions of Section 529A of the Companies Act, 1956 will override all other claims of the creditors even where a decree has been passed by a court.

In view of the above stated legal position, the contention of the workmen of SAM Ltd. is valid and the Official Liquidator will have to pay their dues as provided in Section 529A of the Act.

Preferential Payments (Section 530)

Question 16

Ms XYZ Limited is being wound up by the Court. The official liquidator after realisation of the assets has an amount of Rs. 56,00,000 at his disposal towards payment of creditors of the company. Details of creditors are as under:

	Rs.
(i) Dues to secured creditors	40,00,000
(ii) Dues to workers	30,00,000
(iii) Taxes and duties payable to Government authorities	4,00,000
(iv) Unsecured creditors	80,00,000

Since the available amount is insufficient to meet the claims of all the creditors, explain the procedure to be followed for payment of dues as provided in the Companies Act, 1956, assuming that the company has created a charge on all the assets of the company in favour of the secured creditors.

Answer

Section 530 of the Companies Act, 1956 lays down the procedure for payment of debts out of available funds with the Official Liquidator. However, Section 529A provides for overriding of the preferential payments as mentioned in Section 530. According to Section 529A, notwithstanding anything contained in other provisions of this Act or any other law for the time being in force, in the winding up of a company ,

- (a) workmen's dues; and
- (b) debts due to secured creditors, shall be paid in priority to all other debts.

The above debts have to be paid in full unless the assets are insufficient to meet them, in which case they shall abate in equal proportions.

In this light of the legal provisions explained, the funds available with the Official Liquidator are not even sufficient to meet fully the dues payable to secured creditors and workers. Thus, tax dues to the tune of Rs.4,00,000 payable to Government authorities will not get any payment even though they are to be considered as preferential payments as per section 530 of the Act. The secured creditors dues and workmen dues will get abated equally and they get Rs. 32 lakhs and Rs.24 lakhs respectively. The other creditors will get nothing.

Question 17

Mars India Limited, a company incorporated under the Companies Act, 1956 is being wound up by the court. After realization of the assets of the company, the official liquidator has an amount of Rs. 70,00,000 at his disposal towards payment of creditors of the said company. The details of creditors are as follows:

- (i) Unsecured creditors 50,00,000
- (ii) Taxes and duties payable to Government 5,00,000
- (iii) Dues to workers 30,00,000
- (iv) Dues to secured creditors 40,00,000

The available amount with the liquidator, obviously, is not sufficient to meet the claims of all the creditors. Moreover, the company had already created a charge on all the assets of the company in favour of the secured creditors. Explain the procedure to be followed by the liquidator for payment of dues as provided in the Companies Act, 1956. **(November 2008)**

Answer

WINDING UP (PAYMENT OF CREDITORS): Section 530 of the Companies Act, 1956 lays down the procedure for payment of debts out of available funds with the official liquidator. However Section 529A of the said Act provides for overriding of the preferential payments as mentioned in Section 530. According to Section 529A of the Companies Act, 1956 notwithstanding anything contained in other provisions of this Act or any other law for the time being in force, in the winding up of a company – (1) Workmen's dues and (2) debts due to secured creditors, shall be paid in priority to all other debts. Further these debts have to be paid in full unless the assets are insufficient to meet them, in which case they shall abate in equal proportion.

In the light of the above mentioned provisions, the funds available with the official liquidator are not sufficient to meet fully the dues payable to all the creditors. Thus, tax dues to the tune of Rs. 5,00,000 payable to government authorities will not get any payment even though they are to be considered as preferential payments as per Section 530 of the Act. Thus the secured creditors will get Rs. 40,00,000 and the remaining amount of Rs. 30,00,000 shall be paid towards workers dues. The other creditors will get nothing.

Effect of winding up on antecedent and other transactions

Fraudulent preference (Section 531)

Question 18

M/s. Info-tech Overtrading Ltd. was ordered to be wound up compulsory by an order dated 15th October, 2007 of the Delhi High Court. The official liquidator who has taken control for the assets and other records of the company has noticed the following:

- (i) *The Managing Director of the company has sold certain properties belonging to the company to a private company in which his son was interested causing loss to the company to the extent of Rs. 50 lakhs. The sale took place on 0th May, 2007.*
- (ii) *The company created a floating charge on 1st January, 2007 in favour of a private bank for the overdraft facility to the extent of Rs. 5 crores, by hypothecating the current assets viz., stocks and book debts.*

Examine what action the official liquidator can take in this matter. Having regard to the provisions of the Companies Act, 1956. **(November 2007)**

Answer

The official liquidator can invoke the provisions contained in Section 531 of the companies Act, 1956 to recover the sale of assets of the company. According to Section 581, any transfer of property, movable or immovable made within 6 months before the commencement of winding up will be deemed to be a fraudulent preference and hence invalid in the eyes of laws. Since in the present case, the sale of immovable property took place on 10th May, 2007 and the company went into liquidation on 15th October, 2007 i.e., within 6 months before the winding up of the company and since the sale has resulted in a loss of Rs. 50 lakhs to the company. The official liquidator will be able to succeed in proving the case under Section 531 by way of fraudulent preference as the property was sold to a private company in which the son of the ex-managing was interested.

According to Section 534 of the Companies Act, any floating charge created within 12 months of the commencement of the winding up will be treated as invalid unless it is proved that the company immediately after the creation of charge was solvent. In the present case it may be difficult for the Bank, the charge holder to prove that the company was solvent after the creation of the floating charge. The charge holder i.e., the Bank is however, entitled to recover from the company. The amount advanced along with 5% interest. Further preferential debts under Section 530 will have priority over debts secured by a floating charge. The official liquidator may thus prove that the floating charge created by the company is invalid.

Effect of winding up on antecedent and other transactions

Effect of floating charge (Section 534)

Question 19

A Company created a floating charge of its Current Assets in favour of a Bank to secure a Current Account, which was in debit of Rs.5 lakhs and also to secure further Working Capital facilities provided by the bank. The charge created on 1st January, 2003 was duly registered with the registrar of Companies. The bank advanced Rs.10 lakhs subsequent to the creation of charge. The company has gone into voluntary liquidation pursuant to a resolution passed on 1st September, 2003. Examine the validity of the floating charge in case it is a creditors'

voluntary winding up, but there is no fraudulent preference. Would your answer be different, if it was a member's voluntary winding up? **(May, 2004)**

Answer

Effect of floating charge in Winding-up

Section 534 of the Companies Act, 1956 deals with effect of floating charge. Where a company is being wound up, a floating charge created on the assets of the company within 12 months prior to the commencement of winding up will be valid only to the extent of money advanced at the time of creating charge or subsequent to creating charge, plus interest at 5% or such other rate notified by the Central Government in this behalf. In other words, floating charge created for pre-existing debt will be invalid. This section does not, however, affect companies which can prove that after the creating of the floating charge, they were in quiet solvent condition.

The voluntary winding up commences at the time when the resolution for voluntary winding up is passed by the company (Section 486).

Members' voluntary winding up is permissible only when the company is solvent and declaration of solvency is made (Section 488). If declaration of solvency is not made, the winding up would be termed as creditors' voluntary winding up.

In this case, the floating charge was created within 12 months preceding the commencement of winding up and hence the provisions of Section 534 are attracted. In the question, there is no fraudulent preference and hence it is not necessary to examine the applicability of Section 531. In the case of creditors' voluntary winding up, the company cannot be considered as solvent. In view of the position explained above the floating charge is valid only to the extent of advances made subsequent to the creation of charge i.e. Rs.10 lakhs plus interest at 5%.

In the case of members' voluntary winding up, the position is different. As the company is solvent, the floating charge is valid for the entire debt of Rs.15 lakhs including the pre-existing debt of Rs.5 lakh (at the time of creation of charge).

Offences antecedent to or in course of winding up

Power of Tribunal to assess damages against delinquent directors etc (Section 543)

Question 20

The official liquidator of ABC Limited (in liquidation) instituted misfeasance proceedings under section 543 of the Companies Act, 1956 against 'A', a director of the company in liquidation. During the pendency of misfeasance proceedings 'A' died.

What is meant by Misfeasance? Is it possible for the official liquidator to impede the legal representatives of 'A' and continue the proceeding against them? **(November 2006)**

Answer

Misfeasance

The term 'misfeasance' has not been defined in the Companies Act, 1956. It can be considered as an act or omission in the nature of breach of trust in relation to the company which causes losses or injuring to the company. Although loss to the company has not been expressly stated in Section 543 nevertheless such 'loss' has to be implied in case of misapplication or retainer. Only such an act of misfeasance as results in the loss to the company will fall within the ambit of section 543.

As regards the second question (ii) in case of death of the directors, the Supreme Court held that the proceedings commenced against the delinquent director of a company liquidation under section 543 can be continued after his death against his legal representatives and the amount declared to be due in such misfeasance proceeding can be realized from the estate of the deceased on the hands of his legal representatives. The Court further held that the legal representatives would not, however, be liable for any sum beyond the value of the estate of the deceased in their hands (*Official Liquidator, Supreme Bank Ltd. V.P.A. Tendolkar (1973) 43 Comp. (Case 382) (Official Liquidator vs. Parthasarthy Sinha (1983) 53. Comp. Case (SC) (3c)*). Hence the misfeasance proceeding can be continued against the legal representatives of A.

Question 21

M/s Raman Ltd. was wound up by the Court. The official liquidator invited claims from its creditors which stood as under:

<i>Income tax dues</i>	<i>Rs.11 lakhs</i>
<i>Sales tax dues</i>	<i>Rs. 5 lakhs</i>
<i>Dues of workers</i>	<i>Rs.25 lakhs</i>
<i>Unsecured loans payable to directors</i>	<i>Rs.25 lakhs</i>
<i>Trade creditors who supplied raw material</i>	<i>Rs.15 lakhs</i>
<i>Secured creditor being the bankers of the company</i>	<i>Rs.75 lakhs</i>
	<i>Rs. 156 lakhs</i>

Official Liquidator could realize only Rs.80 lakhs by sale of assets and realizations made from the company's debtors, which is not sufficient to pay to all the creditors. Please decide the order of priority for payment to creditors explaining the relevant provisions of the Companies Act, 1956.

Answer

Under section 529A of the Companies Act, 1956, (i) workmen's dues, and (ii) debts due to secured creditor shall be paid in priority of all debts, and shall be paid in full, unless the assets are

insufficient to meet them, in which case they shall abate in equal proportions. Income tax dues and sales tax dues are preferential creditors under section 530 of the Act, and subject to the provisions of section 529A, the same may be paid in priority to the claims of unsecured creditors.

In the present case, the available funds are only to the extent of Rs.80 lakhs which will be distributed amongst the secured creditor and workmen in proportion to their dues, as follows:

Workmen

(1/4th of Rs.80 lakhs) : Rs.20 lakhs

Secured creditor

(3/4th of Rs.80 lakhs) : Rs. 60 lakhs

As such, the dues of preferential creditors (namely, Income tax and sales tax dues) and unsecured creditors (unsecured loan and trade debtors) cannot be paid any amount.

Provisions as to dissolution (Section 560)

Question 22

Ganesh Textiles Private Limited has discontinued its Business since 2006. Negligible assets are available with the company, but also some liabilities. The company has been regular in filing Annual Returns and Balance Sheets. The Director of the Company proposes to apply to the Registrar of Companies for striking the name of the company on the ground that it is a defunct company.

Advise, as to what steps can be taken to get the name of the company struck off under the provisions of the Companies Act, 1956. **(CA Final, New Course, May 2010)**

Answer

Striking off defunct company: In the given case Ganesh Textiles Private Ltd. is required to follow the established procedure to enable the Registrar to remove the name of the company under Section 560 of the Companies Act, 1956. For this purpose, an application accompanied with the following documents be submitted to the Registrar of Companies –

1. An affidavit of at least two directors including that of the Managing Director or whole time Director to the effect that the company has no assets or liabilities as on date and the company has not been carrying on any business during the last one year or more.
2. Latest audited balance sheet and profit and loss account of the company.
3. An indemnity bond from the aforesaid directors to the effect that the liabilities of the company if any will be met by them even after the name of the company is struck off.

In view of the above, Ganesh Textiles Private Limited must first take steps to realize all the assets and pay all the liabilities and make it nil. Thereafter the company may apply to the Registrar of Companies along with “nil” balance sheet, affidavit and indemnity bond. After making necessary inquiry, the Registrar will publish notice in the official Gazette that the name of the company has

been struck off. Under Section 560(5) of the said Act, the company shall stand dissolved from the date of publication of notice in the Official Gazette.

Question 23

Super Chemicals Private Limited has discontinued its business since 1992. Its entire capital has been lost. It has some liabilities, but negligible assets. The company has been regular in filing annual Returns and Balance Sheets. The Directors propose to apply to the Registrar of Companies for striking the name of the company under Section 560 of the Companies Act, 1956 on the ground that it is a defunct company.

State the circumstances under which the name of the company can be struck off under Section 560 of the Act and the steps to be taken by the Directors of the Company to get the name of the company struck off.
(November, 2003)

Answer

Striking off defunct company

Where the Registrar of companies has reasonable cause to believe that a company is not carrying on business or in operation, he shall send to the company by post a letter inquiring whether the company is carrying on business or in operation (Section 560(1)). If no reply is received from the company within one month, Registrar will send another letter to the company by registered post [Section 560(2)].

If the Registrar either receives an answer from the company to the effect that it is not carrying on business or in operation or does not receive any reply from the company after second letter, the Registrar will publish a notice in official Gazette that the name of the company will be struck off and company dissolved, unless cause is shown to the contrary within 3 months from the date of notice. [Section 560(2) and (3)].

If no reply is received or no cause is shown within 3 months, Registrar will publish notice in Official Gazette that the company's name has been struck off. Company shall stand dissolved from the date of publication of Official Gazette [Section 560(5)].

This power can be exercised by Registrar even in the case of company being wound up, if he has reasons to believe that no liquidator is acting or the company is completely wound up or any returns required to be made to Registrar have not been made for 6 months [Section 560(4)].

Hence a defunct company can be struck off from the Register of Companies by the Registrar by following the procedure laid down in Section 560.

However, the company in this case, which is admittedly not carrying on any business since 1992 must follow the procedure laid down by Department's Circular No. 9/7/83-CL III dated 17.2.1987 to enable the Registrar of Companies to remove the name of the company under Section 560.

The company should make an application to the Registrar accompanied by the following documents:

- (1) An affidavit of at least 2 directors including that of the managing director or whole time director to the effect that the company has no assets or liabilities as on date and the company has not been carrying on any business during the last one year or more.
- (2) Latest audited balance sheet and profit and loss account of the company.
- (3) An indemnity bond from the aforesaid directors to the effect that the liabilities of the company, if any will be met by them even after the name of the company is struck off from the Register under Section 560.

The Department of Company Affairs simplified the procedure for removal of defunct companies vide Circular letter No. 17/78/2001-CLV dated 25.3.2003. This simplified procedure was in operation till 30.09.2005. But the essential condition that the assets and liabilities of the company should be zero must be fulfilled [Dept's Clarification No. 17/78/2001 - CLV dated 17.4.2003].

Hence the company must first take steps to realise all the assets and pay all the liabilities and make it 'Nil'. Thereafter, the company may apply to Registrar of Companies along with 'Nil' balance sheet, affidavit and indemnity bond.

PRODUCER COMPANIES (SECTIONS 581A – 581ZT)

Appointment of Directors (Section 581P)

Question 1

XYZ Producer Company Limited was incorporated on 1st April, 2003. At present it has got 200 members and its board consists of 10 Directors. The Board of Directors of the company seeks your advice on the following proposals:

- (i) Appointment of one expert Director and one Additional Director by the Board for a period of four years.*
- (ii) Loan of Rs.10,000 to Mr. X, a Director of the company repayable within a period of six months.*
- (iii) Donation of Rs.10,000 to a Political Party.*

Advise the Board of Directors explaining the relevant provisions of the Companies Act, 1956.

(May, 2004)

Answer

Producer Company

Appointment of expert director or additional director: Section 581P(6), Companies Act, 1956 empowers the Board of Directors of a producer company to co-opt one or more expert directors or an additional director not exceeding one fifth of the total number of directors for such period as the Board may deem of it. But the maximum period shall not exceed the period specified in the Articles of the company (Proviso 2 to Section 581P(6)).

The number of directors proposed to be co-opted is only 2 and it does not exceed one-fifth of the total number of directors. They can hold office for the period specified by the Board provided it does not exceed the period specified in the Articles (Section 260 stipulating that the additional director can hold office only upto the date of the next annual general meeting is not applicable to a producer company). Hence the proposed appointment of one expert director and one additional director is in order.

Loan to a director: Section 581ZK empowers the Board of Directors to provide financial assistance to the members of the producer company subject to the provisions made in articles

and also subject to certain conditions laid down in 581ZK(b). But any loan or advance to any director or his relative shall be granted only after the approval by the members in general meeting. (Proviso to Section 581ZK).

In view of the above, the directors must convene the general meeting and get the approval of the members before granting the proposed loan of Rs.10,000 to X, a director of the company (According to Section 581C(5) a producer company is a private limited company and there is no limit to the number of its members. Hence, Section 295 is not applicable to a producer company).

Donation to a Political Party: Producer company shall not make directly or indirectly to any political party or for any political purpose to any person any contribution or subscription or make available any facilities including personnel or material (Second proviso to Section 581ZK). As the donation to a political party is prohibited, the company cannot donate Rs.10,000 to a political party.

Option to inter-State cooperative societies to become producer companies (Section 581J)

Question 2

- (i) *The existing Inter-state Cooperative Society seeks your advice regarding the papers to be submitted to the Registrar of Companies for its registration as a Producer Company under the provisions of the Companies Act, 1956. You are required to prepare a list of such papers.*
- (ii) *A group of individuals eligible to form a Producer Company within the meaning of the Companies Act, 1956 has entrusted you with the job of preparing the Memorandum of Association of the proposed Producer Company. You are required to state the matters, which are required to be included in such Memorandum of Association.*
(November 2005)

Answer

- (i) As per Section 581J of the Companies Act, 1956, any Inter-State Co-operative Society with objects not confined to one State may make an application to the Registrar of Companies for registration as Producer Company.

The application for registration as a producer Company is to be submitted along with the following:

- (a) a copy of the special resolution, of not less than two-third of total members of Inter-State Co-operative Society, for its incorporation as a Producer Company under the Companies Act:

- (b) a statement showing:
 - (i) Names and addresses or the occupation of the directors and Chief Executive, if any, by whatever name called, of such inter-State Co-operative Society, and
 - (ii) list of members of such Inter-State Co-operative Society;
 - (c) a statement indicating that the Inter-State Co-operative Society is engaged in any one or more of the objects specified in Section 581B of the Companies Act, 1956;
 - (d) a declaration by two or more directors of the Inter-state co-operative society certifying that particulars given in the above statements are correct.
- (ii) As per Section 581F of the Companies Act, 1956, the Memorandum of Association of a Producer Company has to state the following:
- (a) the name of the company with "Producer Company Limited" as the last words of the name of such Company;
 - (b) the State in which the registered office of the Producer Company is to situate;
 - (c) the main objects of the Producer Company confirming to the objects specified in Section 581B of the Companies Act, 1956;
 - (d) the names and addresses of the persons who have subscribed to the memorandum of Association;
 - (e) the amount of share capital with which the Producer Company is to be registered and division thereof into shares of a fixed amount;
 - (f) the names, addresses and occupations of the subscribers being producers, who shall act as the first directors in accordance with section 581J(2) of the Companies Act, 1956;
 - (g) that the liability of its members is limited;
 - (h) opposite to the subscriber's name the number of shares each subscriber takes (Each subscriber must take at least one share);
 - (i) in case the objects of the Producer Company are not confined to one State, the States to whose territories the objects extend.

Number of Directors (Section 581O)

Question 3

- (i) *An Interstate Cooperative Society has been incorporated on 1st May, 2004 as a Producer Company under the provisions of the Companies Act, 1956. Give your*

comments on its proposal to have 18 directors on its Board after incorporation as a Producer Company.

- (ii) *A Producer Company wants to issue bonus shares. You are required to state the relevant provisions of the Companies Act, 1956 in this regard.*
- (iii) *What are the modes of investment, from and out of its general reserves, available to a Producer Company formed and registered under Section 581C of the Companies Act, 1956?*
(November, 2004)

Answer

- (i) As per provisions of section 581-O of the Companies Act, 1956, any Producer Company can not have more than fifteen directors. However, by way of a proviso, the said section further provides that in the case of an inter-State co-operative society which is incorporated as a Producer Company, may have more than fifteen directors for a period of one year from the date of its incorporation as a Producer Company.

In view of the above provisions of the Companies Act, 1956 the proposal to have 18 directors by the Producer Company after its incorporation as such, is a valid proposition, but since it is incorporated on 1st May, 2004, it can have more than 15 directors for one year only from the date of its incorporation

- (ii) As per provisions of section 581ZJ of the Companies act 1956, any Producer Company may, upon recommendation of the Board and passing of resolution in the general meeting, issue bonus shares by capitalisation of amounts from general reserves referred to in section 581ZI in proportion to the shares held by the Members on the date of the issue of such shares.
- (iii) As per Producer Companies (General Reserves) Rules. 2003 issued by the Department of Company Affairs, Ministry of Finance, Government of India on 7th August, 2003 a producer company formed and registered under section 581C of the Companies Act, 1956, shall make investments from and out of its general reserves in the following manner, namely:-
 - (a) in approved securities, fixed deposits, units and bonds issued by the Central or State Governments or cooperative societies or scheduled bank; or
 - (b) in a co-operative bank, state co-operative bank, co-operative land development bank or central co-operative bank; or
 - (c) with any other scheduled bank; or
 - (d) in any of the securities specified in section 20 of the Indian Trusts Act, 1882; or
 - (e) in the shares or securities of any other multi-state co-operative society or any co-operative society; or

- (f) in the shares, securities or assets of a public financial institutions specified under section 4A of the Companies Act, 1956.

Donation or subscription to Producer Companies (Section 581 ZH)

Question 4

- (i) *A two year old Producer Company registered under Section 581C of the Companies Act, 1956 wants to donate some amount. The Chief Executive of the Producer Company has approached you to advise him as to how and for what purposes the donation can be made by such company. Also state the monetary restrictions, if any, laid down in the Companies Act, 1956 on making donations by a Producer Company. You are informed that as per the Profit & Loss account of the Producer Company for its last accounting year, net profit was Rs.20.00 lacs.*
- (ii) *Is it obligatory for every producer company to appoint a whole time secretary under the provisions of the Companies Act, 1956?* **(May, 2005)**

Answer

- (i) As per provisions of section 581 ZH of the Companies Act, 1956, a Producer Company may, by special resolution, make donation or subscription to any institution or individual for the following purposes:-
- (a) For promoting the social and economic welfare of Producer Members or Producers or general public; or
 - (b) For promoting the mutual assistance principles.

Thus as per the above stated provisions of the Companies Act, 1956, a Producer Company may make a donation by passing a special resolution and for the above mentioned purposes.

The 1st Proviso to the said section 581ZH lays down the monetary limit for making the donation by a Producer Company. According to the said proviso the aggregate amount of all such donation and subscription in any financial year shall not exceed three per cent of the net profit of the Producer Company in the financial year immediately preceding the financial year in which the donation or subscription was made.

Since the net profit of the Producer Company as per its last profit & loss account was Rs.20.00 lacs, it can make a total donation of Rs.60,000/- in this year being three percent thereof.

- (ii) Under section 581X of the Companies Act, 1956 every Producer Company having an average turnover exceeding Rs.5 crores in each of three consecutive financial years shall have a whole time secretary who is a member of ICSI.

Incorporation of Producer Companies and other matters (Section 581B to 581N)

Option to inter-State co-operative societies to become Producer Companies (Section 581J)

Question 5

The Executive Committee of an Inter-state Co-operative society decides to convert the society into a 'Producer Company' under the provisions of the Companies Act, 1956. You being a practicing Chartered Accountant are approached by the society for advice. Advise the society on the following matters:

- (i) *The steps to be taken for conversion of the society into a 'Producer Company'.*
 - (ii) *Manner in which voting rights of members of Producer company after conversion may be exercised.*
- (May 2006)**

Answer

Conversion of inter state cooperative society into producer company steps to be taken and manner in which voting rights of members after conversion to be exercised. [Section 581J and 581D The Companies (Amendment) Act, 2002.]

As a practicing Chartered Accountant the following advice can be given to the inter-state society which wants to get converted into a 'Producer company' under the provisions of Companies (Amendment) Act, 2002.

1. Steps to be taken for conversion (Section 581J):

Any inter-state cooperative society having objects for multiplicity for states may make an application to the Registrar for registration as producer company. Such application should be accompanied by –

- (a) A copy of the special resolution, of not less than 2/3rd of total member of Inter-State Cooperative Society, for its incorporation as a producer company.
- (b) A Statement showing : (i) names and address or the occupation of the directors and Chief Executive, if any, by whatever name called, of such inter-state cooperative society; and (ii) list of members of such inter-state cooperative society.
- (c) A statement indicating that the inter-state cooperative society is engaged in any one or more of the objects specified in Section 581B.
- (d) A declaration by two or more directors of the inter-state cooperative society certifying that particulars given in clauses (a) to (c) given above are correct.

The word “Producer Company Ltd.” should form part of its name to show its identity. On compliance with the requirements of the Act, the Registrar shall, within a period of 30 days of the receipt of application, certify under his hand that the society applying for registration is registered and thereby incorporated as a producer company.

Upon registration as a producer company, the Registrar of Companies who registers the company is required to intimate the Registrar with whom the erstwhile inter-State cooperative society was earlier registered for appropriate deletion of the society from its register.

2. Manner in which voting rights of members can be exercised (Section 581Z):

Section 581Z of the Companies Act, 1956 states that subject to the provisions of sub-sections (1) and (3) of Section 581D, every member shall have one vote and in the case of equality of votes, the chairman or the person presiding shall have a casting vote except in the case of election of the chairman. As regards the voting rights it may be noted that:

1. Where individual is a member of the producer company, he has one vote irrespective of the size of his holding.
2. Where both individuals and producer institutions are members – single vote for every member.
3. Where membership is confined to producer institutions only, in the first year of registration of the company, the voting rights shall be based on the size of the shareholding of the member institution and in the following years it will be based on participation by the respective institutions in the business of the producer company in the previous year (as may be specified in the Articles),
4. A producer company, may, if authorized by the Articles, restrict the voting rights to active members of the producer company, and
5. Casting vote can be cast by the presiding member (Chairman) in case of equality of votes on any resolution (except for election of the Chairman).

Appointment of Directors (Section 581P)

Question 6

Mr. Z an expert in modern agriculture practices is willing to lend his services as a director of M/s. Lord Krishna Cotton Producer Company Ltd. registered under Section 581C of the Companies Act, 1956. Advise Mr. Z as to how he can be appointed as a director including (1) The total number of directors that can be appointed (2) The tenure of the directors (3) The time limit within which the appointment should be made (4) the co-option of directors and (5) the voting powers of such co-opted directors
(November 2007)

Answer

According to Section 581P of the Companies Act, 1956 the members who sign the memorandum and the articles and designated as first directors and shall given the affairs of the company until the directors are appointed at the Annual General Meeting. According to Section 581-0 every producer company shall have at least five and not more than fifteen directors. The election of directors shall be conducted within 90 days from the date of registration of the producer company. In the case of Inter-state co-operative society the election shall be held within a period of 360 days. The period of office of director shall be not less than one year and not exceeding 5 years as may be specified in the articles. The directors are normally elected and appointed by the members in the Annual General Meeting. The Board may also co-opt one or more expert directors as an additional directors. Such directors cannot exceed $\frac{1}{5}$ th of the total number of directors. The expert directors shall not have the right to vote in the election of Chairman but shall be eligible to be elected as Chairman if it is provided by the articles. The maximum period for which such experts are appointed as directors will be as provided in the articles of association and it cannot exceed 5 years. Thus Mr. Z can be appointed as expert director but he will not have any voting right in the election of chairman of the Board of Directors. Him tenure of office can be between one to five years.

Question 7

- (i) *An inter-state co-operative society has been incorporated on 1st May, 2008 as a Producer Company under the provisions of the Companies Act,, 1956. Give your comments on its proposal to have 18 directors on its Board after incorporation as a Producer Company.*
- (ii) *Mr. Zameen, a member of a Producer Company, wants to transfer his shares. You are required to state as to how he can transfer his shares under the provisions of the Companies Act, 1956.*
- (iii) *A Producer Company wants to issue bonus shares. You are required to state the relevant provisions of the Companies Act, 1956 in this regard.*
- (iv) *What are the modes of investment, from and out of its general reserves, available to a Producer Company formed and registered under Section 581C of the Companies Act, 1956?*
(May 2008)

Answer

- (i) As per provisions of Section 581-O of the Companies Act, 1956, any producer Company can not have more than fifteen directors. However, by way of a proviso, the said section further provides that in the case of an inter-state cooperative society which is incorporated as a Producer Company, may have more than fifteen directors for a period of one year from the date of its incorporation as a Producer Company.

In view of the above provisions of the Companies Act, 1956 the proposal to have 18 directors by the Producer Company after its incorporation as such, is a valid proposition, but since it is incorporated on 1st May, 2008, it can have more than 15 directors for one year only from the date of its incorporation.

- (ii) According to the provisions of Section 581ZD(1) and (2) of the Companies Act, 1956, the shares of a member of a Producer Company shall not be transferable but a member of a Producer Company may after obtaining the previous approval of the Board, transfer the whole or part of his shares along with any special rights, to an active member at par value.

Based on the above provisions relating to the transfer of shares of a member in a Producer Company, Mr. Zameen has to obtain prior approval of the Board and then transfer his shares to an active member of the Producer Company at par value.

- (iii) As per provisions of Section 581ZJ of the Companies Act, 1956, any Producer Company may, upon recommendation of the Board and passing of resolution in the general meeting, issue bonus shares by capitalization of amounts from general reserves referred to in Section 581ZI in proportion to the shares held by the Members on the date of the issue of such shares.
- (iv) As per Producer Companies (General Reserves) Rules, 2003 issued by the Department of Company Affairs, Ministry of Finance, Government of India on 7th August, 2003, a producer company formed and registered under Section 581C of the Companies Act, 1956, shall make investments from and out of its general reserves in the following manner namely:
- (a) in approved securities, fixed deposits, units and bonds issued by the Central or State governments of cooperative societies or scheduled banks; or
 - (b) in a co-operative bank, State co-operative Bank, co-operative land development bank or Central co-operative bank; or
 - (c) with any other schedule bank; or
 - (d) in any of the securities specified in Section 20 of the Indian Trusts Act, 1882; or
 - (e) in the shares or securities of any other multi-State Co-operative society or any co-operative society; or
 - (f) in the shares, securities or assets of a public financial institutions specified under Section 4A of the Companies Act, 1956 specified.

Further, Section 581ZL of the Act provides that the general reserves of any producer company shall be invested to secure the highest returns available from approved securities. A producer company may, for promotion of its objectives acquire the shares

of another producer company. Again a producer company, either by itself or together with its subsidiaries may invest in the shares of any other company, other than a producer company for an amount not exceeding thirty per cent of the aggregate of its paid up capital and free reserves. Provided that a producer company may, by special resolution passed in its general meeting and with prior approval of the Central Government, invest in excess of the limits specified in the section. All investments by a producer company may be made if such investments are consistent with the objects of the producer company.

Question 8

A Producer Company wants to issue bonus shares. You are required to state the relevant provisions of the Companies Act, 1956 in this regard **(CA Final, New Course, May 2009)**

Answer

As per provisions of Section 581ZJ of the Companies Act, 1956, any Producer Company may, upon recommendation of the Board and passing of resolution in the general meeting, issue bonus shares by capitalization of amounts from general reserves referred to in Section 581ZI in proportion to the shares held by the Members on the date of the issue of such shares.

Question 9

A Producer Company has received applications from Mr.Ramanathan, a Director of the Company, and Mr.Prem, a member of the Company, for grant of loan of Rs.2,00,000 and Rs.25,000 respectively. Discuss the relevant provision of the Companies Act, 1956 as to how the applications for grant of loan will be disposed of by the Company. **(November 2009)**

Answer

Under Section 581ZK of the Companies Act, 1956, the Board of the Producer Company may, subject to the provision in the Articles of Association, provide financial assistance by way of loan and advances against such security as may be specified in its Articles of Association to any member repayable within a period exceeding three months but not exceeding seven years from the date of disbursement of such loan or advances. In the instant case, member has applied for loan of Rs.25,000. The period is not specified in the question. The Company may grant the member a loan of Rs.25,000 against such security and at such rate of interest as may be specified in the Articles. However, in the case of a director, loan of Rs.2 lakh can be granted only after its approval by the members in general meetin

COMPANIES INCORPORATED OUTSIDE INDIA (SECTIONS 591–608)

Provisions as to establishment of places of business in India

Applications of sections 592 to 602 to foreign companies (Section 591)

Question 1

Examine with reference to the provisions of the Companies Act, 1956 whether the following companies can be treated as foreign companies:

- (i) *A company incorporated outside India having a share registration office at Mumbai.*
 - (ii) *Indian citizens incorporated a company in Singapore for the purpose of carrying on business there.*
- (May, 2003)**

Answer

“Foreign company” as per Section 591 of the Companies Act 1956, means a company incorporated outside India but having a place of business in India. Accordingly, to qualify as ‘foreign company’ a company must have both the following features:

- (a) it should be a company incorporated outside India; and
- (b) it should have a place of business in India.

As to what amount to having a place of business in India, Section 602 (e) provides that the expression ‘place of business’ includes a share transfer or share registration office.

Thus a company incorporated outside India having a share registration office at Mumbai is a foreign company.

But, the company incorporated in Singapore for the purpose of carrying on business in Singapore is not a foreign Company. Its incorporation by Indian citizen is immaterial. In order to be a foreign company it has to have a place of business in India.

Question 2

- (i) *As per provisions of the Companies Act, 1956, what is the status of XYZ Ltd., a Company incorporated in London, U.K., which has a Share Transfer Office at Mumbai?*
- (ii) *ABC Ltd., a foreign company having its Indian principal place of business at Kolkata, West Bengal is required to deliver various documents to Registrar of Companies under*

the provisions of the Companies Act, 1956. You are required to state, where the said company should deliver such documents.

- (iii) *In case, a foreign company does not deliver its documents to the Registrar of Companies as required under Section 597 of the Companies Act, 1956, state the penalty prescribed under the said Act, which can be levied. (November, 2004)*

Answer

- (i) According to section 591 of the Companies Act, 1956, a company incorporated outside India and having a place of business in India is treated as a "Foreign Company". As per clause (c) of section 602 of the said Act, the expression 'place of business' includes a Share Transfer office. Thus, according to the provisions of the Companies Act, 1956, the status of XYZ Ltd. incorporated in London, U.K., which has a Share Transfer office in Mumbai, shall be that of a 'Foreign Company'.

According to section 597 of the Companies Act, 1956, any document which a foreign company is required to deliver to the Registrar of Companies shall be delivered to the Registrar having jurisdiction over New Delhi and also to the Registrar of the State in which the principal place of business of the foreign company is situate.

In light of the above provisions of the Companies Act, 1956, ABC Ltd. is required to deliver the requisite documents to the Registrar of Companies having jurisdiction over New Delhi and also to the Registrar of Companies, West Bengal.

Section 598 of the Companies Act, 1956 prescribes the penalty for non-compliance of the provisions of section 597 of the said Act. According to the provisions of the said section 598, the foreign company and its every officer or agent, who is in default, shall be punishable with a fine upto Rs.10,000/- and in case of continuing offence, additional fine upto Rs.1,000/- per day for the period during which the default continues.

Question 3

M/s Joel Ltd. was incorporated in London with a paid up capital of 10 million pounds. Mr. Y an Indian citizen holds 25% of the paid up capital. M/s. X Ltd. a company registered in India holds 30% of the paid up capital of Joel Ltd. M/s. Joel Ltd. has recently established a share transfer office at New Delhi. The company seeks your advice as to what formalities it should observe as a foreign company under Companies Act, 1956. State briefly the requirements relating to filing of accounts with the Registrar of Companies by the foreign company in respect of its global business as well as Indian business. (November 2007)

Answer

As per section 591 companies falling under the following two classes shall be known as foreign companies namely:

- (i) companies incorporated outside India which, after the commencement of this act, establish a place of business within India, and
- (ii) companies incorporated outside India which have, before the commencement of this act, established a place of business within India and continue to have an established place of business within India at the commencement of this act.

(2) notwithstanding anything contained in sub-section (1), where not less than fifty percent of the paid up share capital (whether equity or preference or partly equity and partly preference) of a company incorporated outside Indian and having an established place of business in India, is held by one or more citizens of Indian or by one or more bodies corporate incorporated in India, or by one or more citizens of Indian and one or more bodies corporate incorporated in India, whether singly or in the aggregate, such company shall comply with such of the provisions of this act as may be prescribed with regard to the business carried on by it in India, as if it were a company incorporated in India.

Here as more than 50% of the paid-up capital is held by Indian citizen and Indian company M/s Joel Ltd. shall be treated as Indian company. It shall have to comply with such provision of the act as may be prescribed as if it were a company incorporated in India.

Jeet Ltd. has to submit the following document with the registrar of companies with 30 days of establishment of business in India.

- (a) a certified copy of the charter, statutes, or memorandum and articles, of the company or other instrument constituting or defining the constitution of the company; and, if the instrument is not in the English language, a certified translation thereof.
- (b) the full address of the registered or principal office of the company;
- (c) a list of the directors and secretary of the company, containing the particulars mentioned in sub-section (2).
- (d) the name and address or the names and addresses of the some one or more persons resident in India, authorized to accept on behalf of the company service of process and any notices or other documents required to be served on the company; and
- (e) the full address of the office of the company in India which is t be deemed its principal place of business in India.

Question 4

Ashes Ltd is a company incorporated outside India. 50% of its preference share capital and 20% of its equity share capital is held by companies incorporated in India. It issued prospectus inviting subscriptions in India for its shares but did not state the country in which it is incorporated.

Examine

- (i) *Is the prospectus of the company valid?*
- (ii) *What is none of the shares (preference and equity) were held by Companies Incorporated in India?*
- (iii) *What other disclosures and required to be made by a Foreign Company?*

(November 2008)

Answer

Section 591(2) of the Companies Act, 1956, provides that where not less than fifty per cent of the paid up share capital (whether equity or preference or partly equity and partly preference) of a company incorporated outside India and having an established place of business in India, is held by one or more citizens of India or by one or more bodies corporate incorporated in India, or by one or more citizens of India and one or more bodies corporate incorporated in India, whether singly or in the aggregate, such company shall comply with such of the provisions of this Act as may be prescribed with regard to the business carried on by it in India, as if it were a company incorporated in India.

- (i) As 50% of the preference share capital and 20% of the equity share capital of Ashes Ltd. is held by companies incorporated in India, it shall be treated as if it were a company incorporated in India. As such it is not necessary for Ashes Ltd. to comply with the provisions relating to foreign companies. So the prospectus of the company shall be valid.
- (ii) If none of the shares (preference and equity) were held by companies incorporated in India, Ashes Ltd. would be a foreign company within the meaning of Section 591 of the Act. Section 595 of the Act provides that every foreign company shall in every prospectus inviting subscriptions in India for its shares or debentures, state the country in which the company is incorporated. As Ashes Ltd. did not mention the name of the country in which it is incorporated, the prospectus shall not be valid.
- (iii) Section 595 of the Act provides for the following additional disclosures to be made by a foreign company:
 - (a) conspicuously exhibit on the outside of every office or place where it carries on business in India, the name of the company and the country in which it is incorporated, in letters easily legible in English characters, and also in the characters of the language or one of the languages in general use in the locality in which the office or place is situated;
 - (b) cause the name of the company and of the country in which the company is incorporated, to be stated in legible English characters in all business letters, bill

heads and letter paper, and in all notices, and other official publications of the company; and

- (c) If the liability of the members of the company is limited, cause notice of the fact-
- *to be stated in every such prospectus as aforesaid and in all business letters, bill heads, letter paper, notices, advertisements and other official publications of the company, in legible English characters; and*
 - *to be conspicuously exhibited on the outside of every office or place where it carries on business in India, in legible English characters and also in legible characters of the languages or one of the language in general use in the locality in which the office or place is situated.*

Documents, etc to be delivered to Registrar by for eign companies carrying on business in India (Section 592)

Question 5

A company incorporated in Singapore has established its place of business at Chennai. State the documents which are required to be furnished on such establishment of business in India under the Companies Act, 1956 and the authorities to whom such documents are to be furnished.

(CA Final, New Course, May, 2009)

Answer

Foreign Company: A foreign company has to furnish to the Registrar of Companies the following documents within 30 days of the establishment of the place of business in India (Section 592 of the Companies Act, 1956).

- (i) Certified copy of charter, statute or memorandum and articles of the company or other instruments deferring the constitution of the company. If it is not in English Language its certified translation should be submitted.
- (ii) Full address of the registered or principal office of the company.
- (iii) List of directors and Secretary giving details like present and former name and surname, his usual residential address, nationality, business occupation etc.
- (iv) The names and address of one or more persons resident in India authorized to accept on behalf of the company, service of process and any notices or other documents required to be served on the company.
- (v) The full address of the office of the company in India which is deemed to be its principal place of business in India.

The aforesaid documents shall be required to be filed at two places first with the Registrar of the state where principal place of business (Chennai) is situated i.e. Registrar of Tamil Nadu in this case and second with the Registrar of New Delhi (Section 597).

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Question 6

Considering the provisions of the Companies Act, 1956, advise a foreign company on filing of World Accounts' and the 'Indian Business Accounts' with the Registrar of Companies in India?

Answer

Filing of World Accounts and Indian Business Accounts with the Registrar of Companies:

World Accounts: Three copies of balance-sheet and profit and loss account, including documents relating to every subsidiary of the foreign company, in such form, containing such particulars and including such documents as required under the provisions of the Companies Act, 1956, are required to be filed with the Registrar of Companies. However, the Central Govt., may exempt any foreign company from this requirement by notification in the official gazette.

The World accounts shall be delivered to the Registrars within a period of 9 months from the close of the financial year of the foreign company. The Registrar at New Delhi may extend the said period by 3 months, vide Rule ISA of Companies (Central Government's) General Rules and Forms, 1957.

Indian Business Accounts: Three copies of balance-sheet and profit and loss accounts of Indian business accounts of a foreign company duly audited by a practising Chartered Accountant in India, in the form prescribed in Schedule VI (as modified in terms of Notification, dated 4-10-1957 and 6-1-1959) shall be filed with the Registrar within 9 months of the close of the financial year. The Registrar at New Delhi may extend this period by 3 months. The accounts shall be audited by such person and in such manner as provided in Section 226 and 227 (as modified in terms of the notifications cited above).

The aforesaid accounts have to be filed with the Principal Registrar (i.e., Registrar of Companies, New Delhi) and the concerned Registrar having jurisdiction over the principal place of business of the foreign company (Section 597).

It may be pointed out that the Indian accounts have to be drawn up in Indian rupees as per the requirements of Schedule VI.

The profit and loss account of the Indian business in respect of a foreign company which, if not incorporated under this Act would be deemed to be a private company, shall not be open for inspection by any person other than a member of the company.

Section 594 provides for the requirements of accounts of foreign company. As per this section

- (1) Every foreign company shall, in every calendar year –
 - (a) make out a balance sheet and profit and loss account in such form containing such particulars and including or having annexed or attached thereto such documents (including, in particular documents relating to every subsidiary of the foreign company) as under the provisions of this act it would, if it had been a

company within the meaning of this act, have been required to make out and lay before the company in general meeting; and

- (b) deliver three copies of those documents to the registrar;

Provided that the Central Government may, by notification in the official gazette, direct that, in the case of any foreign company or class of foreign companies the requirements of clause (a) shall not apply, or shall apply subject to such exceptions and modifications as may be specified in the notification.

- (2) If any such document as is mentioned in sub-section (1) is not in the English language, there shall be annexed to it a certified translation thereof.
- (3) Every foreign company shall send to the registrar with the documents required to be delivered to him under sub-section (1), three copies of a list in the prescribed form of all places of business established by the company in India as at the date with reference to which the balance sheet referred to in sub-section (1) is made out.

Prospectuses

Dating of prospectus and particulars to be contained therein (Section 603)

Question 7

Under Section 603 of the Companies Act, 1956, what are particulars required for incorporating a prospectus to be issued by an existing foreign company?

Answer

Under Section 603, (Companies Act, 1956), the prospectus to be issued by an existing or intended Foreign Company in India must be dated and contain the following particulars:

- (a) the instrument constituting or defining the constitution of the company;
- (b) the enactment's or provisions under which the company was incorporated;
- (c) the address of the place in India where the said instrument, enactments etc. translation thereof in English if they are in some other foreign language, can be inspected;
- (d) the date on which and the country in which the company was incorporated; and
- (e) whether there is a place of business in India and if so, the address of its principal office.

The provision contained in (a), (b) and (c) above, shall not be applicable if the prospectus is issued more than 2 years after the company had become entitled to commence business.

The prospectus of Foreign Company must contain the matters laid down in Part-I of the Schedule II and set out the report specified in Part II of the Schedule subject always to the provisions of Part-III of the Schedule.

LEGAL PROCEEDINGS (SECTIONS 632 – 635AA)

Power of Court to grant relief in certain cases (Section 633)

Question 1

Gulmohar Ltd., a company registered under Indian law owns a factory' in Calcutta, wherein it manufactures jute products. By a notification of the State Government, issued during October, 2002, due to a strike and lock-out, it was declared a relief undertaking. After four months, in February, 2003, the lock-out was lifted. However, during the said period the company's directors defaulted in payment of Provident Fund (PF) and other ancillary dues. During the month of December, 2002, the Regional PF Commissioner initiated criminal proceedings against the company and its directors under the Employees PF and Miscellaneous Provisions Act, 1952, for default and delay in payment of PF dues.

Immediately the directors of the company applied to the High Court for relief under Section 633 of the Companies Act, 1956, praying for relief from liable under the PF law. 77th petition is now pending before a single judge. The company desire to know from you, as to the tenability of their claim for relief at the High Court, and as to whether they would be excused and exonerated by the High Court, in respect of the contraventions committed under the PF law.

Briefly discuss the law on the subject and state whether the petition filed by the directors would be admitted or not under the Companies Act.

Answer

The crux of the matter involved in the above case, is whether the words “any proceeding” against an officer of a company, would mean only a proceeding under the Companies Act or any Criminal proceeding under any other law. The provisions of the Companies Act, define “officer” and “officer in default” but there is no definition for the word “proceeding”. In the present case, the proceeding has not resulted from or has not been brought about as a consequence of default, refusal, contravention, non-compliance or failure under the Companies Act, 1956, but has come about as a result of certain acts and omissions committed by the directors of the company Gulmohar Ltd., under the Employees PF and Misc. Provisions Act, 1952. The Court has powers under Section 633 to grant relief only to a director/officer of a company, and not to the company. But the significance of the words “in any proceeding” employed in Section 633(1) require to be understood.

The facts of the case, bear resemblance to those which came up before their Lordships of the Supreme court in *Rabindra Chamarla and Others Vs Registrar of Companies, West Bengal and others*, 1992 (73) Comp. Cas. 257 (SC).

Going by the tenor of section 633 of the Companies Act, 1956 and the Supreme Court ruling the directors of Gulmohar Ltd., cannot avail of relief under Section 633 of the Companies Act, 1956 and their Petition is not likely to succeed. It is liable to be dismissed.

APPLICATION OF SECRETARIAL PROCEDURES AND PRACTICES

Question 1

Explain the procedure for passing the resolution by Circulation under Section 289 of the Companies Act, 1956. (November, 2000)

Answer

The procedure for passing resolution by circulation as under section 269 of the Companies Act, 1956 are as follows:

- (a) Circulate the draft of the resolution in duplicate with all necessary papers if any, to all the directors then in India not being less in number than the quorum for a board meeting and to all other directors at their usual addresses in India for approval by signing one copy of the resolution and send it back to the company.
- (b) If all are majority of the above directors as are entitled to vote on the resolution approve the resolution, the resolution shall deemed to have been duly passed by the Board.
- (c) Record the resolution having been passed by circulation in the minutes of the immediate next Board meeting.
- (d) See that the resolution do not pertain to the matters which cannot be passed by the Board by circulation (i.e. Sections 262(1), 292, 297, 299, 307 etc.
- (e) Enclose a copy of the circular resolution to the Agenda of the ensuing immediately next Board meeting.

Question 2

Under Section 603 of the Companies Act, 1956, what are the particulars required for incorporating in a prospectus to be issued by an exiting Foreign Company? (November 2000)

Answer

Under Section 603, Companies Act, 1956, the prospectus to be issued by an existing or intended Foreign Company in India must be dated and contain the following particulars:

- (a) the instrument constituting or defining the constitution of the company;
- (b) the enactment's or provisions under which the company was incorporated;

- (c) the address of the place in India where the said instrument, enactments etc translation thereof in English if they are in some other Foreign language, can be inspected;
- (d) the date on which and the country in which the company was incorporated; and
- (e) whether there is a place of business in India and if so, the address of its principal office.

The provision contained in (a), (b) and (c) above, shall not be applicable if the prospectus is issued more than 2 years after the company had become entitled to commence business.

The prospectus of Foreign company must contain the matters laid down in specified in part-II of the schedule subject always to the provisions of Part-III of the schedule.

Question 3

Explain briefly the salient points to be taken into account while drafting the minutes of the Board of Directors. Draft a specimen Board resolution regarding the appointment of Mr. Sincere as the Managing Director of Full Cure Pharma Ltd. (May, 2001)

Answer

While drafting the minutes of the Board of directors, the following points have to be kept in mind.

- (i) The minutes may be drafted in a tabular form or in the form of a series of paragraphs numbered consecutively and with relevant headings.
- (ii) The place, date and time of the meeting should be stated.
- (iii) The names of the persons present at the meeting should be stated.
- (iv) Contents of the meeting giving serial number of the minute, brief subject heading, full terms of the resolutions adopted including the statistical details etc.
- (v) Names of directors dissenting or not concurring with any resolution passed.
- (vi) Reference about interested directors abstaining from voting is necessary.
- (vii) Chairman's signature and date of verification of minutes as correct.

Specimen board resolution: *"Resolved that Shri Sincere who fulfills the conditions specified in Parts I and II of schedule XIII to the Companies Act, 1956 be and is hereby appointed as the Managing Director of the company for a period of 5 years effective from 1.4.2001 and that he may be paid remuneration by way of salary, commission and perquisites in accordance with Part II of Schedule XIII of the Act.*

Resolved further that the Secretary of the company be and is hereby directed to file the necessary returns with the Registrar of Companies and to do all acts and things as may be necessary in this connection."

Question 4

Some of the small shareholders of M/s Progressive Industries Ltd. approach you for advice regarding appointment of one of them as a director of the company. Explain the meaning of a small shareholder and the legal position regarding appointment of a director by such small shareholders. (November 2001)

Answer

According to Section 252 of the Companies Act, 1956 as amended, every public company having a paid up capital of Rs.5 cores or more and 1000 or more small shareholders may have a director elected by such small shareholders in the manner as may be prescribed. For this purpose, a small shareholder means a shareholder holding shares of nominal value of Rs.20,000 or less in a public company. If the paid up capital of M/s Progressive Industries Ltd., is more than Rs.5 crores and the Company has 1000 or more small share holders, then the small share holders can proceed to elect their nominee as a director. The appointment is to be made in accordance with Companies (Appointment of small shareholders-Director) Rules, 2001.

Question 5

M/s A to Z Technologies Ltd. has been wound up and the official liquidator has been asked to take charge of the company. Briefly explain the relevant provisions regarding filing of statement of affairs in relation to the company in liquidation. (May, 2002)

Answer

According to section 454 of the Companies Act, 1956 where the Court has made a winding up order or the Official Liquidator has been appointed a provisional liquidator, a statement as regards the affairs of the company in the prescribed Form No. 57 shall be filed with the Official Liquidator. The said statement should be verified by an affidavit and contain particulars of (i) the assets of the company stating separately the cash balance in hand and at bank (ii) its debts and liabilities (ii) the details of creditors including their names, residence, occupations and amounts due to them as secured and unsecured (iv) the details of debtors including the particulars of securities and their values, the names and particulars of debtors (with estimated amount to be realised) and (v) such further or other information as may be prescribed or required by the Official Liquidator. The said statement is required to be verified by one or more directors at the time of passing the winding up order by the court. Further the said statement is required to be submitted within 21 days of the winding up order or within such extended time not exceeding three months as may be fixed by the Official Liquidator or the court for special reasons.

Question 6

The Board Meeting of M/s ABC Company Ltd. was adjourned for want of Quorum. Advise the

procedure now to be followed and also whether a resolution can be passed by circulation. If so, how?

(November 2002)

Answer

Quorum and Resolution by circulation: For the conduct of business in the Board Meeting quorum is required. The Board Meeting of M/s. ABC Company Ltd. is adjourned for want of quorum. Section 288 of the Companies Act, 1956 provides the procedure when a Board Meeting is adjourned for want of quorum. Thus, under section 288 of the Act, following procedure is applicable:

1. If a Board Meeting could not be held for want of quorum, then, unless the articles otherwise provide, the meeting shall automatically stand adjourned till the same day in the next week, at the same time and place, or if that day, is a public holiday, till the next succeeding day which is not a public holiday, at the same time and place.
2. The provisions of Section 285 shall not be deemed to have been contravened merely by reason of the fact that a meeting of the Board which had been called in compliance with the terms of that provision, could not be held for want of quorum.

When the question of passing resolution by circulation arises, the provisions of section 289 of the Companies Act, 1956 are applicable. For the passing of the circular resolution following conditions must be complied with:

1. The draft resolution, together with supporting papers has been circulated, to all the directors or members of the committee of the board thereof, then in India, not being less in number than the quorum fixed for a meeting of the Board or Committee, as the case may be.
2. to all the directors of the Board or member of the committee who are not in India, at their usual address in India, and
3. the same has been approved by such of the directors then in India, or by a majority of them, who are entitled to vote on the resolution.

Question 7

Explain the circumstances under which a Director retiring at an annual general meeting shall be deemed to have been re-appointed even though no such appointment has been made.

(May, 2003)

Answer

Section 256 of the Companies Act, 1956 deals with deemed re-appointment of a retiring director. The vacancies caused by the retirement of a director by rotation should be filled up at the same meeting or at an adjourned meeting. If it is not so done, the retiring director shall be deemed to have been re-appointed at such adjourned meeting except in the following cases:-

1. at any previous meeting, a resolution for his re-appointment was put to vote but was lost, or
2. the retiring director has, in writing expressed his unwillingness to continue or
3. he is not qualified or is disqualified for appointment, or
4. a special or ordinary resolution is necessary for his appointment by virtue of any provisions of the Companies Act; or
5. it is resolved to appoint two or more directors by a single resolution {Section 263(2) Proviso}; or
6. it is resolved not to fill the vacancy.

Question 8

Examine whether the following transactions are permissible under Foreign Exchange Management Act, 1999:

- (i) *Payment of remuneration to foreign technician.*
- (ii) *Remittance of dividend to non-residents.*

State also the procedure to be followed with regard to payment of dividend to non-residents.

(November 2003)

Answer

Foreign Technician: Salary payable to a foreign technician is a current account transaction. According to Section 5 of Foreign Exchange Management Act, 1999, any person can sell or draw foreign exchange to or from authorised person if such sale or drawal is a current account transaction and reasonable restrictions on current account transaction can be imposed by the Central Government in public interest, in consultation with RBI. Hence, basically all current account transactions are free, unless specifically restricted by the Central Government. Hiring of foreign nationals as technician is permissible without any restrictions. There is no ceiling on salary, which can be paid as per contract. Their salary can be remitted abroad, after tax deducted at source.

Remittance of dividend: Since remittances of dividend on investment are current account transactions, these are permitted without restrictions, if the shares were issued as per guidelines/regulations/permission. Dividend is restricted only when permission for issue of shares to non-residents was granted with condition for dividend balancing.

Procedure for remittance of dividend to non-residents: The procedure involved is briefly as follows:

1. **Application in Form A2** - Application should be submitted in Form A2 to authorised dealers. It should be accompanied by (a) List of non-resident shareholders (b) dividend

to be remitted - the amount will be payable in Indian Rupees and payment will be made to payee in foreign exchange at current exchange rate.

2. **Supporting documents:** Application should be accompanied by copies of supporting documents to establish that the issue of shares was permissible as per regulations/specific approval was obtained as required. Copy of resolution in general meeting/Board meeting approving dividend/interim dividend should be submitted.
3. **Certificates:** Certificate from Chartered Accountant, practicing Company Secretary in respect of amount payable and details of calculation should be submitted. A certificate from Chartered Accountant that tax has been properly deducted at source should be submitted.

Remittance of dividend:- The dividend may be remitted through normal banking channels. If shareholder has issued instructions, the amount can be credited to NRE/FCNR account of NRI.

Question 9

An existing society seeks your advice as to its eligibility to be registered as a 'Producer Company' under the Companies Act, 1956 and the procedure to be followed for such registration. Advise explaining the relevant provisions of the Companies Act, 1956.

(November 2003)

Answer

Producer Company: Any existing inter-state co-operative society with objects not confined to one State may make an application to the Registrar of Companies for registration as 'Producer Company' under the Companies Act, 1956. The conversion is purely optional (Section 581J(1)).

'Inter-State Co-operative Society' means a 'Multi-State Co-operative Society' within the meaning of Multi-State Co-operative Societies Act, 2002 and includes any co-operative society registered under any other law for the time being in force which has, subsequent to its formation, excluded any of its objects to more than one State by enlisting the participation of persons or by extending any of its activities outside the State, whether directly or indirectly through an institution of which it is a constituent [Section 581A(e)]. Hence a co-operative society registered under Multi-state Co-operative Societies Act, 2002 or any other State Act with objects not confined to one State may opt for conversion into a 'producer company' under Companies Act, 1956.

The application to the Registrar of companies must be accompanied by the following:

- (1) A copy of the special resolution of not less than two-third of total members of inter-state co-operative society, for its incorporation as a producer company under the Companies Act.
- (2) A statement showing the names and addresses or the occupation of the directors and Chief Executive.
- (3) A statement showing the list of members.
- (4) A statement indicating that the Inter-State Co-operative Society is engaged in one or more of the objectives specified in Section 581B.
- (5) A declaration by two or more directors of the Inter-State Co-operative Society (certifying that the particulars given in the above statements are correct. [Section 581J(2)].

When an Inter-State Co-operative Society is registered as a 'producer company', the words 'Producer Company Limited' shall form part of its name with any word or expression to show its identity preceding it [Section 581J(3)].

On completion of all formalities, the Registrar of Companies shall register and incorporate such society to be a 'Producer Company' under Part IXA of the Companies Act, 1956 (Section 581J (4)).

Upon registration as a Producer Company, the Registrar of Companies shall forthwith intimate the Registrar with whom the erstwhile Inter-State Co-operative Society was earlier registered for appropriate deletion from its register [Section 581J(7)].

Question 10

Draft a resolution proposed to be passed at a General Meeting of a Public Company giving consent to the Board of Directors for borrowing upto a specified amount in excess of the limits laid down under Section 293(1)(d) of the Companies Act, 1956 and also state the borrowings, which are to be excluded from the said limits. **(May, 2004)**

Answer

Draft of ordinary resolution under Section 293(1)(d)

Resolved that the company hereby consents to the Board of Directors borrowing monies not exceeding Rs.....(Rupees.....) in excess of the aggregate of the paid-up capital of the company and its free reserves, that is to say reserves not set apart for any specific purpose, as provided in Section 293(1)(d) of the Companies Act, 1956, and in addition to any temporary loans obtained from the company's bankers in the ordinary course of business.

Borrowings

Section 293(1)(d) does not apply to the borrowing by a company by way of temporary loans

obtained from the company's bankers in the ordinary course of business. Therefore, in calculating the limits stipulated in this provision, temporary loans obtained from the company's bankers in the ordinary course of business shall be excluded.

The expression 'temporary loans' in i.e. (d) means loans repayable on demand or within six months from the date of the loan such as short term cash credit arrangements, the discounting of bills and the issue of other short term loans of a seasonal character, but does not include loans raised for the purpose of financing expenditure of capital nature [Explanation II to Section 293(1)].

Question 11

ABC Engineering Limited proposes to invest Rs.20 lakhs in the Equity shares of PQR Trading Limited. The proposed investment together with the investments in securities of companies and loans to body corporates already made exceed 60 per cent of the paid-up share capital and also 100 per cent of free reserves of the company. The company has taken term loans from IDBI.

Explain the procedure to be followed by ABC Engineering Limited to give effect to the proposed investment.
(May, 2004)

Answer

Investment in Shares: The proposed investment together with the investments, loans already made exceed 60% of the paid-up share capital of the company and also 100% of the free reserves. Hence, the proposed investment must be approved by a special resolution passed in a general meeting [Proviso to Section 372A (i)].

The Board of Directors must convene a general meeting for the purpose of passing a specific special resolution authorizing the proposed investment. The special resolution should specify:

- (a) The limit upto which Board is to be authorized to make investment;
- (b) Particulars of the body corporate in which the investment is proposed to be made;
- (c) The purpose of the proposed investment;
- (d) The source of funds to be invested; and
- (e) Other relevant details (3rd proviso to Section 372A(1)).

The special resolution passed at the general meeting will be filed with the Registrar of Companies.

As the total amount of inter-corporate investments, loans, etc. exceeds 60% of the paid-up share capital prior approval of public financial institution i.e. IDBI must be taken [Section 372A(2)].

Board meeting must be convened and the proposed investment must be sanctioned by a resolution passed with the consent of all the directors present at the Board meeting (Section 372A(2)).

The following particulars must be entered in the 'Register of Investments, Loans, Guarantees and Securities pursuant to Section 372A:

- (a) Name of the body corporate on which the investment is made.
- (b) Amount invested.
- (c) Type and nature of securities in which investment is made.
- (d) Main terms of the issue of the securities.
- (e) The date on which the investment is made.

Particulars must be entered in the register in respect of each investment chronologically within 7 days of the making of the investment. [Section 372A(5)].

The register must be kept at the registered office of the company. Any member of the company can inspect the register. [Section 372A(6)].

Question 12

Answer any **one** of the following:

- (i) *Board of Directors of DBM Limited held a board meeting on 2nd May, 2008 at its registered office. You are required to state the salient points to be taken into account while drafting the minutes of the said board meeting.*
- (ii) *Draft a board resolution for appointment of Mr. Paul as the managing director for 5 years with effect from 1st June, 2008 of DBM Limited passed in the above stated board meeting.* **(May 2008)**

Answer

- (i) While drafting the minutes of a board meeting following salient points should be kept in mind:
 - (a) the minutes may be drafted in a tabular form or they may be drafted in the form of a series of paragraphs, numbered consecutively and with relevant headings.
 - (b) the place, date and time of the meeting should be stated.
 - (c) the minutes should contain the constitution of the meeting, i.e., persons present and the capacity in which present, e.g. name of the person chairing the meeting, names of the directors and secretary, identifying them as director or secretary, names of persons in attendance like auditor, internal auditor etc. The minutes

should also contain the subject of leave of absence granted, if any, to any of the board members.

- (d) content of the meeting giving serial number of the minute, brief subject heading, full terms of the resolution adopted including the statistical details, if any.
 - (e) names of the directors dissenting or not concurring with any resolution passed at the board meeting.
 - (f) reference about interested directors abstaining from voting is also required to be stated in the minutes.
 - (g) Chairman's signature and date of verification of minutes as correct.
- (ii) Resolution passed at the meeting of board of directors of DBM Limited held at its registered office situated at on 2nd May, 2008 at AM.

"RESOLVED that subject to the approval by the shareholders in a general meeting and pursuant to provisions of Sections 198, 309, 310, Schedule XIII and other applicable provisions of the Companies Act, 1956, Mr. Paul be and is hereby appointed as the Managing Director of the Company with effect from 1st June, 2008 for a period of five years on a remuneration approved by the Remuneration Committee as enumerated below:

- (1) Salary: Rs. per month
- (2) Perquisites, Benefits and Facilities

"RESOLVED FURTHER that Mr. Paul, so long as he functions as the Managing Director of the Company shall not be entitled to any sitting fee for attending any meeting of the board of directors or any committee thereof and that he shall not be liable to retire by rotation."

"RESOLVED FURTHER that Mr. Paul till he holds the office of Managing Director of the Company shall not become interested or concerned in any selling agency directly or through his wife or minor children in future without prior approval of the Central Government."

"RESOLVED FURTHER that Mr. Paul, the Chairman, as well as the Company shall have right to terminate the appointment by giving 3 (three) months' notice in writing."

"RESOLVED FURTHER that the Secretary of the company be and is hereby directed and authorized to file necessary returns with the Registrar of Companies and to do all other necessary things required under the provisions of the Companies Act, 1956."

Question 13

Mr. Shrikant is working as Chief accountant in Black marbles Limited. The Board of Directors of the said company propose to charge him with the duty of ensuring compliance with the provisions of the Companies Act, 1956 so that books of account can be properly maintained and Balance sheet and Profit and loss Account can be prepared as per the provisions of law.

Draft a “Board Resolution” for the said purpose.

Also point out the consequences in case of default, when such a resolution is passed.

(June 2009)

Answer

DRAFT BOARD RESOLUTION:

“Resolved that pursuant to Sections 209 (7) and 211 (8) of the Companies Act, 1956 Mr. Shrikant, Chief Accountant of the company be and is hereby charged with the duty of seeing that the requirements of Sections 209 and 211 of the Companies Act, 1956 are duly and fully complied with.

Resolved further that Mr. Shrikant is hereby entrusted with the authority to do such acts, things and deeds as may be necessary or expedient for the purpose of compliance with the requirements of the said sections 209 and 211 of the said Act.”

Consequences in case of default

According to Section 209 (6) of the companies Act, 1956 the following persons are responsible to ensure that the company duly complies with the provisions of section 209:

1. The managing Director or manager of the company, if any;
2. All officers and other employees of the company or.
3. If the company has no managing director, every director of the company.

Penalty for default is imprisonment up to six months or fine up to Rs.10,000/- if the persons mentioned above fail to take all reasonable steps to ensure that the provisions of Section 209 are duly complied with by the company or default has been committed by their own willful act. The punishment by way of imprisonment shall not be imposed unless the default was committed willfully [Section 209(5)].

In any penal proceedings, it shall be a defence to prove that a competent and reliable person was charged with the duty of seeing that these requirements are complied with and that he was in a position to discharge that duty. Thus, the above Board resolution makes the chief accountant responsible for compliance with the provisions of sections 209 and 211 of the Companies Act, 1956.

Question 14

Draft a board resolution for appointment of Mr. Paul as the Managing Director for 5 years with effect from 1st July, 2009 of DBM Limited passed in the board meeting of the said company held on 6th June, 2009.

(CA Final, New Course, June 2009)

Answer

Resolution passed at the meeting of Board of Directors of DBM Limited held at its registered office at on 6th June, 2009 at A.M.

“Resolved that subject to the approval by the shareholders in a general meeting and pursuant to provisions of Sections 198, 309, 310, schedule XIII and other applicable provisions of the Companies Act, 1956, Mr. Paul be and is hereby appointed as the Managing Director of the Company with effect from 1st July, 2009 for a period of five years on a remuneration approved by the Remuneration committee as enumerated below:

1. Salary: Rs _____ per month.
2. Perquisites, Benefits & Facilities:

Resolved Further that Mr. Paul, so long as he functions as the Managing Director of the Company, shall not be entitled to any sitting free for attending any meeting of the Board of Directors or any Committee thereof and that he shall not be liable to retire by rotation.

Resolved Further that Mr. Paul, till he holds the office of Managing Director of the Company, shall not become interested or concerned in any selling agency directly or through his wife or minor children in future without prior approval of the Central Government.

Resolved Further that Mr. Paul, the Chairman, as well as the company shall have right to terminate the appointment by giving 3 (three) months' notice in writing.

Resolved Further that the Secretary of the company be and is hereby directed and authorized to electronically file necessary returns with the Registrar of Companies by putting his digital signature and to do all other necessary things required under the provisions of the Companies Act, 1956”

Question 15

Draft a board resolution for appointment of Mr. Paul as the Managing Director for 5 years with effect from 1st July, 2009 of DBM Limited passed in the board meeting of the said company held on 6th June, 2009.
(CA Final, New Course, June 2009)

Answer

Resolution passed at the meeting of Board of Directors of DBM Limited held at its registered office at on 6th June, 2009 at A.M.

“RESOLVED that subject to the approval by the shareholders in a general meeting and pursuant to provisions of Sections 198, 309, 310, schedule XIII and other applicable provisions of the Companies Act, 1956, Mr. Paul be and is hereby appointed as the Managing Director of the Company with effect from 1st July, 2009 for a period of five years on a remuneration approved by the Remuneration committee as enumerated below:

1. Salary: Rs _____ per month.

2. Perquisites, Benefits & Facilities:

RESOLVED FURTHER that Mr. Paul, so long as he functions as the Managing Director of the Company, shall not be entitled to any sitting free for attending any meeting of the Board of Directors or any Committee thereof and that he shall not be liable to retire by rotation.

RESOLVED FURTHER that Mr. Paul, till he holds the office of Managing Director of the Company, shall not become interested or concerned in any selling agency directly or through his wife or minor children in future without prior approval of the Central Government.

RESOLVED FURTHER that Mr. Paul, the Chairman, as well as the company shall have right to terminate the appointment by giving 3 (three) months' notice in writing.

RESOLVED FURTHER that the Secretary of the company be and is hereby directed and authorized to electronically file necessary returns with the Registrar of Companies by putting his digital signature and to do all other necessary things required under the provisions of the Companies Act, 1956."

Question 16

DVJ Limited decide to appoint Mr. A, as its Managing Director for a period of 5 years with effect from 1st May, 2010. A, fulfils all the conditions as specified in Part I and Part II of Schedule XIII of the Companies Act, 1956.

The terms of appointment are as under:

- (i) Salary Rs. 1 lac per month.*
- (ii) Commission, as may be decided by the Board of Directors of the Company.*
- (iii) Perquisites :*

Free Housing

Medical reimbursement upto Rs. 10,000 per month.

Leave Travel concession for the family.

Club Membership Fee.

Personal Accident Insurance Rs. 10 lacs.

Gratuity; and

Provident Fund as per company's policy.

You, being the Secretary of the company, are required to draft a resolution to give effect to the above, assuming that A is already the Managing Director of a public limited company.

(May, 2010)

Answer

- I. “Resolved that Mr. A who fullfills the conditions specified in Parts I and Part II of Schedule XIII to the Companies Act, 1956 be and is hereby appointed as the Managing Director/Whole-time Director/Manager of the company for a period of five years effective from and that he may be paid remuneration by way of salary, commission and perquisites in accordance with Part II of Schedule XIII of the Act, subject to approval of the Central Government.

Resolved further that in the event of loss or inadequacy of profits the salary payable to him shall be subject to the limits specified in Schedule XIII”.

- II. “Resolved that Mr. A be and is hereby appointed as Managing Director/Whole-time Director/Manager of the company subject to the approval of the Central Government for a period of five years effective from And that he may be paid remuneration as follows:

(i) Salary

(ii) Commission

(iii) Perquisites: Housing, Medical reimbursement, Leave Travel Concession, Club fee, Personal Accident Insurance, Gratuity, Provident Fund etc.

Resolved further that the Secretary of the company be and is hereby authorized to make an application to the Central Government seeking their approval to the above appointment.

Sd/ Board of Directors

DVJ Ltd.