5 MEETINGS AND RESOLUTIONS

Objects

The corporate system of business organisation is essentially democratic in structure. The business of the Company is carried on by officials acting under the orders of the Board of Directors, which is the executive head of the Company. But the directors are elected to the Board by the shareholders of the Company and must abide by the wishes of the shareholders as expressed in resolutions passed in meetings convened for the purpose. The shareholders are, subject to the provisions of the Memorandum and the Articles, the final authority as regards the affairs of the Company. The shareholders cannot interfere in the day to day administration of the Company but they can elect Directors who will carry on the administration in the manner desired by them. Also, there are many matters which are beyond the powers of the Board of Directors to decide and which must be placed before the shareholders for decision. Meetings of shareholders are held for this purpose and the decisions of the shareholders are expressed in the form of resolutions.

Meetings

The Companies Act provides for the following types of meetings :

A. Meetings of the shareholders : (1) Statutory Meeting (2) Annual General Meeting (3) Extra-ordinary General Meeting (4) Class Meetings. Under certain circumstances the Court can order certain meetings.

B. Other Meetings : (1) Meetings of the creditors (2) Meetings of the debenture holders.

C. Meetings of directors.

STATUTORY MEETING

Every public company limited by shares and every company limited by guarantee and having a share capital, must within a period of not less than one month and not more than six months from the date at which the company is entitled to commence

business, hold a general meeting of members which is to be called, the Statutory Meeting. In this meeting the members are to discuss a report by directors, known as the Statutory Report, which contains particulars relating to the formation of the Company.—Sec. 165(1).

STATUTORY REPORT

This is a report drafted by directors and certified as correct by at least two of them (including the managing director, where there is one). A copy of the report must be sent to every member, at least 21 days before the date of the meeting. A copy is also to be sent to the Registrar for registration. Section 165(3) provides that the Statutory Report must contain the following particulars :

(*a*) the total number of fully paid up and partly paid up shares allotted ;

(*b*) the total amount of cash received by the company in respect of the shares ;

(*c*) an abstract of the receipts, classifying them according to source and mentioning the expenses incurred for commission, brokerage etc. ;

(*d*) the name, address and occupations of directors, auditors, manager and secretary and changes of the names, addresses etc. ;

(*e*) particulars of contracts which are to be submitted to the meeting for approval, with proposed modifications, if any ;

(*f*) if any underwriting contracts have not been carried out, the reasons therefor ;

(*g*) the arrears due on calls from directors and others ;

(*h*) particulars of commissions and brokerages paid to directors and managers.

Particulars as regards cash in the statutory report are to be certified as correct by the auditors of the Company.

The members of the company who are present in the Statutory Meeting are at liberty to discuss any matter relating to the formation of the company or arising out of the Statutory Report, whether previous notice has been given or not. But no resolution can be passed of which notice has not been given in accordance with the provisions of the Act.

If default is made in complying with the provisions of Section 165, every director or other officer of the company who is in default shall be punishable with fine which may extend to Rs. 500.

ANNUAL GENERAL MEETING

General Meeting of a company means a meeting of its members for specified purposes. There are two kinds of General Meetings, (*i*) the Annual General Meeting and (*ii*) other General Meetings. The statutory provisions regarding the Annual General Meeting are summarised below :

(*a*) *Section* 166 : The first Annual General Meeting of a company may be held within a period of not more than 18 months from the date of its incorporation. If such a meeting is held within the period, it shall not be necessary for the company to hold any annual general meeting in the year of its incorporation or in the following year.

Subject to the above mentioned provision, a company must hold an annual general meeting *each* year. Not more than 15 months shall elapse between the date of one annual general meeting and the next.

The Registrar may, for any special reason, extend the time of holding an annual general meeting (other than the first annual general meeting) by a period not exceeding 3 months.

The notice, by which an annual general meeting is called, must specify it as such.

Every annual general meeting shall be called during business hours, on a day which is not a public holiday, at the Registered Office of the Company or at some other place within the town or village where the Registered Office is situated. The Central Government may exempt any class of companies from the provisions mentioned in this paragraph.

The time of holding of the annual general meeting may be fixed by the articles of the company. A public company or a private company which is a subsidiary of a public company may, by a resolution passed in one general meeting, fix the time for its subsequent general meetings. Other private companies may do so by a resolution agreed to by *all* the members thereof.

(*b*) *Sec.* 167 : If default is made in holding an annual general meeting in accordance with Sec. 166, the Regional Director of

the Company Law Board may (on the application of any member of the company) call or direct the calling of a general meeting. He may also give directions regarding the calling, holding and conducting the meeting. Such a meeting shall be deemed to be an annual general meeting of the Company.

(*c*) *Sec.* 168 : If the provisions of Sections 166 and 167 are not complied with the company and every officers of the company in default be fined. (Maximum fine—R . 5,000. For continuing default—further fine of Rs. 250 per day.)

(*d*) *Sec. 171* : A general meeting may be called by giving not less than 21 days' notice in writing. The annual general meeting may be called with a shorter notice if it is agreed to by *all* the members entitled to vote in the meeting.

The court has no power to direct the calling of the *annual* general meeting. *In re Coal Marketing Company of India (P) Ltd.*[1]

OTHER GENERAL MEETINGS

Meeting called by the Board of directors

The Board of directors can call a general meeting of the members any time by giving not less than 21 days' notice. A general meeting may be called with a shorter notice under certain circumstances (See below, under Notice).

Meeting by order of Company Law Board

The Company Law Board can order a meeting of a company other than an annual general meeting. The Company Law Board can call such a meeting of its own motion or on the application of any director of the company or any member of the company who would be entitled to vote in the meeting. The Company Law Board can decide when the meeting is to be called, how it is to be conducted and also direct other ancillary and consequential matters regarding such meetings.—Sec. 186, (as amended in 1974).

Extraordinary General Meeting on Requisition

The Board of directors can be compelled to hold a General Meeting upon request or requisition made for it, under the following conditions.—Sec. 169 :

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[1] 71 C.W.N. 440

(*a*) The requisition must be signed by members holding at least 1/10th of the paid up capital of the Company, in the case of Companies having a share-capital ; and, by members holding at least 1/10th of the total voting power in other cases.

(*b*) The requisition must set out the matters which will be considered at the meeting.

(*c*) The requisition must be deposited at the registered office of the Company.

The Board must, within 21 days of the receipt of a valid requisition, issue a notice for the holding of the meeting on a date fixed within 45 days of the receipt of the requisition. If the Board does not hold the meeting as aforesaid, the requisitionists can call a meeting to be held on a date fixed within 3 months of the date of requisition.

Resolutions, properly passed at a meeting called by the requisitionists, are binding on the Company.

RULES OF PROCEDURE REGARDING MEETINGS

The general rules of procedure as regards shareholders' meeting can be summarised as follows :

1. Proper authority

The Board of directors is the proper authority to pass a resolution at a duly convened Board meeting to convene a meeting.

2. Notice (Sec. 172)

Notice of every meeting must be given to (*a*) all members entitled to vote upon the matters which are proposed to be dealt with in the meeting ; (*b*) the legal representatives of deceased or insolvent members coming under the above category ; and (*c*) the auditors of the Company. Notice must be given at least 21 days before the meeting.

Meetings may be called with a shorter notice under the following circumstances :

(*a*) In the case of an annual general meeting, if it is agreed to by all the members entitled to vote thereat.

(*b*) In the case of any other meeting of a *company with a share capital*, if it is agreed to by members holding not less than 95% of such part of the paid up share capital of the company as gives a right to vote at the meeting. If the company has *no share capital*, a meeting may be held with a shorter notice if

holders of not less than 95% of the total voting power exercisable at that meeting agree to it.

3. The Agenda : The Explanatory Statement (Sec. 173)

The notice must specify the business to be transacted in the meeting. The Act states that notice must annex an "Explanatory Statement" at which some special business is to be transacted. The statement must contain all the material facts relating to each item of the business, indicating the nature and extent of the interest of every director and the manager of the company. The statement must mention the time and place where all documents relating to special business can be inspected.

The business transacted in a shareholders' meeting, can be divided into two classes, (i) Ordinary and (ii) Special. Ordinary business means, consideration of accounts and the balance sheet ; declaration of dividend ; appointment of directors ; and appointment of and fixation of remuneration of auditors. All other business in special business.

4. The Quorum (Sec. 174)

Quorum means the minimum number of members required to hold a meeting. According to the Act, quorum is constituted by 5 members, personally present (in the case of a public company, other than a public company which has become such by virtue of Sec. 43A) and 2 members, personally present in the case of other companies. The articles may prescribe a larger number.

If there is no quorum within half an hour of the notified time for starting the meeting, it is dissolved. If the meeting is one called upon requisition, no further meeting on the same notice is permitted. In other cases, the meeting is automatically adjourned to the same day next week at the same hour and place or at such other day, hour and place as the Board may determine.

No quorum is necessary in any adjourned meeting.

5. Chairman (Sec. 175)

Unless otherwise laid down in the articles, the members personally present at the meeting shall elect a Chairman, from amongst themselves, by show of hands. But if a poll is demanded, it must be taken forthwith with a chairman elected for the purpose. (Poll means secret voting by ballot papers.)

6. Proxy (Sec. 176)

Any member, entitled to attend and vote in a meeting, can appoint another person to attend and vote on his behalf. The person appointed is called the Proxy. The appointment of a proxy must be made by a written instrument (See below) signed by the appointer and deposited with the Company, not more than 48 hours before the meeting.

A. B. LIMITED
Registered Office
201/A, Netaji Subhash Chandra Bose Road, Kolkata-700001
PROXY FORM
Twelfth Annual General Meeting—September 24th, 2001

Regd. Folio No. .....
I/We ..... of ..... being a member/members of the above company hereby appoint ..... of ..... or failing him/her ..... of ..... as my/our proxy to vote for me/us on my/our behalf at the TWELFTH ANNUAL GENERAL MEETING of the Company to be held on Monday, September, 24th 2001 and at any adjournment thereof.

Signed this ..... day of 2001

Signature ..... | 1/- Rupee Revenue Stamp | .....

Note : This form in order to be effective should be duly stamped, completed and signed and must be deposited at the Registered Office of the Company not less than 48 hours before the meeting.

A. B. LIMITED
Registered Office
201/A, Netaji Subhash Chandra Bose Road, Kolkata-700001
ATTENDANCE SLIP
Twelfth Annual General Meeting—September 24th, 2001

Regd. Folio No. .....

I certify that I am a registered shareholder proxy for the registered shareholder of the Company. I hereby record my presence at the Twelfth Annual General Meeting of the Company at Bharatiya Bhasha Parishad Auditorium, 36A, Shakespeare Sarani, Kolkata-700017 on Monday, September, 24th 2001.

....
Members/Proxy's name in BLOCK letter Members/Proxy's signature

Note : Please fill in this attendance slip and hand it over at the Entrance of the meeting Hall.

A proxy is not entitled to speak in the meeting and *can vote only on a poll* unless the articles provide otherwise. A proxy need not be a member of the Company. A member of a private company cannot appoint more than one proxy to attend on the same occasion, unless the articles otherwise provide.

A member entitled to vote can inspect the proxy forms deposited, if he gives 3 days' notice of his intention to do so.

An instrument appointing a proxy, if in one of the forms set out in Schedule IX to the Act, cannot be questioned on the ground that it fails to comply with any special requirement specified for such instruments in the articles.

Every notice of meeting must prominently mention that a member is entitled to appoint a proxy and that the proxy need not be a member.

A body corporate, which is a member of a Company, can appoint a representative or proxy, by resolution of the Board.

The President of India or the Governor of a State, if he is a member of a company, may appoint any person to act as his representative in a meeting.—Sec. 187A.

7. Method of Voting (Sections 177-185)

Resolutions are to be voted upon, in the first instance, by show of hands. The Chairman's declaration of the results of voting by show of hands is conclusive.

A poll is to be taken (*i*) if the Chairman so directs ; (*ii*) in all cases, if it is demanded by members holding at least 1/10th of the voting power or paid up capital ; (*iii*) in the case of public companies if it is demanded by at least 5 members present and entitled to vote ; and (*iv*) in the case of private companies if it is demanded by any one member if not more than seven members are present and by two members if more than seven members are present.

A poll on a resolution for adjournment, or for the appointment of a Chairman is to be taken immediately. In other cases it is to be taken when the Chairman decides ; but it must be within 48 hours of the demand for poll.

A poll is to be taken in the manner decided by the Chairman. The usual method is to ask each member to record his decision on ballot papers provided for the purpose. The Chairman shall appoint two scrutineers to scrutinise the ballot papers. At least

one of them shall be a member present in the meeting, if a member, willing to act as such, is found.

The Chairman has a casting vote in addition to his ordinary vote, *i.e.*, in case of a tie, he can give another vote, either for or against the resolution.

Section 179 states that a poll may be ordered on a demand made in that behalf by the shareholders.

RESOLUTIONS

The Act of 1956 classifies resolutions into the following types : (*i*) Special Resolution (*ii*) Ordinary Resolution and (*iii*) Resolution requiring Special Notice.

Special Resolution

A special resolution is necessary for deciding important matters. The Act specifies what these matters are. (*Examples* : Reduction of Capital ; Winding up etc.)

Procedure for Passing a Special Resolution

A special resolution may be passed in a general meeting of members called in the usual way with the usual notice. But the following conditions must be satisfied.—Sec.189.

(*a*) The notice calling the general meeting must specify that a special resolution will be moved.

(*b*) The number of votes cast in favour of the resolution whether by show of hands or by poll, must be at least three times the number cast against it.

Special resolution is required for the following issues.

(*a*) Alteration of Memorandum for changing the place of registered office from one state to another or alteration of objects with the leave of the Company Law Board, (*b*) change of name of the company with the consent of the Central Government, (*c*) alteration of the Articles of the company, (*d*) conversion of any portion of the uncalled capital into reserve capital, (*e*) reduction of share capital, (*f*) variation of shareholders' rights, (*g*) payment of interest out of capital, (*h*) allowing a director to hold an office of profit under the company, (*i*) alteration of memorandum of render the liability to directors unlimited, (*j*) winding up a company voluntarily.

Ordinary Resolution

All matters not required to be decided by a special resolution, may be decided by ordinary resolution. An ordinary resolution is passed, when the number of votes cast in its favour exceeds those cast against it.

Member's Resolution

If members of a Company intend to move a resolution, at the next annual general meeting, the following procedure is to be adopted. (Sec. 188) :

1. A requisition in writing, with a copy of the resolution, must be deposited with the Company. If it is desired to circulate the requisition to the members, it must be deposited not less than 6 weeks before the meeting. In other cases it may be deposited not less than 2 weeks before the meeting.

2. The requisition must be signed (*a*) by members holding at least 1/10th of the total voting power, or (*b*) by not less than 100 members, holding shares with an aggregate paid up capital of Rs. 1 lakh.

3. The requisition may require the circulation to the members, along with the resolution, a statement of not more than 1000 words relating to the resolution.

4. The requisitionists must pay the expenses necessary for circulating the notice and the statement.

If the aforesaid procedure is complied with, the resolution must be dealt with at the next annual general meeting. But the statement, if any is sent with the resolution, will not be circulated in the following cases :

(*a*) If the Company is a banking company and the Board of Directors is of opinion that its circulation will injure the interest of the Company.

(*b*) If on an application made by the company or of any person feeling aggrieved, the Court is satisfied that the rights conferred by Section 188 are being abused to secure needless publicity for defamatory matter, it may prohibit the circulation.

Registration of Resolutions

All special resolutions and important resolutions (like voluntary liquidation) must, within 30 days of their adoption be

registered with the Registrar and also annexed to all copies of the articles.—Sec. 192.

RESOLUTION BY SPECIAL NOTICE

Where by any provision contained in the Act or in the articles, *special notice* is required of any resolution, the intention to move the resolution shall be given to the Company not less than 14 days before the date of meeting where the resolution is to be moved, exclusive of the day on which the notice is served or deemed to be served and the day of the meeting.—Sec. 190(1).

The Company shall give notice of the resolution to the members in the same manner as it gives notice of the meeting. If this is not practicable, it shall give notice by advertisement in a newspaper having an appropriate circulation or in any other mode allowed by the articles, not less than 7 days before the meeting.—Sec. 190(2).

The Act requires special notice in certain cases. Examples—Appointment of a retired or removed auditor (Sec. 225); appointment of a director in place of a removed director; etc.

MINUTES OF PROCEEDINGS

By the term "minutes" is meant a written record of the proceedings of a meeting. As company meetings are of considerable legal importance, it is necessary to keep a record of the proceedings in a permanent form. Section 193 of the Act provides as follows :

(1) Every company shall keep minutes of all proceedings of every general meeting, meetings of its Board of Directors, and of every committee of the Board. Entries in the minute books must be made within 30 days of the conclusion of a meeting. The pages of a minute book must be consecutively numbered. Each page must be initialled or signed and the last page recording the proceedings of a meeting must be dated and signed (*a*) in the case of Board meetings or committee meetings, by the Chairman of the meeting or the succeeding meeting, and (*b*) in the case of general meetings, by the Chairman of the same meeting, or in the event of his death or liability, by a director duly authorised by the Board. Entries in a minute book must not be attached to it by pasting or otherwise.

(2) The minutes of each meeting shall contain a fair and correct summary of the proceedings.

(3) All appointments of officers made at the meeting shall be included in the minutes.

(4) In the case of a meeting of the Board of directors or of a committee of the Board, the minutes shall also contain—

(*a*) the names of the directors present at the meeting, and

(*b*) in the case of each resolution passed at the meeting, the names of the directors, if any, dissenting from, or not concurring in, the resolution.

(5) The minutes need not contain any matter which, in the opinion of the chairman of the meeting—

(*a*) is, or could reasonably be regarded as, defamatory of any person ;

(*b*) is irrelevant or immaterial to the proceedings, or

(*c*) is detrimental to the interests of the company.

The Chairman's discretion, as regards what is to be included in the minutes, is final.

The minutes kept in accordance with the aforesaid rules shall be evidence of the proceedings in a meeting. They are presumed to be correct records of proceedings, unless otherwise proved. The minutes of general meetings are to be kept at the registered office of the Company and can be inspected members. Copies of any minutes are to be furnished upon payment of the requisite fees.

Apart from the minutes, no reports of the proceedings of a general meeting are to be published at the expense of the Company.

ANNUAL RETURN

The Annual Return is a statement of particulars, which is required to be filed by a company after every annual general meeting. Section 159 of the Act provides that every company having a share capital shall, within sixty days from the day on which each annual meeting is held, prepare and file with the Registrar a return containing particulars regarding the following :

(*a*) its registered office,

(*b*) the register of its members,

(*c*) the register of its debenture holders,

(*d*) its shares and debentures,

(*e*) its indebtedness,
(*f*) its members and debenture holders, past and present, and
(*g*) its directors, managing directors, managing agents, secretaries and treasurers, managers and secretaries, past and present.

Where full particulars as to past or present members were given in any of the two immediately preceding Returns, a Return may mention only the changes that have occurred in shareholding.

The Return must be in the form set out in Part II of Schedule V or as near thereto as circumstances admit.

A similar return is to be field by Companies not having a share capital.—Sec. 160.

The copy of the Annual Return filed with the Registrar by a director and by the manager or secretary of the company; or where there is no manager or secretary, by two directors of the company, one of whom shall be the managing director where there is one.—Sec. 161(1).

Section 161 has been amended and the amended section states that where the annual return is filed by a Company whose shares are listed on a recognised stock exchange, the copy of such annual return shall be signed by a secretary in whole-time practice.

In the case of private companies, the directors must certify that there has been no violation of the rules of private companies regarding number of members and invitation to the public for purchase of shares.—Sec. 161(2)(b). The directors must also certify that 25% or more of the shares are not being held by any bodies corporate and if so, why the company will continue to be treated as a private company.—Sec. 43A.

EXERCISES

1. Discuss the provisions of the Companies Act relating to meetings. (Page 652)
2. What are the classes of general meetings held by companies? State the powers and duties of the chairman of a general meeting of a company. (Pages 652, 657-658)
3. (*a*) What do you understand by "Statutory Meeting" of the shareholders of a Public Limited Company? (*b*) Must a Private Limited Company hold such a meeting? (Pages 652, 654)

4. Explain 'Annual General Meeting' of a company, its objects and purposes, and the requisites for holding a valid annual general meeting. Who may call it ? (Page 654)
5. What kinds of meetings are held by a company ? State the nature of business to be transacted in each meeting. (Pages 652-654)
6. What are the consequences of the failure by a company to hold its Annual General Meeting ? (Pages 654-655)
7. State rules regarding an extra-ordinary general meeting to be held on requisition. (Page 656)
8. What is a statutory report and what are the contents of a statutory report ? What is the effect of not holding a statutory meeting ? (Page 653)
9. Can a member of a company, by him or jointly with others, insist on, convening a general meeting of a company ? What are the conditions to be fulfilled ? (Page 656)
10. State the provisions of the Companies Act relating to resolutions requiring special notice, mentioning the matters required. (Pages 662)
11. What are the consequences of not filing the Annual Return of a company in time ? (Pages 664)
12. Explain the following terms :
(*a*) Statutory Meeting ; (*b*) Statutory Report ; (*c*) Annual General Meeting ; (*d*) Extraordinary General Meeting on Requisition ; (*e*) The Quorum, (*f*) Proxy ; (*g*) Special Resolution ; (*h*) Ordinary Resolution ; (*i*) Special Notice ; (*j*) Annual Return. (Pages 652-664)
13. Objective Questions :
(*a*) What are the different kinds of meetings of the shareholders ? (Page 652)
(*b*) Enumerate six purposes for which a special resolution is required. (Page 660)
(*c*) What is the length of notice for calling a general meeting ? (Page 656)
(*d*) Can the Company Law Board to call a general meeting of the Company ? (Pages 655)
(*e*) Fill in the blanks—
(*i*) The First Annual General Meeting of a Company may be held within a period of not more than—months from the date of its incorporation. (Page 654)
(*ii*) Not more than—months shall elapse between the date of one Annual General Meeting and the next. (Page 654)

6 DIRECTORS

DEFINITION

The Directors of a Company are selected according to the Articles of Association of the Company and provisions of the Companies Act. They are in charge of the management of the affairs of the Company. The directors are collectively called the Board of directors. The Board is the Company's executive authority.

A director is an officer of the company within the meaning of section 2(30). Section 2(13) states that a director includes "any person occupying the position of the director by whatever name called."

The welfare of the shareholders and of the company depends upon who the directors are and how they carry out their duties and responsibilities. To protect the interests of the Company and of the shareholders, the Companies Act contains detailed rules regarding the appointment, remuneration, powers, duties, liabilities and various other matters concerning directors.

NUMBER OF DIRECTORS

The number of directors to be appointed to the Board of directors of a Company is determined by the articles. The Act provides that there must be at least 3 directors in a Public Company (other than a public company which has become such by virtue of Sec. 43A) and at least 2 directors in other Companies.—Sec. 252.

[Sec. 43A states that under certain circumstance a private company may become a public company by a change in its structure of ownership.—See p. 553]

Subject to the minimum stated above and the maximum fixed by the articles, the Company can, by ordinary resolution, increase or decrease the number of directors. It can also appoint additional directors for one year.—Sec. 258.

The Company can increase the number of directors beyond the maximum fixed by the articles provided previous sanction

of the Central Government is obtained. Where the maximum fixed by articles is 12 or less, the number can be increased to 12 without Government approval.—Sec. 259.

MODE OF APPOINTMENT OF DIRECTORS

1. First directors

Persons named in the articles of association as directors become the first directors of the Company. In the case of public companies, the persons named as directors must file with the Registrar, their consent in writing to become directors and must agree to pay for the minimum number of shares which, by the articles, a director is required to have.

Persons who sign the Memo

If no person is named in the articles as directors, the persons who sign the memorandum of association of the Company (and who are individuals, not companies) become the first directors.—Sec. 254.

Election

The normal mode of appointing directors is election by the members at the annual general meeting. The manner of holding the election must be provided for in the articles.—Sec. 255.

2. Appointment of directors by company

According to Sec. 255 directors must be appointed by the company in a general meeting.

3. Appointment of directors by the Board of directors

The Board of directors may appoint directors in the following circumstances :

(*a*) *Additional directors* : The Board of directors can appoint additional directors subject to the maximum number, fixed by the Articles of the company. Such additional directors hold office only up to the date of the next annual general meeting of the company.—Sec. 260.

(*b*) *Casual vacancy* : Casual vacancies among directors in public companies and private subsidiaries of public companies may be filled by the Board of directors by nomination. The person appointed to a casual vacancy holds office for the period during which the director, whose post is vacant, would have remained in office.—Sec. 262.

(c) *Alternate Directors* : The Board of directors of a company may, if so authorised by its articles or by a resolution passed by the company in a general meeting, appoint an alternate director to act for a direct during his absence for a period not less than three months from the State in which meetings of the Board are ordinarily held. The alternate director cannot hold office longer than the original director and vacates his office if and when the original director returns to the State.—Sec. 313.

4. Appointment of directors by third parties. The Articles under certain circumstances empower the debenture-holders or other creditors who have advanced loans to the company to appoint their nominees to the Board.

5. Appointment of directors by proportional representation. The Articles of a company may provide for the appointment of not less than two-thirds of total number of directors of a public company, according to the principle of proportional representative whether by the single transferable vote or by a system of cumulative voting or otherwise.

6. Nomination by the Central Government

Under Section 408 of the Act, the Central Government can (in case of mismanagement and oppression) nominate some directors to the Board of a company as the Company Law Board may specify as being necessary to effectively safeguard the interest of the company, its shareholders or the public interest. The Directors so appointed are not required to hold any qualification shares. Besides, they are required to keep the Company Law Board informed of the affairs of the company to take such timely action as may be required.

7. Nomination in Statutory Corporations

The Government can nominate a director to the Board of a Company coming within the purview of the Industries (Development and Regulation) Act of 1951. Certain statutory corporations possess similar powers. For example, the Industrial Finance Corporation Act of 1947 empowers the Corporation to nominate a director to the Board of a Company to which it has advanced money.

Other rules regarding the appointment of directors are mentioned below :

1. Qualification Shares

(Sections 270, 272, 273). The articles may provide that no person shall be eligible for appointment as director unless he holds a certain minimum number of shares. Such shares are called Qualification Shares. In the case of public companies and private companies which are subsidiaries of public companies, the following provisions apply, notwithstanding anything to the contrary contained, in the articles :

(*a*) A director shall be deemed to be qualified if he secures the qualification shares within two months after his appointment.

(*b*) The nominal value of the qualification share or shares shall not exceed Rs. 5,000, or the nominal value of one share where it exceeds Rs. 5,000.

(*c*) The bearer of a share warrant shall not be deemed holder of shares for the purposes of qualification shares.

If after the expiry of the said period of two months, any person acts as a director of the company when he does not held qualification shares, he shall be punishable with fine which may extend to Rs. 50 for every day between such expiry and the last day on which he acted as director.—Sec. 272. Also he has to vacate his office as director.

2. Notice

In the case of public companies and private companies which are subsidiaries of public companies, when it is intended to propose the name of some person as director, notice of the fact must be given by the candidate or the proposer to the Company at least 14 days before the date of the meeting in which the election will take place. This provision does not apply to a retiring directors. The company shall inform every member of the candidature by individual notices not less than 7 days before the meeting or by advertisement in two local newspapers (one English and one regional language paper) not less than 7 days before the meeting.—Sec. 257.

Section 257 of the Principal Act has been amended and the amended provision states that any person contesting the post of

director must submit a notice "along with a deposit of five hundred rupees which shall be refunded to such person" if the person succeeds in getting elected as a director.

3. Filing of Consent

In the case of public companies and private subsidiaries of public companies every person (other than a director retiring by rotation) proposed as director must sign and file with the company his consent to act as such if appointed, unless he himself notifies his candidature to the company.—Sec. 264(1).

A person shall not act as director unless he has within 30 days of his appointment signed and filed with the Registrar his consent in writing to be one. But this rule does not apply to (*a*) a director re-appointed after retirement by rotation or immediately on the expiry of his term of office ; (*b*) an additional or alternate director, or a person filling a casual vacancy, appointed or re-appointed under Sec. 262, and (*c*) a person named as a director of the company under its articles as first registered.—Sec. 264(2).

4. Method of Voting

Every person, proposed for election as a director, must be voted upon individually. Two or more names are not to be put together, unless such a procedure is agreed to by the members present unanimously. The articles may provide for the election of not less than two-thirds of the directors by the method of proportional representation with single transferable votes or cumulative votes. A non-profit and non-dividend paying company may provide in its articles for the election of all its directors by ballot.—Sections 263, 263A, 265.

5. Amendment of provisions relating to appointment of Directors

In the case of a public company or a private company which is a subsidiary of a public company, an amendment of any provision relating to the appointment or re-appointment of a managing or whole-time director or a director not liable to retire by rotation, whether that provision be contained in the Company's memorandum or articles, or in an agreement entered into by it, or in any resolution passed by the Company in general meeting or by its Board of directors, shall not have any effect unless

approved by the Central Government ; and the amendment shall become void if, and in so far as, it is disapproved by that Government.—Sec. 268.

6. Directors to be Individuals

A body corporate, association or firm cannot be appointed director, only an individual can be sc appointed.—Sec. 253.

7. Disqualification of Directors

Section 274 provides as follows : A person shall not be capable of being appointed director of a company, if—

(*a*) he has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force ;

(*b*) he is an undischarged insolvent ;

(*c*) he has applied to be adjudicated as an insolvent and his application is pending ;

(*d*) 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 ;

(*e*) he has not paid any call in respect of shares of the Company held by him, whether alone or jointly with others, and six months have elapsed from the last day fixed for the payment of the call ; or

(*f*) an order disqualifying him for appointment as director has been passed by a Court in pursuance of Section 203 and is in force, unless the leave of the Court has been obtained for his appointment in pursuance of that Section.

(Section 203 empowers the Court to prohibit a person, who is guilty of fraudulent practices, from participating in the management of Companies.)

The Central Government may, by notification in the Official Gazette, remove the disqualifications under Clauses (d) and (e) above, as regards any individual.

A private company, which is not a subsidiary of a public company, may provide by its articles that a person shall be disqualified from being appointed a director on any ground in addition to those specified in (*a*) to (*f*) above.

of Directorships

e commencement of the Act of 1956, no person can as director, at, the same time, of more than 20 .—Sec. 275.

ptions : But the following companies are *not to be taken count* while calculating the maximum allowable appo.. .ments as director : (*a*) a private company which is neither a subsidiary nor a holding company of a public company ; (*b*) an unlimited company ; (*c*) an association not carrying on business for profit ; and (*d*) a company in which the person concerned is only an alternate director.—Sec. 278.

Penalty : A person who contravenes this rule can be fined up to Rs. 5000 for each Company of which he is a director in excess of 20.—Sec. 279.

Who can be a Director ?

Qualification of a Director : A director must be appointed in the mode stated in page 508. A director need not have any academic qualification : he need not have any degree from the university ; he need not have been to school. From the Contract Act and the Companies Act, it can be said that the director must have the following qualifications ;

1. A director must be capable of entering into a contract, *i.e.*, (a) he must have attained the age of majority, (b) he must have sound mind and (c) he must not be disqualified from contracting by any law to which he is subject.—Sec. 11, Contract Act, p. 50.

2. A director must be a natural person, *i.e.* not an artificial person. (See para 6 above)

3. A director must have the requisite qualification shares. (See para 1 above). The qualification shares are not required in nomination by the Central Government or in certain Statutory Corporations.

4. A director must not be disqualified under the circumstances enumerated in Sec. 274, *e.g.*, if he is an undischarged insolvent or a person convicted by the Court. (See para 7 above).

RETIREMENT OF DIRECTORS

Rotation

Section 255 of the Companies Act provides that *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 be persons whose period of office is liable to terminate *by rotation*. The articles may be provided for the retirement of *all* directors at every annual general meeting.

Section 256 of the Act provides that at every annual general meeting after the one by which the first directors are appointed, one-third of such of the directors for the time being as are liable to retire by rotation, shall retire from office. If the number of directors is not three or a multiple of three, then the number nearest to one-third shall so retire.

The directors to retire by rotation at every annual general meeting shall be those who have been longest in office since their last appointment, but as between persons who became directors on the same day, those who are to retire shall, in default of and subject to any agreement among themselves, be determined by lot.

At the annual general meeting at which a director retires as aforesaid, the Company may fill up the vacancy by appointing the retiring director or some other persons thereto.

If the vacancy is not filled at the annual general meeting or at the adjourned meeting, the retiring directors will be deemed to be automatically re-elected.

RESIGNATION OF A DIRECTOR

The Company Act does not provide for resignation of a director. But the Articles of a company may have express provision of it. A director is an agent of a company and, therefore, he can resign his office by notice. A resignation cannot be withdrawn without the consent of the company. *Glossop* v. *Glossop*.[1] An oral resignation is effective, if it is accepted at a meeting of the company, even though the Articles provide that the director must vacate his office in writing. *Latchford Premier Cinema* v. *Ermion*.[2] A resignation is effective only when it is accepted by the Board of directors of the company. If a director part with his qualification shares he has to vacate his office. If this is voluntary, then parting with his qualification shares is equivalent to resignation.

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[1] (1907) 2 Ch. 370 [2] (1931) 2 Ch. 400

VACATION OF OFFICE BY DIRECTORS

1. Statutory vacation

Section 283 of the Companies Act provides that the office of a director shall become vacant under the following circumstances :

(*a*) if he fails to obtain within due time or ceases to hold the share qualification, if any, required of him by the articles of the Company ;

(*b*) if he is found to be of unsound mind by a Court of competent jurisdiction ;

(*c*) if he applies to be adjudicated an insolvent ;

(*d*) if he is adjudged an insolvent ;

(*e*) if he is convicted by a Court of any offence involving moral turpitude and is sentenced in respect thereof to imprisonment for not less than six months ;

(*f*) if he fails to pay any call in respect of shares of the company held by him whether alone or jointly with others within six months from the last date fixed for the payment of the call, unless the Central Government has by notification in the Official Gazette removed the disqualification incurred by such failure ;

(*g*) if he absents himself from three consecutive meetings of the Board, or from all meetings of the Board for a continuous period of three months, whichever is longer, without obtaining leave of absence from the Board ;

(*h*) if he (whether by himself or by any person for his benefit or on his account) or any firm in which he is a partner or any private Company of which he is a director, accepts a loan, or any guarantee or security for a loan, from the Company in contravention of Section 295 ; [Section 295 deals with the rules relating to the grant of loans to directors.]

(*i*) if he acts in contravention of Section 299 (which imposes a duty on directors to disclose their personal interest, if any, in any contracts entered into by the Company) ;

(*j*) if he becomes disqualified by an order of Court under Section 203 (which provides that the Court can prohibit a person guilty of fraudulent practices from managing a company) :

(*k*) if he is removed from the post of director by the members : or

(*l*) having been appointed a director by virtue of his holding any office or other employment in the company, he ceases to hold such office or other employment in the company.

Consequences : (1) The office of a director shall become vacant.

(2) In case of insolvency or conviction, the director shall vacate office within 30 days of the order of adjudication or sentence. But if there is any appeal or petition against the order of adjudication or sentence, he shall vacate office within seven days of the disposal of the appeal or petition, unless the order or sentence is set aside.

(3) If a director continues to function when be knows that his post has become vacant under any of the aforesaid provisions, he is liable to a fine up to Rs. 500 per day.

2. Additional grounds of vacation in private companies

A private company, which is not a subsidiary of a public company, may by its articles provide that the office of director shall be vacated on any grounds in addition to those specified in Section 283.

3. Acceptance of office of profit

Under Section 314 of the Act. if a director accepts an office of profit under the company (except certain special posts like that of a managing director, etc.) without previous consent of the company accorded by a special resolution. he shall be deemed to have vacated his office as director. (See 'office of profit' p. 696)

REMOVAL OF DIRECTORS

Directors may be removed by shareholders, the Central Government or the Court. The rules regarding the removal of directors are stated below.

I. Removal by Shareholders

Section 284 of the Act provides that the members of a Company may, *by ordinary resolution* remove a director before the expiry of his period of office, except in the following cases :

1. An additional director appointed by the Central Government under Section 408 (in case of mismanagement and oppression) cannot be removed. (See Ch. 10.)

2. In a private company, a director appointed for life and holding office as such on 1st April 1952, cannot be removed by a members' resolution.

3. When the articles of a company provide for the election of directors by proportional representation, a director elected by that method cannot be removed by resolution.

Special notice must be given of the resolution to remove a director. A copy of it must be given to the director concerned. A statement relating to the matter may be sent by the director concerned, to the company and such statement shall be circulated among the members, if received in time, or read out in the meeting. The circulation of such statement may be prohibited by Court if it contains defamatory matter.

The meeting which removes a director can elect another in his place if the director was originally appointed by election.

If a director is, by agreement or otherwise, entitled to receive compensation for premature termination of his services, he can enforce his claim notwithstanding the removal by resolution.—Sec. 284(7)(a).

II. Removal by the Central Government

The Central Government can make a reference to the High Court to remove managerial personnel, including directors when—(*a*) any person is guilty of fraud, misfeasance, persistent negligence or default, etc., or (*b*) the business of the Company is not following sound business principle or prudent commercial practices or (*c*) the Company is causing damage to the trade and industry of the business pertaining to it or (*d*) any person of the Company is trying to defraud creditors, members, etc. or a fraudulent or unlawful purpose.—Sections 388B to 388E. See Chapter 10.

III. Removal by the Company Law Board

Under Section 402, where, on an application to the Company Law Board for prevention of oppression (Sec. 397) or mismanagement (Sec. 398), the CLB finds that the relief ought to be granted, it may by an order provide for the termination, setting aside or modification of any agreement between the Company and the Director. When the appointment of a Director so terminated or set aside, he or she cannot sue the Company for damages or compensation for loss of office.

MANAGING DIRECTOR

Definition

The term Managing Director is defined in Section 2(26) of the Act. The Managing Director is a director who is "entrusted with any substantial powers of management". The power to do administrative acts of a routine nature when so authorised by the Board (*e.g.*, the power to affix the common seal of the company or to draw and indorse any cheque etc.) shall not be deemed "substantial powers of management".

The term Managing Director includes a director occupying the position of a managing director, by whatever name called.

Position of Managing Director

The Managing Director is a member of the Board of directors. He is a wholetime director. He is the chief executive of the company.

The managing director is not an employee, nor is he a servant of the company. But he is a director of the company and has certain duties and responsibilities. In an English case, it was held that the managing director has two functions and two capacities. He is a director of the company and he has a contract with the company for his services. There is nothing anomalous in this. The same individual may have two or more capacities each including special rights and duties in relation to the same thing or matter in relation to the same persons. *Anderson* v. *James Sutherland (Peterhead) Ltd.*[1]

Whole Time Director

A whole time director is a director who is entrusted with certain duties and responsibilities. He is an employee of the Company. The ambit of his jurisdiction is defined by his contract of employment. The articles of some Companies contain the provisions regarding their services. It can be inferred that a whole time director gives the whole or the most of the working time to the Company. The term "Whole time director" has not been defined in the Act, but it has been used with the term managing director in sections of the Act.

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[1] (1941) S.C. 203

Appointment of Managing Director and Whole Time Director

The appointment of a managing director or of a whole time director can be made by any of the methods (*i*) an agreement with the company, or (*ii*) a clause in a memo or articles of the company, or (*iii*) a resolution passed by a company in its general meeting, or (*iv*) a resolution of the Board of directors.

Under the Amendment Act, every public company or a private company which is a subsidiary of a public company having a paid up share capital of such sum as may be prescribed shall have a managing or a whole-time Director or a manager. The sum prescribed is Rs. 5 crores or more. Such appointment can be made without prior approval of the Central Government provided the appointment is made in accordance with the conditions specified in Schedule XIII and a return in the prescribed form filed within 90 days from the date of such appointment. [Sec. 269(2)]

Every application seeking approval to the appointment of a managing or whole-time director or a manager shall be made to the Central Government within a period of 90 days from the date of such appointment. The Central Government shall not accord its approval to such an application, if it is specified that (*a*) the managing or whole-time director or the manager appointed is in its opinion, not a fit and proper person to be appointed as such or such appointment is not in the public interest ; or (*b*) the terms and conditions of the appointment of managing or whole-time director or the manager are not fair and reasonable [Sec. 269(4)].

When the appointment is not approved by the Central Government it may refer the matter to the Company Law Board for decision under Section 269(7).

The following rules are applicable to a public company and a private company which is a subsidiary or a public company :

(1) The rules relating to the appointment or reappointment of "managing" or "whole-time directors" or "a director in the whole-time employment of the company" cannot be amended without the approval of the Central Government.—Sec. 268.

(2) The appointment of a person as a managing or whole-time director shall not have any effect unless approved by the Central Government.—Sec. 269(1).

(3) In the case of an existing company, the re-appointment of a person as a managing or whole-time director shall not have

any effect unless approved by the Central Government.—Sec. 269(2).

(4) The Central Government shall not accord its approval under Sec. 269(1) in any case, unless it is satisfied that—

(*a*) it is in the interests of the company to have a managing or whole-time director,

(*b*) the managing or whole-time director of the company is, in its opinion, a fit and proper person to be appointed as such and that the appointment of such person as managing or whole-time director is not against the interest and

(*c*) the terms and conditions of appointment of the proposed managing or whole-time director of the company are fair and reasonable.—Sec. 269(3), Companies (Amendment) Act, 1974.

(5) Regarding the appointment of the managing director or whole-time director of a company, the Central Government can reduce the period of appointment when the approval is given.

(6) If the appointment of a person is not approved, the person so appointed shall vacate the office on the date when the decision of the Central Government is communicated to the company. If a person omits or fails to do so he shall be punishable with a fine up to Rs. 500 per day.—Sec. 269 as amended in the Act of 1974.

Powers and Duties of a Managing Director

The powers and duties of a managing director are specified in (*i*) the agreement with the company by which he is appointed or (*ii*) in the memorandum or articles of the company or (*iii*) in a resolution passed by the company in general meeting or (*iv*) a resolution by its Board of directors. Thus managing directors of different companies may have different powers and duties. Strangely enough, Model Articles in Table A do not provide any specific powers to Managing Director only. Articles of some companies do provide the powers in Article itself. Again, the Company Act does not provide any specific powers to M.D.

A managing director exercises his powers subject to the superintendence, control and direction of the Board of directors.

Disqualification of Managing Director

As Managing Director or Whole-time Director is a Director first, he will be appointed only when he is qualified to become a Director. If he is disqualified as director he is automatically disqualified as Managing Director. So no company can employ,

or continue the employment, of any person as its managing or whole-time Director who—

(*a*) is an undischarged insolvent, or has at any time been adjudged an insolvent;

(*b*) suspends, or has at any time suspended, payment to his creditors, or makes, or has at any time made, composition with them; or

(*c*) is, or has at any time been, convicted by a Court of an offence involving moral turpitude.—Sec. 297.

(*d*) A managing director is also a director. Therefore all the disqualifications applicable to a director also apply to a managing director. Further any one who is below 25 years or above 70 years of age is usually disqualified for Managing Director.

Number of Managing Directorships

No person can ordinarily be managing director of more than *one* public company or private company which is a subsidiary of a public company. He can be managing director of *two* such companies if the second appointment is approved by a resolution of the Board of directors with the consent of *all* the directors present in a meeting of which specific notice was given to all the directors in India. No person can be managing director of more than two companies. But the Central Government may, by a special order, allow a person to be managing director of more than two such companies where it is satisfied that the companies should, for their proper working, function as a single unit and have a common managing director. A person may be managing director of more than two companies where the companies are private companies not subsidiaries of public companies.—Sec. 316.

Term of Office

No person can be appointed managing director for a term exceeding five years at a time. There is, however, no bar to the reappointment of a person after the expiry of his term of service.—Sec. 317. This section does not apply to a private company, unless it is a subsidiary of a public company.

LOANS TO A DIRECTOR, HIS RELATIVES ETC.

Without obtaining the previous approval of the Central Government, no company can, directly or indirectly, make any loan to, or give any guarantee or provide any security for,

(*a*) any director of the lending company or of a company which is its holding company or any partner or relative of any such director ;

(*b*) any firm, in which any such director or relative is a partner,

(*c*) any private company of which any such director is a director or member ;

(*d*) any body corporate at a general meeting of which not less than twenty-five per cent of total voting power may be exercised or controlled by any such director, or by two or more such directors together, or

(*e*) any body corporate the Board of Directors, or Manager whereof is accustomed to act in accordance with the directions or instructions of the Board or of any Director or Directors of the lending Company.—Sec. 295(1).

Sec. 295(2) provides that the above rules do not apply to any loan made, guarantee given or security provided—

(*a*) by a private Company unless it is a subsidiary of a public Company ;

(*b*) by a banking Company ; or

(*c*) by a holding Company to its subsidiary.

The restrictions imposed by Section 295 apply to a transaction represented by a book debt which was from its inception in the nature of a loan or an advance.—Sec. 296.

Every person, including the director to whom the loan is given, who knowingly contravenes the rules mentioned above, may be punishable by simple imprisonment up to six months and fine up to Rs. 5000. All persons who are knowingly parties to the contravention, are liable to make good the amount which the company paid on account of the loan, guarantee or security.

CONTRACTS IN WHICH A DIRECTOR IS INTERESTED

A director or his relative or a firm in which he is partner or a private Company in which he is member or director, shall not enter into contracts with the Company for the sale, purchase or supply of goods and services or for underwriting the subscription of its shares or debentures, *except with the consent of the Board of directors.*—Sec. 297(1).

The above rule does not apply to the following cases :

(*a*) contracts for the purchase and sale of goods and materials for cash at prevailing market prices ;

(*b*) contracts for the sale, purchase or supply of goods, materials and services in which either of the parties regularly trades or does business provided the value of the goods etc. does not exceed Rs. 5000 in any year ; and

(*c*) any transaction of a banking or insurance company in the ordinary course of business.—Sec. 297(2).

In circumstances of urgent necessity a contract may be entered into *without the prior consent* of the Board, but such consent must be obtained within 3 months of the date on which the contract was entered into.—Sec. 297(3).

The consent of the Board of directors is to be given by a resolution passed in a meeting.—Sec. 297(4).

If consent is not given, anything done in pursuance of the contract shall be voidable at the option of the Board of directors.—Sec. 297(5).

In case of a company having a paid-up share capital of not less than Rs. 1 crore, no such contract shall be entered into except with the previous approval of the Central Government.—Sec. 297. Amendment of 1974.

Every director who is in any way concerned or interested in a contract by or on behalf of a Company shall disclose the nature of his interest at a meeting of the Board of directors.—Sec. 299.

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 ; nor shall his presence count for the purpose of forming a quorum at the time of any such discussion or vote ; and if he does vote his vote shall be void.—Sec. 300(1).

The bar imposed upon participation in the Board's discussion does not apply in the case of a private Company which is not a subsidiary or a holding Company of a public Company, and certain other cases.—Sec. 302(2).

Every Company must maintain one or more registers in which shall be entered particulars of all contracts entered into by the Company, in which any of the directors are interested (except contracts not exceeding Rs. 1000 in value and the ordinary transactions of banking and insurance companies)—Sec. 301.

When a director has an interest in a contract by which a Manager or Managing Director is appointed, the Company must send to every member of the Company an abstract of the contract, together with a statement clearly specifying the nature of the director's interest.—Sec. 302.

Case Law :

Interested Director—Who is : The interest or concern spoken of by Sections 299(1) and 300(1) cannot be a merely sentimental interest or ideological concern. Therefore, a relationship of friendliness with the Directors who are interested in contract or arrangement or even the mere fact of a lawyer-client relationship with such directors will not disqualify a person from acting as a Director on the ground of his being an "interested" Director. *Needle Industries (India) Ltd., and Others, v. Needle Industries Newey (India) Holdings Ltd. and others* [1]

REGISTER OF DIRECTORS ETC.

Every Company shall keep at its registered office, registers containing particulars about its Directors. Manager and Secretary.—Sec. 303.

Copies of the particulars entered in the aforesaid registers shall be sent to the Registrar, who shall keep similar registers.

All the registers can be inspected by any person.

The Company must also maintain a register showing the number of shares and debentures (of the Company, its subsidiaries and its holding Company) held by every director and manager.—Sec. 307. Such persons must also disclose to the Company their shareholdings in the Company.—Sec. 308.

REMUNERATION OF DIRECTORS

The remuneration payable to the directors must be determined according to the provisions of Sections 198 and 309 either by the Articles or by the resolution of a company.

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[1] AIR (1981) Supreme Court 1298

Rules regarding director's remuneration are summed up below.

1. The remuneration payable to the directors of a Company shall be determined either by the articles, or by a resolution passed in a general meeting of the members. The articles may require the resolution to be a special resolution.—Sec. 309(1).

2. If a director gives professional service to the company, he may be paid for it, provided that, in the opinion of the Central Government, he has requisite qualifications for the profession.

3. The remuneration of directors is part of the overall managerial remuneration which, according to Section 198, cannot exceed 11% of the net profits. When profit is inadequate or company is in loss a managerial person is entitled to a minimum remuneration. The ceiling an minimum remuneration has been prescribed in Part II of Schedule XIII. The minimum remuneration is in terms of 'effective capital' of the company. Minimum remuneration will be Rs. 40,000 up to effective capital Rs. 1 crore, Rs. 57,000 between Rs. 1 and Rs. 5 crores effective capital, Rs. 72,000 between 5 to 15 crores and maximum remuneration will be Rs. 87,000 when effective capital is more than Rs. 15 crores.

4. A director may receive remuneration either by way of a monthly payment, or by way of a fee for each meeting of the Board, or a Committee thereof attended by him, or partly by the one way and partly by the other.—Sec. 309(2).

5. A director, who is either in the whole-time employment of the company or a Managing Director, may be paid remuneration either by way of a monthly payment or at a specified percentage of the net profits of the company or partly by one way and partly by the other. But, except with the approval of the Central Government, such remuneration shall not exceed 5% of the net profits for one such director, and if there is more than one such director. 10% for all of them together.—Sec. 309(3).

6. Directors (who are not in the whole-time employment of the company and not a Managing Director) may be allowed a monthly, quarterly or annual sum with the approval of the Central Government, or a commission on net profits (if sanctioned by a special resolution). Such commission shall not exceed for all the directors together (i) 1% of the net profits of the company, if the company has a managing or whole-time director, or a

manager ; and (ii) 3% of the net profits of the company, in any other case. Commission, in excess of these rates, may be allowed with the approval of the Central Government if so resolved in a general meeting of the company.—Sec. 309(4).

7. The net profits are to be calculated in the manner laid down in Section 198(1).—Sec. 309(5).

8. Remuneration drawn in excess of what is allowable, must be refunded to the company and, till so refunded must be held in trust for the company.—Sec. 309(5A). The company cannot waive recovery of such sums.—Sec. 309(5B).

9. A whole-time director or a Managing Director who receives a commission from a Company is not entitled to receive any commission or remuneration from any subsidiary of the Company.—Sec. 309(6).

10. The rules stated above do not apply to private Companies unless they are subsidiary of public Companies.—Sec. 309(9).

11. Any provision relating to the remuneration of directors or managing directors or an amendment thereof, whereby such remuneration is increased, will not be valid unless sanctioned by the Central Government. But the director's fee, for attending a meeting of the Board or a Committee can be increased up to Rs. 250 without Government sanction. When paid up capital of the Company is not more than Rs. 50 lakhs Rs. 500 between Rs. 50 lakhs to Rs. 5 crores paid up capital Rs. 750 between Rs. 5 crores and Rs. 10 crores and Rs. 1,000 in case of more than Rs. 15 crores paid up capital.

12. ***Legal decisions*** :

(*a*) The remuneration payable to directors is a debt for which a director may sue the Company. *Orton* v. *Cleveland etc. Co.*[1] Such remuneration may be paid out of capital if there are no profits.

(*b*) Directors are not entitled to any remuneration as of right. The become entitled to remuneration when the articles so provide or when a resolution is passed by the members granting them remuneration. *In re George Newman & Co.*[2] *Stroud* v. *Royal Aquarium. etc. Society.*[3]

(*c*) R and H were appointed managing directors of the company for the first time after the coming into force of the Act. The Law Board, while granting approval, inserted the condition that the total

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[1] (1865) 3 H & C 868 [2] (1895) 1 Ch. 674
[3] (1903) 87 L.T. 243

remuneration of each managing director by way of commission and salary shall not exceed Rs. 12,000 per annum. The said remuneration was in addition to the benefit of certain perquisites which would be available to the managing directors.

Held, in view of the provisions of the Sections 269 and 637A, the Company Law Board was well within its powers in imposing the condition. *Company Law Board* v. *The Upper Doab Sugar Mills Ltd. etc.*[1]

MEETINGS OF THE BOARD OF DIRECTORS

The Board of directors is the executive authority of the Company. Generally, the directors exercise their powers through resolutions passed in meetings of the Board. The Companies Act contains the following rules regarding Board meeting :

1. In the case of every Company, a meeting of its Board of directors shall be held at least once in every three months and at least four such meetings shall be held every year. The Central Government may, by notification in the Official Gazette, exempt any class of companies from this rule either wholly or subject to modifications and conditions.—Sec. 285.

2. Notice of every meeting of the Board of directors shall be given in writing to every director for the time being in India, and at his usual address in India to every other director.—Sec. 286.

3. The quorum for a meeting of the Board of directors 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.

But when some directors are unable to participate in the discussions of the Board (because some contract or arrangement in which they are interested is being discussed) and the number of such directors exceeds or is equal to two-thirds of the total strength, the number of the remaining directors, that is to say, the meeting being not less than two, shall be the quorum during such time.—Sec. 287.

Case Law :

A quorum of two directors meant a quorum of two directors who were competent to transact and vote on the business before the Board. *Needle Industries (India) Ltd., and others.* v. *Needle Industries Newey (India) Holdings Ltd., and other.*[2]

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[1] AIR (1977) Supreme Court 831 [2] AIR (1981) Supreme Court 1298

4. If a meeting of the Board could not be held for want of quorum, then unless the articles otherwise prove, 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.—Sec. 288.

A meeting, which could not be held for want of quorum, will count as a meeting for the purposes of Section 285. (Sec. 1, above.)

5. A resolution shall be deemed to have been passed by the Board (or by a Committee thereof) *by circulation*, if the resolution has been circulated in draft, together with the necessary papers, if any, to all the directors, or to all the members of the Committee then in India (not being less in number than the quorum fixed) and to all other directors or members, at their usual address in India and has been approved by such of the directors as are then in India or by a majority of such of them, are entitled to vote on the resolution.—Sec. 289.

LEGAL POSITION OF DIRECTORS

There are different views about the legal position of directors. They have been described sometimes as *trustees* of the company and sometimes as its *agents*. Neither view is wholly correct but both contain elements of truth.

Trustees

A director is not a trustee in the correct legal sense of the term. A trustee is a person who is the owner of property and deals with it as principal. A director is not the owner of the company nor does he enter into contracts with third parties as owner of the company's property. Therefore a director is not a trustee. But the director's position is *similar* to that of a trustee because the directors are bound to exercise their powers in the interest of the company and are liable for misuse of powers if any. A director may be called trustee in the sense that the courts expect from directors the same degree of integrity and standard of conduct as is expected from a trustee.

Fiduciary Position

It is generally agreed that the directors occupy a *fiduciary position* in relation to the company. *Re Lands Allotment Co.*[1] They

[1] (1894) 1 Ch. 616

cannot make secret profits and must make full disclosure of all material facts concerning their interests in connection with the company. There is, however, no fiduciary relationship between a director and an individual shareholder and he is not a trustee for any particular shareholder. *Perceival* v. *Wright.*[1]

Agents

If is more accurate to describe directors as *agents.* The directors are agents of the company because the company acts through the directors. Contracts with third parties are entered into by the directors, not as principals, but as agents of the company. But it is not strictly speaking true to say that the directors are nothing more than agents of the company. By the articles and under the Companies Act the directors have independent powers in certain matters. An agent is bound to take instructions from his principal and to abide by his wishes in the business of the agency. But the directors are not bound to consult the shareholders in all matters.

"Directors are, in the eye of the law, agents of the company for which they act, and the general principles of the law of principal and agent regulate in most respects the relationship of the company and its directors."—Palmer's Company Law. Quoted and approved in *R. K. Dalmia* v. *Delhi Adm.*[2] and in *Chavalier etc.* v. *The Dharmodayam Co.*[3]

In a case under the Penal Code, Sec. 409 (Criminal Breach of Trust), the Supreme Court observed as follows : A Director is not only an agent but is in the position of trustee. A Director, being a trustee of the assets which has come into his hand, has dominion and control over the same. *Shivanarayan* v. *State of Maharashtra.*[5]

Officers

The Section 3(30) of the Companies Act provides that a director is an officer of the Company. Section 3(31) provides that an officer, 'who is in default' may be punished if he is guilty of default, non-compliance, failure or refusal of the rules regarding the Companies Act (see p. 705).

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[2] (1902) 2 Ch. 421
[3] (1963) S.C.R. 253 (Supreme Court)
[4] (1963) 1 S.C.R. 85
[5] AIR(1980) Supreme Court 439

Employees or Servants

A director may enter into a service contract with the Company. For example, a director may be the legal advisor of a company.

A Director can become a servant of the company under a special contract of service. *K. R. Kothandaraman* v. *Commissioner of Income-Tax.*[1]

Conclusion

In the case, *Re Forest of Dean Coal Mining Co.*[2] the position of the directors was described as follows: "Directors are described as trustees, agents or managing partners, not as exhausting their powers and responsibilities but as indicating useful points of view. It does not matter much what you call them, so long as you understand what their true position is, which is that they are commercial men, managing a trading concern for the benefit of themselves and all other shareholders in it."

POWERS OF DIRECTORS

Directors derive their power and authority from two sources (*i*) the Articles of Association of the Company and (*ii*) the Companies Act.

The articles of association generally contain a list of the powers which may be exercised by directors and the limitations on those powers if any. The articles, also contain a list of those matters which are to be decided by the members in a general meeting. Section 291 of the Companies Act lays down that subject to the provisions of the articles the Board of directors of a company shall be entitled to exercise all such powers and do all such acts and things as the company is authorised to exercise and do.

All acts and things done by the Board of directors, within the powers given to it by the articles, are valid and binding on the company. If the Board does something which is beyond the powers of the Board but within the powers of the company as laid down in the Memo, the members can, if they wish, ratify the act of the Board. The thing done will thereupon be binding

[1] AIR (1967) Mad 143 [2] (1878) 10 Ch. D. 450

on the company. But the members, even if unanimous, cannot ratify and validate an act which is beyond the powers of the company.

It is to be noted that a director individually has no authority over the affairs of the company except as regards matters which have been specifically delegated to him by the Board. Such delegation is permissible within certain limits. Apart from such delegated authority exercisable by individual directors, the authority and powers of directors are to be exercised collectively through resolutions of the Board of directors.

"The directors and shareholders in general meeting are primary organs of the company between whom the company's powers are divided. The general meeting retains ultimate control, but only through its powers to amend the Articles, to take away powers from the directors and to remove the directors and to substitute others to the taste of the shareholders." *Murarka P. and V. Works Ltd.* v. *Mohan Lal.*[1]

Section 292 of the Companies Act provides that the Board of directors shall exercise the following powers on behalf of the company and it shall do so only by resolutions passed at meeting of the Board: (*a*) make calls on shareholders; (*b*) issue debentures; (*c*) borrow moneys otherwise than on debentures; (*d*) invest the funds of the company; and (*e*) make loans.

[Clauses (*c*) and (*e*) do not apply to banking companies.]

Some of these powers may be delegated to a committee of directors, or to the managing director, manager etc.

Restrictions on the powers of the Board

Section 293(1) of the Act imposes the following restrictions on the powers of the Board.

The Board of directors of a public company or of a private company which is subsidiary of a public company shall not, except with the consent of the company in general meeting,—

(*a*) sell, lease or otherwise dispose of the whole, or substantially the whole, of the undertaking of the company, or any of its undertaking where the company owns more than one undertaking;

(b) remit or give time for the re-payment of any debt due by a director (except in the case of a loan by a banking company);

[1] AIR (1961) Cal 251

(*c*) invest otherwise than in trust securities the sale proceeds resulting from the acquisition, after the commencement of this Act without the consent of the company, of any such undertaking as is referred to in clause (a), or of any premises or properties used for any such undertaking ;

(*d*) borrow moneys, where the moneys to be borrowed together with the moneys already borrowed by the Company, (apart from temporary loans obtained from the company's bankers in the ordinary course of business) will exceed 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 ; or,

(*e*) contribute, after the commencement of this Act, to charitable and other funds not directly relating to the business of the company or the welfare of its employees any amounts the aggregate of which will, in any financial year, exceed twenty five thousand rupees or five per cent of its average net profits during the three financial years immediately proceeding, whichever is greater.

Under Sec. 293A, the Board of directors of a company cannot contribute to any *political party* or for any *political purpose* (See below).

Sole selling agents

Section 294 provides that after the commencement of the Act of 1956, the Board of directors of a company shall not appoint a sole selling agent for any area for a term exceeding five years at a time. There may be re-appointment or the extension of the term of office. The above rules are 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.

An appointment of sole selling agent would be void *ab initio,* unless the agreement contains the above condition. *Arantee Manufacturing Corpn.* v. *Bright Bolts Pvt. Ltd.*[1]

The Central Government can prohibit the appointment of sole selling agent in certain cases *e.g.*, (1) where the agent to be appointed has a substantial interest of the company (2) where the company has a paid-up share capital of Rs. 50 lakhs or more, etc.—Sec. 294AA. Companies (Amendment) Act, 1974.

[1] AIR (1967) Bom. 440

Validity of Acts of Directors

Acts done by a person as director are valid, notwithstanding that it may afterwards be discovered that his appointment was invalid by reason of any defect or disqualification or that his appointment as director had terminated by virtue of any provision contained in the Act or in the articles.—Sec. 290. It is, however, provided that nothing in Section 290 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.

CONTRIBUTION FOR POLITICAL PURPOSES

293A. (1) Notwithstanding anything contained in any other provision of this Act, neither a company in general meeting nor its Board of directors shall, after the commencement of the Companies (Amendment) Act, 1969, contribute any amount or amounts—

(*a*) to any political party, or

(*b*) for any political purpose to any individual or body.

(2) If a company contravenes the provisions of sub-section (1) then—

(*i*) the company shall be punishable with a fine which may extend to five thousand rupees ; and

(*ii*) every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and shall also be liable to fine.

293B. The Board of directors of any company or any person or authority exercising the powers of the Board of directors of a company, or of the company in general meeting, may, contribute such amount as it thinks fit to the National Defence Fund or any other Fund approved by the Central Government for the purpose of national defence.

Every company shall disclose in its profits and loss accounts the total amount or amounts contributed by it to the Fund.

Donations

Companies can make donations to any individual or organisation for charitable purposes and to other funds up to 5% of its average profits during the three financial years immediately preceding or Rs. 25,000 whichever is greater. See Section. 293(1)(e), p. 689.

Every donor company will be required to disclose in its annual statement of accounts the amount contributed by it to any individual or organisation. It will also have to mention the name of the recipient.

Any company failing to furnish the information and every officer of the company in default will be punishable with a fine of up to Rs. 5,000.

RIGHTS OF DIRECTORS

1. Participation

A director validly appointed to the Board, and not suffering from any disqualification which would prevent him from acting as such, is entitled to attend meetings of the Board and participate in the direction of the company's affairs. If this right is interfered with by the other directors or by the company's officers, it can be enforced by a mandamus from High Court.

2. Remuneration

A director is entitled to receive the remuneration fixed by the articles or otherwise, subject to the provisions of the Act.

3. Compensation

[Sections 318-321.] A whole-time director and a managing Director may be given compensation by the company in case of premature termination of service.

But no compensation can be given in the following cases—where the termination is due to reconstruction or amalgamation ; where the director concerned has to vacate office in accordance with the provisions of the Act ; where the company is being wound up ; where the director is guilty of fraud or breach of trust ; and, where the director has instigated or has directly, or indirectly taken part in bringing about the termination of his office.

The amount of compensation paid must not exceed the remuneration which he would have earned if he had been in office for the unexpired residue of his term of office or three years whichever is another.

DUTIES OF DIRECTORS

The duties of directors of a company have been elaborately explained by Romer L. J. in *Re City Equitable Fire Insurance Co.*[1] The important duties are quoted from this case and summed below :

1. Distribution of work

"The manner in which the work of a company is to be distributed between the board of directors and the staff is a business matter to be decided on business lines."

2. Good faith

Every director must act honestly and in the interest of the company.

3. Reasonable care

A director, "must exercise such degree of skill and diligence as would amount to the reasonable care which an ordinary man might be expected to take in the circumstances on his own behalf."

4. Degree of skill

A director, "need not exhibit in the performance of his duties a greater degree of skill than what can be reasonably expected from a person of his knowledge and experience ; in other words, he is not liable for mere errors of judgment."

5. To attend meetings

A director, "is not bound to give continuous attention to the affairs of his company ; his duties are of an intermittent nature to be performed at periodical board meetings and the meetings of any committee to which he is appointed, and though not bound to attend all such meetings, he ought to attend them when reasonably able to do so."

6. The director's duty of disclosure

The Companies Act of 1956 makes it obligatory upon directors to disclose certain facts to the company :

(*i*) If a director is interested in any contract or arrangement proposed to be entered into by the company, he must disclose the interest to the Board of directors.—Sec.299.

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[1] (1925) 1 Ch. 407

(*ii*) He must disclose, for the purpose of entry in the register of directors his name, address, occupation, nationality and certain other particulars.—Sections 303 and 305.

(*iii*) He must disclose the number of shares of the company which he holds.—Sec. 308.

7. Other duties

In addition to the duties mentioned above every director has the following duties : (*i*) A director has to send to the registrar stating his consent to the post of director.—Sec. 266. (*ii*) Every director must obtain the qualification share of directorship according to the article of the company.—Sec. 270. (*iii*) Every director must pay his share monies according to the 'Call' of the Board of directors. (*iv*) A director must not participate in the meeting of the Board of directors, when they decide his contract with the company.

Conclusion

If a director fails to preform his duties, as explained above, he is guilty of negligence. If on account of such negligence the company suffers any damages, the director must compensate the company.

DISABILITIES OF DIRECTORS

The Companies Act imposes certain disabilities on directors, with a view to protect the interests of the company and of the shareholders. A list of the disabilities is given below.

1. No Assignment

A director cannot assign his office.—Sec. 312.

2. No indemnity

Any provision (contained in the articles or in any other document) for exempting any officer of the company or its auditor from any liability for negligence, misfeasance, default, breach of duty or breach of trust in relation to the company, or indemnifying him against such liability is void.—Sec. 201. The company may, however, indemnify any such officer against any liability incurred for defending a civil or criminal proceedings in which judgment is given in his favour.

3. Loans to director

There are restrictions on the giving of loans to directors.

4. Contract with directors

There are restrictions upon contract with directors.

5. Number of directorships

There are certain restrictions upon the number of directorships.

6. Office or place of profit (Sec. 314)

An office or place of profit means any post that carries with it any remuneration or any perquisite in the form of rent-free quarters or otherwise.

Subject to the exceptions noted below, an office or place of profit under a company or its subsidiary cannot be held by a director of the company. Also, a director's *partner or relative*—(*i*) a firm of which the director or his relative is a partner, (*ii*) a private company of which the director is a director or member, and (*iii*) all directors and managers of such private companies—cannot hold an office or place of profit carrying a total monthly remuneration of Rs. 500 or more.

Exceptions :

(*a*) The office or place of profit can be held if the consent of the company is given by a special resolution passed in the general meeting *first* held after the appointment. In case the *relative* of a director is so appointed without the knowledge of the director, further time is given, *viz.*, 3 months or 1st meeting whichever is later.

(*b*) The office or place of profit can be held in the subsidiary company, if the remuneration received is handed over to the company or its holding company.

(*c*) The following posts are not considered to be offices or places of profit for the purposes of this rule—the post of the managing director, manager, legal or technical adviser, and banker or trustee for debenture holders of the company.

(*d*) The *relative* of a director may hold an office or place of profit if he was appointed before the director became a director.

Any person violating the above rules shall lose his post (as director etc.) with effect from the date next after date on which his appointment could have been sanctioned by the company in a general meeting. [See under para (*a*).] He shall also be liable to refund to the company the remuneration received and the money equivalent of the advantages enjoyed by him in respect of the office or place of profit.

The Companies (Amendment) Act 1974 provides that (*a*) no partner or relative of a director or manager, (*b*) no firm in which such director or manager, or relative of either, is a partner, (*c*) no private company of which such a director or manager, or relative of either, is a director or member shall hold any office or place of profit in the company which carries a total monthly remuneration of not less than Rs. 3,000, except with the prior consent of the company by special resolution and the approval of the Central Government.—Sec. 314(1B).

If a contravention of the rule occurs the person concerned must refund the remuneration and monetary equivalent of the perquisites or advantage. The company shall not waive the recovery of such monies.

The above rules are not applicable to a director appointed by Central Government under Section 408.—Sec. 314(2B), (2C) and (2D), Companies (Amendment) Act, 1974.

LIABILITIES OF DIRECTORS

The liabilities of directors may be analysed with reference to liability of directors to third parties, liability to the company, liability for breach of statutory duties and liability for acts of his co-directors. Directors' liability may be civil liability, criminal liability and unlimited liability.

I. Civil Liability

The directors may, under certain circumstances, be liable to pay compensation to the company and to outsiders. Some of these circumstances are mentioned below.

1. The directors are liable for untrue statements in the prospectus.

2. For contracts entered into on behalf of the company, the directors are not personally liable. But if the authority possessed

by the directors is exceeded, they may be liable to pay damage to the other party for breach of warranty of authority.

3. The directors are liable to the company for *ultra vires* acts. For example, if dividend is paid out of capital, the directors are bound to refund the money to the company out of their own pockets. (See p. 580)

4. If a director performs his duties negligently and the company thereby suffers damage, he must pay compensation to the company.

5. A director is liable to account for all secret profits made by him in connection with the affairs of the company.

6. A director is liable for any act amounting to a breach of trust relating to the properties and funds of the company.

7. Directors are liable for misfeasance, *i.e.*, any breach of duty which causes loss to the company.

Misfeasance and breach of trust include breach of duty to the Company resulting in misapplication or loss of company's assets. Proof of fraud is not essential. The offender is also criminally liable. The offender is liable to repay or restore the company's loss. *P. K. Nedungadi* v. *Malayalee Bank Ltd.*[1] See *Shivanarayan* v. *State of Maharashtra*, p. 688.

II. Criminal Liability

For certain breaches of duty the Companies Act imposes a criminal liability upon directors. Various sections of the Act provide for the imposition of fines for non-performance of the prescribed duties. There is provision for imprisonment in certain cases. Examples—untrue statements in prospectus; failing to keep certain register; falsification of books and reports etc.

Section 633 of the Act provides that in any proceedings against any director or officer of the company for negligence, breach of duty, misfeasance etc. the court can excuse him from any liability if it is of opinion that such director or officer has acted honestly and reasonably and that having regard to all the circumstances of the case, he ought fairly to be excused. But in criminal proceedings, the court has no power to grant relief from any civil liability.

During Misfeasance proceedings a director died. The proceedings can be continued against his legal representatives.

[1] AIR (1971) Supreme Court 829

But his liability would be limited to the value of the deceased estate in his hands. *Offical Liquidator* v. *Parthasarathi Sinha and others.*[1]

Offences against the Act are cognizable only upon a complaint in writing by the Registrar, a shareholder, or a person authorised by the Central Government in that behalf.—Sec. 621. But if a shareholder makes a frivolous or vexatious complaint and any of the accused is acquitted or discharged, the magistrate may direct the complainant to pay compensation. The magistrate may further order that if default is made in the payment of compensation, the complainant shall suffer simple imprisonment for a term not exceeding two months.—Sec. 625.

III. Unlimited Liability of Directors

The memorandum of association of a company may provide that the liability of the directors or any director or manager, may be unlimited.—Sec. 322.

A limited company may, if so authorised by its articles, alter its memorandum of association by special resolution so as to render unlimited the liabilities of its directors or any director or manager.—Sec. 323.

Obligations of Directors etc. on winding up—See in ch. 11, "Contributory". Sec. 427.

EXERCISES

1. What are the modes of appointment of directors of a company. (Page 667)
2. State the effects of invalid appointment of directors.(Page 672)
3. What are the qualifications for directorship of a company limited by shares ? (Page 672)
4. State how the Managing Director of a Public Limited Company is appointed and what his duties are. (Page 677)
5. (*a*) Can a company appoint its directors by proportional representation ? (Page 667)
   (*b*) What are the disqualifications of a managing director ? (Page 679)
   (*c*) Can a director be appointed even if he is an undergraduate ? (Page 672)
   (*d*) What are the rules for the removal of a director ? (Pages 675-676)

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[1] AIR (1983) Supreme Court 188

6. Enumerate the cases in which the office of a director may fall vacant. (Page 674)
7. Are the directors entitled to a remuneration ? Can such remuneration be waived ? (Page 683)
8. "Directors are trustees for their company" Discuss. (Page 687)
9. What is the exact legal position of the Directors of a Public Company ? (Page 687)
10. "Directors are not only agents, but are also in some sense trustee of the company." Discuss. (Page 687)
11. What are the rules of retirement of directors ? (Page 672)
12. State the powers of the Board of directors of a company, and restriction on them. (Page 689)
13. State the matters that may by transacted only at Board meetings. (Pages 683-684)
14. State the true position of shareholders and directors and the relationship between them. (Page 687-688)
15. State what are the disqualifications of directors. (Page 671)
16. Discuss the powers of director of a company under the Companies Act. (Page 689)
17. State the duties of directors. (Page 694)
18. Can a director resign the post of directorship ? What is the law about resignation of directors ? (Page 673)
19. State the powers of directors which cannot be exercised without the approval of members given in a general meeting. (Page 689)
20. What are the powers of directors of a company under the Companies Act ? (Page 689)
21. What are the disabilities of directors under the Companies Act ? (Page 695)
22 What are the liabilities of directors under the Companies Act. (Page 697)
23. What are the rights of a director of a Company ? (Page 693)
24. Write notes : (*a*) Alternate Directors ; (*b*) Qualification Shares ; (*c*) Disqualifications of Directors : (*d*) Rotation ; (*e*) Vocation ; (*f*) Whole-time Director ; (*g*) Board of Directors ; (*h*) Office of profit. (Pages 667-676, 686-687)
25. Problems :
    (*a*) A director holds the bearer of a share warrant for share qualification of his directorship. It is a valid share qualification ? (Pages 696-697)
    (*b*) Mr. X is a director of a company. The Board of Directors unanimously appoint him as manager on a monthly salary of Rs. 2,000. The company refuses to pay his salary on the plea that Mr. X being a director, cannot hold an office of profit. Decide. (Pages 695-696)

(*c*) A, being aware of his invalid appointment as a director, allots shares to himself. Can he avoid the allotment subsequently on the ground of irregularity? Give reasons for your answer. (Page 666)

26. What are the duties of directors of a company? Discuss the liabilities of directors. (Page 694)
27. Describe the legal position of the directors of a public limited company. (Page 687)
28. Objective questions. Give short answers.
    (*i*) State whether an insolvent can become a director of a company. (Page 672)
29. (*a*) Explain clearly the true position of a director in relation to the actual management of a company. (Page 687)
    (*b*) Discuss the different ways a director of a company may be appointed. (Pages 666-668)
    (*c*) What are the qualifications and disqualifications for being appointed as the director of a company? (Pages 670-671)

7 COMPANY MANAGEMENT

MODES OF MANAGEMENT OF A COMPANY

The usual and normal practice is to entrust the management of a company to the Board of Directors. The Companies Act of 1956 formerly recognised and provided for four alternative forms of management, *viz.*, (*i*) by Managing Directors or Whole-time Directors (*ii*) by Managing Agents (*iii*) by Secretaries and Treasurers and (*iv*) by Managers.

But no company can have *at the same time* more than *one* of the above categories of managerial personnel.—Sec. 197A.

The amended Act of 1969 abolished (*ii*) and (*iii*) of the modes from 3rd April, 1970.—Sec. 324A.

Managing Agent

Section 2(25) defines a managing agent as an individual, firm or body corporate, entitled to the management of the whole, or substantially the whole, or the affairs of a company by virtue of an agreement with the company. (Now abolished)

RELATIVE

Section 6 provides that a person shall be deemed to be a relative of another if, and only if, (*a*) they are members of a Hindu undivided family ; or (*b*) they are husband and wife ; or (*c*) the one is related to the other in the manner indicated in Schedule IA.

Schedule IA, after the amendment of 1965, contains a list of 22 items like father, mother, mother's mother, daughter's son, etc. Previously there were 49 items.

THE SECRETARY

The Secretary is an officer of the company having specified duties. The administrative work in a company can be divided into two parts ; management of the business and secretarial work. The latter includes maintenance of the books and registers required by the Companies Act, issue of share certificates,

certification of shares, the recording of transfer of shares etc. The Secretary is in charge of this branch of administration. His duties include, in addition to the items mentioned above *e.g.*, attending meetings of the company, drafting the minutes, issuing notices of meetings, and sending returns to the Registrar, etc. In some companies the Secretary is also in charge of the accounts.

Section 2(45), as amended in 1974, defines a Secretary as, "any individual possessing the prescribed qualifications appointed to perform the duties which may be performed by a secretary under this Act, and any other ministerial or administrative duties."

Section 2(45) of the amending act provides that "Secretary means a Company secretary within the meaning of Clause C of sub-Section (I) of Section 2 of the Company Secretaries Act, 1980." It includes any other individual possessing the prescribed qualifications and appointed to perform the duties which may be performed by a secretary under this Act, 1988.

Section 2(30) provides that a Secretary is an 'officer'. As such he occupies a fiduciary position in relation to the company.

A Secretary is a servant of the company and under the full control of the Board of Directors. The Secretary has no authority to represent the company, unless expressly authorised. *Barnet Hoars & Co.* v. *South London Tramways Co.*[1]

The Companies (Amendment) Act, 1974, provides that a Secretary must be an "individual". Formerly, under the Act of 1956, a Secretary may be an "individual, a firm or a body corporate".

Compulsory appointment

Every company having a paid-up share capital of Rs. 25 lakhs or more shall have a whole-time Secretary. Where the Board of directors of any such company comprised only two directors, neither of them shall be the Secretary of the company.—Sec. 383A(1), Companies (Amendment) Act, 1974.

Section 383A of the amended Act 1988 provides that every Company having such paid-up share capital as may be prescribed, shall have a whole-time secretary and where the Board of directors of any such Company comprises only two directors, neither of them shall be the secretary of the Company. If a

[1] (1887) 18 Q.B.D. 815

Company fails to comply with this provisions of sub-Section (1), the Company and every officer of the Company who is in default shall be punishable with fine.

MANAGER

Definition

Section 2(24) defines a Manager as an individual (not being the managing agent) who, subject to the superintendence, control and direction of the Board of directors, has the management of the whole, or substantially the whole, of the affairs of the company. The term includes a director or any other person occupying the position of a manager, by whatever name called and whether under a contract of service or not. It should be noted that M. D. or W. D. is a Director on Board, while a manager may or may not be a Director on Board. A Director may also be appointed as Manager.

Provisions of the Act regarding Managers

The Act of 1956 contains the following rules regarding Managers :

1. No company can employ a firm, a body corporate or an association as its manager.—Sec. 384.

2. No company can appoint or employ any person as its manager who—

(*a*) is an undischarged insolvent, or has at any time within the preceding five years been adjudged an insolvent ; or

(*b*) suspends payment or makes a composition with his creditors, or has at any time within the proceeding five years suspended payment or made a composition with his creditors ; or

(*c*) is, or has at any time within the preceding five years been convicted by a court in India of an offence involving moral turpitude.—Sec. 385(1).

The Central Government may by notification in the official Gazette remove the disqualification incurred by any person from the aforesaid causes either generally or in relation to any company or companies specified in the notification.—Sec. 385(2).

3. Ordinarily a person can be manager of one company only. He can be manager of two or more companies under the same

conditions under which a person may be managing director of two or more companies.—Sec. 386. (See p. 679)

4. Subject to the overall limits laid down for managerial remuneration, a manager may be given remuneration either by way of monthly payments or by way of a specified percentage of net profits. Except with the approval of the Central Government such remuneration shall not exceed in the aggregate 5% of the net profits.—Sec. 387.

5. Any change in the regulations of the company or any agreement by which the remuneration of a manager is increased, requires the previous approval of the Central Government.—Sections 310, 311, 388.

6. A manager cannot be appointed for a term exceeding five years at a time.—Sections 317, 388.

7. The office of manager cannot be assigned.—Sections 312, 388.

8. Rules 3 to 7 above do not apply to a private company unless it is a subsidiary of a public company.—Sec. 388A.

OFFICER

"Officer" includes any director, manager or secretary or any person in accordance with whose directions or instructions the Board of directors or any one or more of the directors is or are accustomed to act. For Sections 477, 478, 539, 543, 545, 621 625 and 633 an auditor is also taken as an officer. Managing Agent, Secretaries and Treasurers were also regarded as officers, but the posts of Managing Agent and Secretaries and Treasurers were abolished and the question of their inclusion does not arise.—Sec. 3(30).

The expression "Officer who is in default" means any officer of the company who is knowingly guilty of the default, non-compliance, failure, refusal or contravention or who knowingly and wilfully authorises or permits such default, non-compliance, failure, refusal or contravention.—Sec. 3(31) and Sec. 5.

Section 5 of the Companies Act, 1988 has been amended to revise the definition of 'officer in default'. The expression 'officer who is in default' means all the following officers of the Company, namely,

"(*a*) the managing director or managing directors,

(*b*) the whole-time director or whole-time directors,

(*c*) the manager,

(*d*) the secretary,

(*e*) any person charged by the Board with the responsibility of complying with that provision, provided that the person so charged has given his consent in this behalf to the Board."

(*f*) where any Company does not have any of the officers specified in Clause (*a*) to (*c*), any director or directors who may be specified.

CONTRACTS AND DEEDS OF A COMPANY

Contracts which require to be in writing, must be in writing and must be signed by some person acting under the authority of the Company, express or implied. Such contracts may be varied and discharged in the same manner.—Sec. 46(1)(a).

Contracts which may be made orally by private persons, may be made orally on behalf of Companies by any person acting under the authority of the Company, express or implied. Such contracts may be varied and discharged in the same manner.—Sec. 46(1)(b).

A bill of exchange, hundi or promissory note shall be deemed to have been made, accepted, drawn or endorsed on behalf of a company when so done in the name of, or on behalf or on account of the company by any person acting under its authority, express or implied.—Sec. 47.

Deeds, on behalf of a Company must be executed by some person authorised by the Company by a general or special power of attorney. The common seal of the Company must be affixed.—Sec. 48.

All investments made by the Company on its own behalf shall be made and held in its own name, or, where so permitted, in the name of a nominee. This rule does not apply to a company whose business is buying and selling of securities.—Sec. 49.

Where authentication of documents and proceedings by the Company is required it may be done by any Director, the Manager, the Secretary or, other authorised officer of the company. It is not necessary to use the common seal.—Sec. 54.

SERVICE OF DOCUMENTS

Documents may be served on a Company by sending it to the registered office by registered post or under certificate of

posting or by leaving it at the registered office.—Sec. 51. The same is the procedure for serving a document on the Registrar.—Sec. 52.

Service of documents on a member may be done personally or by sending it to him by post to the address supplied by him to the company.—Sec. 53.

GENERAL PROVISIONS REGARDING REGISTERS AND RETURNS

Place of keeping

The register and index of members and debenture holders, and copies of all annual returns together with copies of the certificates and documents required to be annexed thereto, shall be kept at the registered office of the company. They may be kept at any other place within the city, town or village where the registered office is situated, provided (*i*) the other place is approved by a special resolution of the members and (*ii*) the Registrar has been given in advance a copy of the special resolution. The Central Government may make rules for the preservation and disposal (by destruction or otherwise) of such registers, returns and documents.—Sec. 163(1).

Inspection and copies

The registers, indexes, return and certificates and documents shall be open to inspection during business hours. The company may impose reasonable restrictions but not less than two hours each day must be allowed for such inspection. No inspection will be allowed during the period the register of members and debenture holders is closed under the previsions of the Act.

The registers etc. may be inspected by a member or debenture holder without any fee Others will have to pay a fee of Re. 1 for each inspection.

Any person may take extracts from the registers etc., He may also require a copy of any part on payment of 37 paise for every 100 words or part thereof. The company must send such copy within ten days after it is required.

If inspection is refused or if a copy is not sent when required, the company and every officer in default may be fined up to Rs. 50 for each day of default. The court may direct immediate inspection, or the taking of extracts and the despatch of copies.—Sec. 163(2).

Registers etc. to be evidence

The registers, annual returns etc. shall be *prima facie* evidence of any matters directed or authorised to be inserted therein by the Act.—Sec. 164.

MANAGERIAL REMUNERATION

The Act of 1956 contains certain rules regarding the total remuneration payable to Directors, Managers etc. They are as follows.—Sec. 198.

In the case of a public company or a private company which is a subsidiary of a public company, the *total* remuneration payable by the Company to its Directors, and Manager if any, shall not exceed 11% of its net profits.

The term 'remuneration' includes expenditure by the company on rent-free accommodation, other amenities and life insurance premia.

If, in any financial year, no profits or inadequate profits have been made, remuneration has to be at par with Part II of Schedule XIII. Company can pay remuneration lower than the ceiling but not more. It is based on effective capital of the company. Where a monthly payment is made to managing or whole-time directors, the Central Government, on the application of the Company, may sanction a higher amount.

For determining maximum remuneration, net profits are to be calculated in the manner laid down in Sections 349-351 of the Act except that the remuneration of the directors shall not be deducted from the gross profits.

No Company shall after the commencement of the Act of 1956 pay any officer, any remuneration calculated free of income tax or super-tax.—Sec. 200.

There shall be no provision in the articles or in any agreement relieving a person in the employment of a Company from the duty of indemnifying the Company from damages for negligence, breach of trust etc., except against any liability incurred for defending himself in any suit or criminal proceedings, provided judgment has been given in his favour.—Sec. 201.

The Government policy regarding remuneration

Notwithstanding Sections 198, 309 or 637A, when approval of the appointment of a person while fixing the remuneration of the person the Central Government shall have regard to—

(*a*) the financial position of the company.
(*b*) the remuneration or commission drawn by the individual concerned in any other capacity, including his capacity as a sole selling agent ;
(*c*) the remuneration or commission drawn by him from any other company ;
(*d*) professional qualifications and experience of the individual concerned ;
(*e*) public policy relating to the removal of disparities in income.—Sec. 637AA, Companies (Amendment) Act, 1974.

MANAGEMENT BY UNDESIRABLE PERSONS

If an undischarged insolvent acts as director, or discharges the functions of manager ; or directly or indirectly takes part in the promotion, formation or management of a Company, he may be sentenced to imprisonment for 2 years or fined up to Rs. 5,000.—Sec. 202. In this section the term 'company' includes an unregistered company and a body corporate incorporated outside India, which has an established place of business within India.

The Court may prohibit persons found guilty of fraudulent conduct, from participation in the management or formation of a company.—Sec. 203.

APPOINTMENT OF A BODY CORPORATE

Section 204 provides that a firm or a body corporate (See p. 546) cannot be appointed to an office or place of profit under a company for a term exceeding five years at a time. *Exceptions*—The rule does not apply to the following cases : (*i*) appointment of trustees for debenture holders ; (*ii*) technicians and consultants ; (*iii*) appointments by a private company which is not a subsidiary of a public company ; and, (*iv*) reappointment for further terms of five years.

The Central Government may approve an initial appointment of ten years.

PAYMENT OF INTEREST OUT OF CAPITAL

A company can pay interest out of its capital, in the following cases. (Sec. 208) :

(1) Where any shares in a Company are issued for the purpose of raising money to defray the expenses of the construction of any work or building or the provision of any plant, which cannot be made profitable for a lengthy period ;

(2) the payment of interest out of capital is authorised by the articles, or by a special resolution ; and,

(3) the prior sanction of the Central Government is obtained.

Before sanctioning the payment of interest out of capital, the Central Government may, at the expense of the Company, appoint a person to enquire into and report to the Central Government on the circumstances of the case.

The payment of interest shall be made only for such period as may be determined by the Central Government. The period shall in no case extend beyond the close of the half year next after the half year during which the work or building has been actually completed or the plant provided.

The rate of interest must not exceed 4% or such rate as the Central Government may fix by notification.

WHERE A COMPANY IS UNDISCLOSED PRINCIPAL

Section 416 of the Companies Act provides that if the manager or other agent of a public company (or of a private company which is a subsidiary of a public company) enters into a contract for or on behalf on the company, *in which contract the company is an undisclosed principal*, he shall, at the time of entering into the contract, make a memorandum in writing of the terms of the contract, and specify therein the person with whom it is entered into. The memorandum shall be delivered forthwith to the company and a copy sent to each of the directors. The memorandum shall be filed in the office of the company and laid before the Board of directors at its next meeting.

If default is made in complying with the above requirements—

(*a*) the contract shall, at the option of the company, be voidable as against the company ; and

(*b*) the person who enters into the contract, or every officer of the company who is in default, as the case may be, shall be punishable with fine which may extend to two hundred rupees.

EMPLOYEE'S SECURITIES AND PROVIDENT FUNDS

Moneys and securities deposited with the Company by employees in pursuance of their contract of service, shall be kept or deposited (within 15 days of deposit) (*a*) in a post office savings account, or (*b*) in a special account to be opened by the company for the purpose in the State Bank of India or in Schedule Bank, or (*c*) where the company itself is a Scheduled Bank, in a special account to be opened either in itself or in the State Bank of India or in any other Scheduled Bank. No part of such moneys can be used by the Company for any purpose other than the purposes agreed to in the contract of service.—Sec. 417.

Moneys contributed, received or accruing to an employee's provident fund must, within 15 days from the date of contribution, receipt or accrual, be either deposited in the institutions mentioned above (where employees' securities are deposited) or be invested in trustee securities. Where there are trustees for a provident fund, all such moneys must be paid to the trustees within 15 days from the date of collection.—Sec. 418.

An employee is entitled, on request, to see the bank's receipt for the money or securities referred to in Sections 417 and 418.—Sec. 419.

Any officer of the company and any trustee of a provident fund who contravenes or authorises or permits the contravention of the aforesaid rules, is punishable with imprisonment up to 6 months or fine, which may extend to Rs. 1,000.—Sec. 420.

Employees in factories and certain establishments are covered by the Provident Funds Act (Act XIX 1952). It provides for the institution of provident funds for employees in factories and other establishments. Monies of the Provident Fund are to be deposited in the Fund created for this purpose.

DIVIDEND

The term Dividend means the part of profits which is paid to the shareholders of a company.

Dividend may also be defined as receipt of a part of the profits of a trading company by the members in proportion to their respective shares. A trading company is formed for the purpose of earning profits. It can therefore be assumed that the profits will be distributed among the shareholders. The Act

contains no provision enforcing distribution of profits and no shareholder can claim the declaration of dividends unless the articles make it compulsory for the directors to declare dividends. How much of the profit is to be distributed as dividend, is a matter of internal management and the court will not interfere with the discretion of the directors and shareholders. *Burland* v. *Earle.*[1]

Companies Act, Schedule I, Table A, contains certain Regulations (85-94), regarding dividend.

RULES REGARDING DIVIDEND

1. The Board of directors of the company determines what portion of the net profits earned by the company during its financial year is to be distributed to the shareholders.

2. The amount or rate of dividend determined by the Board must be sanctioned by the members of the company in a general meeting. The members can reduce the amount determined by the Board but cannot increase it.

3. A part of the profits may be distributed before the accounts are finally passed and the declaration of dividends sanctioned in the general meeting. Such dividends are called Interim Dividends. An Interim Dividend means dividend paid between two ordinary general meetings of the shareholders of a company. Regulation 86 of Table A provides that the Board may from time to time pay to the members such *interim* dividends a appear to it to be justified by the profits of a company.

4. Dividends may be paid in proportion to the nominal value of the shares or in proportion to the capital actually paid up on each share, as the articles provide. If unequal amounts have been paid on the shares, the dividends may be unequal as among different shareholders.—Sec. 93.

5. Dividend cannot be paid out of capital. It must be paid out of profits of that year or out of the profits of any previous financial year. "Profits" in this context means profits arrived at after providing for depreciation in the manner laid down in the Act. In companies, where the Central or the State Government has given a guarantee for the payment of a certain rate of

[1] (1902) A.C. 83

dividend, any sum paid by the Government in fulfilment to the guarantee may be paid out as dividend.—Sec. 205.

6. Since dividends are to come out of profits, the rate of dividend recommended by the Board of directors will depend on (*a*) how the profit and loss accounts are made up; (*b*) the valuation of assets and the rate of depreciation; and (*c*) the percentage of profits transferred to the reserve fund of the company.

As regards item (*a*), the profit and loss accounts, the Companies Act contains certain rules which all companies must follow. As regards item (*b*) and (*c*) the directors have considerable discretion.

According to Section 205 of the Companies Act, depreciation must be provided for before dividends are paid. There is, however, one exception. The Central Government may, if it thinks necessary so to do in the public interest, allow any company to pay dividends for any year without providing for depreciation.

7. Reserves

From the commencement of the amendment of 1974, no dividend shall be declared or paid by a company for any financial year out of the profits of the company for that year providing depreciation according to Section 205, *except* after the transfer to reserve of the company of such percentage of profits for that year, not exceeding 10% as may be prescribed. There is nothing to prohibit the voluntary transfer by a company of a higher percentage of a profit to reserves, in accordance with rules framed by the Central Government on this behalf.—Sec. 205 (2A), Companies (Amendment) Act, 1974.

8. Dividends are payable in cash or cheque. But the capitalisation of profits (or reserves) by the issue of fully paid-up bonus shares or paying up any amount unpaid on any share is permitted.

9. Any dividend payable in cash may be paid by cheque or warrant sent through the post. *Hanuman Prasad* v. *Hiralal.*[1] Dividend is fully exempt from income-tax at the hands of shareholders. Domestic company declaring dividend has to pay

[1] AIR (1971) Supreme Court 206

10% tax. This tax is in addition to income tax chargeable on income of the company. For the company is not liable to pay this tax.

10. Dividends are payable only to the registered shareholders, bearers of share warrants and their bankers.—Sec. 206.

11. The dividends must be distributed within 42 days after they are declared. Failure to do so is a punishable offence.—Sec. 207.

12. A dividend becomes a debt from the date on which it is declared and becomes payable. A shareholder, who is entitled to get it, can file a suit to recover it.

13. Dividend limitation

On 6th July 1974, the dividends of the companies were limited by an ordinance (and later by an Act). In May, 1975, the limitation was relaxed. All these restrictions were abolished on 6th July, 1977.

14. Unpaid Dividend Account

After the commencement of the Companies (Amendment) Act, 1974, where a dividend has been declared by a company but has not been paid or where the warrant in respect thereof has not been posted within 42 days from the date of declaration, to any shareholder (entitled to the payment of the dividend), the company shall within 7 days from the date of expiry of 42 days, transfer the total amount of unpaid dividend to a special account to be opened by the company in that behalf in any scheduled bank. The account is called, "Unpaid Dividend Account..... Company Limited/Company (Private) Limited".

Where the whole or any part of any dividend declared by the company before the commencement of the amendment, remains unpaid within a period of 6 months from the commencement of the amendment, the company shall transfer the unpaid dividend to such account referred to above.

The Articles of a company may give power to its directors to declare interim dividends, i.e., dividends in between the two annual general meetings of the company.

Where owing to inadequacy or absence of profit in any year, any company proposes to declare dividend out of the accumulated profit earned by a company in previous year and transferred by

it to reserves, such declaration of dividend shall not be made except according to rules as may be made by the Central Government.

If default is made in transferring the unpaid dividend, the company shall pay interest at 12% per annum. The interest shall ensure to the benefit of the members of the company in proportion to the amount remaining unpaid.

The amount, unpaid or unclaimed for a period of seven years from the date of transfer, shall be transferred by the company to the general revenue account of the Central Government.

The Reserve Bank of India will give a receipt of the amount and such receipt is effectual discharge of the company.

Particulars regarding the money transferred to the general revenue are to be sent to the Central Government.

Any person, entitled to get unpaid dividend, can apply to the Central Government. The Amended Act provides the procedure of such application.

If any of the requirements of this Section is not complied, the company and every officer of the company who is in default shall be punishable with fine up to Rs. 500 per day.—Secs. 205A and 205B.

Section 206A of the amended Act, 1988 states that where any instrument of transfer of shares has been delivered to any Company for registration and the transfer of such shares has not been registered by the Company, it shall, transfer the dividend in relation to such shares to the special account referred to in Section 205A.

EXERCISES

1. Define the following terms : Relative; Secretary; Manager; Officer. (Pages 702-705)
2. State the rules relating to managerial remuneration under the Companies Act. (Pages 708-709)
3. What is dividend? State the rules regarding the payment of dividends by a public limited company. (Pages 711-715)
4. Objective Questions :
   (*a*) Can a company pay interest out of Capital? (Page 710)
   (*b*) Can a company pay dividend out of its capital? (Page 712)

8 ACCOUNTS AND AUDIT

ACCOUNT BOOKS

Section 209 as amended in 1974, provides that every company shall keep at its registered office proper books of account with respect to—all sums of money received and expended by the company and the matters in respect of which the receipt and expenditure take place.

Section 209 of the amended Act provides that every Company must keep proper books of account and such books must give a true and fair view of the state of affairs of the Company and such books must be kept on accrual basis and according to the double entry system of accounting.

The Board of Directors may keep the books at some other place in India but the address of such place must be notified to the Registrar.

Where a company has a branch office, whether in India or outside, proper summarised returns of such branch office made up to date at intervals of not more than three months are to be sent by the branch office to the registered office.

Books up to 8 years previous to the current year must be kept in good order, together with the relevant vouchers.

The books of account must give a true and fair view of the state of affairs of the company and explain its transactions.

If the books of account are not properly kept, every person responsible can be fined up to Rs. 1,000, and imprisoned up to 6 months.

Right to inspect and take copies

The books of account and other books and papers shall be open to inspection by any director during business hours.

Sec. 209A of Companies (Amendment) Act of 1974 provides that the books of account and other books and papers of every company shall be open to inspection during business hour (*i*) by the Registrar, or (*ii*) by such officer of the Government as may be authorised by the Central Government in this behalf.

Such inspection may be made without giving any previous notice to the company or any officer thereof.

It shall be the duty of every director, other officers and employee of the company to produce such books, furnish with any statement, information or explanation, within such time and such place as required by the person making the inspection.

It is also duty of every director, other officers or employee of the company to give all assistance for the inspection. The books of account includes, (*i*) all receipts and disbursement of money, (*ii*) all sales and purchases of goods by the company, (*iii*) the assets and liabilities of the company.—Sec. 202A.

The person, making the inspection may make or cause to be made copies of books and papers. He may place marks of identification thereon.

The person making inspection is vested with the powers of a Civil Court, including discovery and production of books and documents, summoning and enforcing attendance, inspection of books, registers and documents of the company.

Any officer authorised to make an inspection has the powers that a Registrar has in relation to making enquiries.

He must also make a report to the Central Government.

If a default is made in complying with above provisions, every officer is punishable (fine not less than Rs. 5000 and also imprisonment not exceeding 1 year.)

If a defaulting director or an officer is convicted, he shall be deemed to have vacated the office. He shall also be disqualified for holding such office in any company for a period of 5 years from such date.

OTHER BOOKS

Statutory Books

Under the Companies Act, every company must maintain the following books : Registers of—Members with an index where necessary ; Debenture Holders with an index when necessary ; Mortgages and Charges ; Directors, Managing Directors. etc. Directors and Chief Executives' Shareholdings, contracts and concerns in which directors are interested ; Investments showing investments in companies under the same group as well as investments not held in the company's name.

Annual Return and Summary of Share Capital.

Minute Books concerning General Meetings & Board Meetings.

Accounts Books.

Duplicate Branch Register for a Foreign branch, if any.

Statutory books include the following :

1. Register of investments not held in company's name. 2. Register of charges, 3. Register of members, 4. Index of member where the number is more than fifty, 5. Register of debenture holders, 6. Index of debenture-holders where the number is more than fifty. 7. Foreign register of members and debenture holders, 8. Minute books, 9. Register of contracts, and companies and firms in which directors are directly interested, 10. Register of directors, managing directors, manager and secretary, 11. Register of director's shareholding, 12. Register of loans made, guarantees given or securities provided to companies under same management, 13. Register of Investments in shares and debentures of companies in the same group.

Optional Books

A company may maintain the following books : Allotment ; Call ; Share Certificate ; Share Transfers ; Share Warrants ; Agenda Book etc.

Accounting Standards

Under Section 211(3A) the accounts should be prepared in accordance with "accounting standards". When it is not prepared according to the 'accounting standards' the Company must disclose the deviation and the reasons behind the deviation from the 'standards'. The auditor has also to mention whether the accounts have been prepared as per "accounting standards" or not.

Under Section 211(3C), the "accounting standards" will be prescribed by Central Government in consultation with National Advisory Committee on "Accounting Standards" (NACAS), on recommendation of the Institute of Chartered Accountants of India (ICAI) under Section 210A(2). The National Advisory Committee on Accounting Standards will be constituted by the Central Government. The Committee will consist of chairperson who will be an eminent person, one nominee each of ICAI, ICWAI and ICSI. One representative each of Central Government, RBI, SEBI and C & AG one University Professor of Accountancy or Management, Chairman of CBDT or his nominee, and two representatives from Chamber of Commerce. The terms and

conditions of the appointment of members will be fixed by the Central Government.

Under Section 210A(3) Accounting Standards will be first recommended by the ICAI. The Advisory Committee will give its recommendation to the Central Government on matters relating to the accounting policies, standards and auditing as per reference to the Advisory Committee for advice from time to time. After consultation with the Advisory Committee Central Government will prescribe the 'Accounting Standards'.

ANNUAL ACCOUNTS AND BALANCE SHEET

At every annual general meeting of the company, the Board of Directors shall lay before the company the *balance sheet* and the *profit and loss account.* In the case of companies not carrying on business for profit there shall be an *income and expenditure account* instead of the profit and loss account.

Period

The period for which the profit and loss account shall be made shall be as follows :

(*a*) In the first annual general meeting—from the date of incorporation of the company to a date not later than nine months previous to the date of the meeting.

(*b*) In the case of any subsequent annual general meeting—from the date immediately after the date of the last accounts to a date not later than six months previous to the date of the meeting.

(*c*) The period of accounts, which is called the financial year of the company, may be less or more than a calendar year but it shall not exceed 15 months. With the special permission of the Registrar, it may extend to 18 months.

Failure to comply with the aforesaid rules may be punished with fine and also imprisonment, if the default is wilfully made.—Sec. 210.

Form and Contents of Balance Sheets

Every balance sheet of a company shall give a true and fair view of the state of affairs of the company, as at the end of the financial year and shall be in the form of the Accounting Standards set out in Part I of Schedule VI to the Act, or as near

thereto as circumstances admit or in such other form as the Central Government may approve.—Sec. 211. Separate forms have been prescribed for banking and insurance companies.

Profit and Loss Account

The profit and loss account shall be prepared in the manner set out in Part II of Schedule VI to the Act and must contain the details mentioned there.

Every profit and loss account of a company shall give a true and fair view of the profit or loss of the company for the financial year.

The form, set out in Part II of Schedule VI, does not apply to any insurance or banking company, or to any other class of company for which a form of profit and loss account has been specified in or under any Act governing such class of company.

The Central Government may, by notification in the official Gazette, exempt any class of companies from compliance with any of the requirements in Schedule VI (form of Balance Sheet and requirements of the Profit and Loss Account) if, in its opinion, it is necessary to grant the exemption in the public interest.

The profit and loss account, and the auditor's report must be annexed to the balance sheet.—Sec. 216.

It is punishable offence to issue, circulate or publish the balance sheet before it is authenticated.—Sec. 218.

Three copies of the balance sheet and the profit and loss account together with other documents required to be annexed to the balance sheet, signed by the manager or secretary or by a director, shall be filed with the Registrar.—Sec. 220.

Directors of a company were prosecuted under Section 220(3) for wilful default in filing copies of balance-sheet and profit and loss account with the Registrar as required by Section 220(1) of the Companies Act. *State of Bombay* v. *Bandhan Ram Bhandari.*[1]

Certain companies (*e.g.*, Banking and Insurance companies) are required to file a statement of assets and liabilities in the form prescribed in Table F.

Authentication

The balance sheet and the profit and loss account of a

[1] AIR (1961) Supreme Court 186

company must be signed on behalf of the Board by the manager or secretary, if any, and not less than two directors one of whom shall be the managing director where there is one. The documents must be approved by the Board before they are authenticated and before they are submitted before the auditors for their report.—Sec. 215.

The method of Authentication is done, in case of Banking Companies, as prescribed by section 29 of the Banking Companies Act, 1949.

Shareholders' rights in respect of accounts

Section 219 provides as follows :

A copy of every balance sheet (including the profit and loss account, the auditors' report and every other document required by law to be annexed or attached, as the case may be, to the balance sheet) which is to be laid before a company in general meeting shall, not less than twenty-one days before the date of the meeting, be sent to every member of the company (and holders of debentures, except bearer debentures).

Copies need not be sent to members and debenture holders who are not entitled to receive notice of the general meeting.

Copies may be sent less than 21 days before the meeting if it is agreed to by all the members entitled to vote at the meeting.

Any member or debenture holder, whether entitled to have copies of the balance sheet etc. sent to him or not, shall be given a copy of the last balance sheet of the company (with annexed and attached documents) on demand without charge. Any person from whom the company has accepted a sum of money by way of deposit shall be entitled to have such copies on payment of a fee of one rupee. Copies are to be furnished within seven days of demand. The Court can also direct the sending of copies forthwith.

Failure to send copies or provide copies on demand, is punishable with a fine.

Section 219 of the amended Act provides that a copy of every balance sheet which is to be laid before a Company in general meeting shall, not less than twenty one days before the date of meeting be sent to every member, every holder of the debentures and to every trustee for the holders of any debentures issued by the Company.

Section 220 of the amended Act states that three copies of the balance sheet must be filed with Registrar within thirty days from the date on which the balance sheet was laid at the annual general meeting of the Company.

BOARD'S REPORT

Section 217 provides that there shall be attached to every balance sheet laid before a company in general meeting, a report by its Board of directors, with respect to—

(*a*) the state of the company's affairs ;

(*b*) the amounts, if any, which it proposes to carry to any reserves in such balance sheet ;

(*c*) the amount, if any, which it recommends should be paid, by way of dividend ; and

(*d*) material changes and commitments, if any, affecting the financial position of the company which have occurred between the last date covered by the balance sheet and the date of the Board's report ;

(*e*) the conservation of energy, technology absorption, foreign exchange earnings and outgo in the prescribed manner.

Section 217 of the amended Act provides that the Companies must submit a report containing all information in respect of "the conservation of energy, technology absorption, foreign exchange earnings and outgo, in such manner as may be prescribed."

The Board's report shall, (so for as is material for the appreciation of the state of the company's affairs by its members and will not in the Board's opinion be harmful to the business of the company or of any of its subsidiaries) deal with any changes which have occurred during the financial year—

(*a*) in the nature of the company's business ;

(*b*) in the company's subsidiaries or in the nature of the business carried on by them ; and

(*c*) generally in the classes of business in which the company has an interest.

The Board shall also be bound to give the fullest information and explanation in its report, on every reservation, qualification or adverse remark contained in the auditor's report.

The amendment of 1974 provides that the Board's report shall include a statement showing the name of every employee

who was getting not less than Rs. 36 thousand per year (or when a part of the financial year) and not less than 3 thousand per month.

The statement shall also show whether any such employee is relative of any director or manager, and if so the name of such director. Other particulars may be prescribed.—Sec. 217(2A).

The Board's report and any addendum thereto shall be signed by its Chairman if he is authorised, in that behalf by the Board ; and where he is not so authorised, shall be signed by such number of directors as are required to sign the balance sheet and the profit and loss account of the company.

THE AUDITORS OF A COMPANY

Appointment of Auditors

(Sections 224, 225). The first auditors of a company shall be appointed by the Board of directors within one month of the date of registration of the company. The members at a general meeting may remove all or any of the first auditors so appointed, and appoint other persons. Notice of the nomination of any person proposed to be appointed as auditor must be given not less than 14 days before the date of the meeting. If the first auditors are not appointed by the Board, they may be appointed by the company in a general meeting. The first auditors hold office until the conclusion of the first annual general meeting. Thereafter, auditors are appointed at each general meeting to hold office from the conclusion of that meeting until the conclusion of the next annual general meeting.

At any annual general meeting a retiring auditor, by whatsoever authority appointed, shall be re-appointed, unless—

(*a*) he is not qualified for re-appointed ;

(*b*) he has given the company notice in writing of his unwillingness to be re-appointed ;

(*c*) a resolution has been passed at that meeting appointing somebody instead of him or providing expressly that he shall not be re-appointed ; or

(*d*) where notice has been given of an intended resolution to appoint some person or persons in the place of a retiring auditor, and by reason of the death, incapacity or disqualification of that person or of all these persons, as the case may be, the resolution cannot be proceeded with.

The appointed auditor must, unless he is a retiring auditor, be informed within 7 days and he must, within 30 days, inform the Registrar whether he accepts or refuses the appointment.

Where at an annual general meeting no auditors are appointed or re-appointed, the Regional Director of the Company Law Board may appoint a person to fill the vacancy. The company shall within seven days of the power becoming exercisable, give notice of the fact.

Casual vacancies in the post of auditors may be filled by the Board till the next meeting, except vacancies caused by resignation which must be filled by the company in a general meeting. When there are several auditors and a vacancy occurs, the remaining auditors can continue to act as auditor.

Special notice shall be required for a resolution at a general meeting appointing as auditor a person other than a retiring auditor or providing expressly that a retiring auditor shall not be re-appointed. Notice of such resolution must be given to the auditor concerned and he may ask for the circulation of a representation regarding the matter to the members. If the representation is received too late for circulation, it may be read out at the meeting. The auditor shall also be heard at the meeting. The representation given by him will not be circulated if the Court, on an application made to it, is of opinion that the right conferred on the auditor is being abused to secure needless publicity for defamatory matter.

New rule regarding appointment of auditor

The amendment of 1974 provides that auditors are not to be appointed except with the approval of the company by special resolution in certain cases, namely, in case of a company in which not less than 25% of the subscribed share capital is held, whether singly or in a 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.—Sec. 224A.

The number of auditors

The Companies (Amendment) Act, 1974 limits the number of audit which (whether singly or in combination) any person does, *viz.*,

(*a*) in the case of a person or firm holding appointment as auditor of a number of companies each of which has a paid-up share capital of less than rupees twenty-five lakhs, twenty such companies ;

(*b*) in any other case, twenty companies, out of which not more than ten shall be companies each of which has a paid-up share capital of rupees twenty-five lakhs or more.

A written certificate has to be obtained by the company from the auditor or auditors proposed to be appointed or re-appointed that it is in accordance with the limits specified above.

Removal of Auditors

The first auditors appointed by the Board can be removed by the company in a general meeting. In other cases, an auditor can be removed, before the expiry of his term by the company in a general meeting provided the previous approval of the Central Government is obtained in that behalf. Special notice of such a resolution must be given and the procedure laid down above regarding the non-appointment of a retiring auditor must be followed. (See last para under. 'Appointment of Auditors'.)—Sections 224-225.

Qualification and Disqualifications of Auditors (Sec. 226)

A person shall not be qualified for appointment as auditor of a company unless he is a chartered accountant within the meaning of the Chartered Accountants Act, 1949.

A firm whereof all the partners practising in India are qualified for appointment as aforesaid may be appointed by its firm name to be auditor of a company, in which case any partner so practising may act in the name of the firm.

None of the following persons shall be qualified for appointment as auditor of a company—

(*a*) a body corporate ;

(*b*) an officer or employee of the company ;

(*c*) a person who is a partner, or who is in the employment, of an officer or employee of the company ;

(*d*) a person who is indebted to the company for an amount exceeding one thousand rupees or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company, for an amount exceeding one thousand rupees.

(*e*) a person who is disqualified for appointment as auditor of any other body corporate which is that company's subsidiary or holding company, or a subsidiary of that company's holding company.

Rights and Powers of Auditors

Section 227(1) of the Act provides that every auditor of the company shall have a right of access at all times to the books and accounts and vouchers of the company, whether kept at the head office of the company or elsewhere, and shall be entitled to require from the officers of the company such information and explanation as the auditor may think necessary for the performance of his duties as auditor.

Any officer of the company who fails to comply with the rules mentioned above, may be fined up to Rs. 500.

Section 231 provides that notice of all general meetings must be given to the auditors and they can attend and speak on all matters concerning them as auditors.

Remuneration of Auditors

Auditors appointed by the Central Government or the Regional Directors of the Company Law Board get remuneration as fixed by the Central Government or the Regional Director. The remuneration of auditors appointed by the Company is fixed by the company in general meeting or in the manner determined by the general meeting. Any sum paid to auditors as expenses is considered part of their remuneration.—Sec. 224 (8).

The Statutory Duties of Auditors. The Report

Section 227(2) lays down the following statutory duties of an auditor :

The auditor shall make a report to the members of the company on the accounts examined by him, and on every balance sheet and profit and loss account and on every other document declared by the Companies Act to be part of or annexed to the balance sheet or profit and loss account, which are laid before

the company in general meeting during his tenure of office, and the report shall state whether, in his opinion and to the best of his information and according to the explanation given to him, the said accounts give the information required by this Act in the manner so required and give a true and fair view—

(1) in the case of the balance sheet, of the state of the company's affair as at the end of its financial year ; and

(2) in the case of the profit and loss account, of the profit or loss for its financial year.

The auditor's report shall also state—

(*a*) whether he has obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purposes of his audit :

(*b*) whether in his opinion, proper books of accounts as required by law have been kept by the company so far as appears from his examination of these books, and proper returns adequate for the purpose of his audit have been received from branches not visited by him ;

(*bb*) whether the report on the accounts of any branch office audited under Sec. 228 by a person other than the company's auditor has been forwarded to him as required and how he has dealt with the same in preparing his report ;

(*c*) whether the company's balance sheet and profit and loss account dealt with by the report are in agreement with the books of account and returns.

Where any of the matters referred to in clauses (a) and (2) or in clauses (*a*), (*b*), (*bb*) and (*c*) above is answered in the negative or with a qualification, the auditor's report shall state the reason for the answer.

According to the clause 227(1A) added by the amending Act of 1965, the auditor shall enquire into the following matters :

(*a*) whether the loans and advances made by the company are property secured and whether their terms are not prejudicial to the interests of the company or its members ;

(*b*) whether transactions represented, merely by book-entries not prejudicial to the interests of the company ;

(*c*) whether the company is not an investment company or a banking company, whether any of its assets of the following types : shares, debentures and other securities, have been sold at a price less than its purchase price ;

(*d*) whether loans and advances made by the company have been shown as deposits ;

(*e*) whether personal expenses have been charged to revenue account ; and,

(*f*) whether cash has been received for shares shown as allotted for cash, and if not, whether the position as shown in the account books and balance sheet is correct, regular and not misleading.

Clause 227(4A) provides that the Central Government may direct the inclusion, in the auditor's report, of statements on certain matters to be specified by notification in the case of certain classes of companies.

Section 223B added by the amending Act of 1965 provides that where a company is required to maintain cost accounts under the amended Section 209 (see under the first heading in this chapter) the Central Government may direct an audit of such cost accounts by a cost accountant (qualified under the Cost and Works Accountants Act, 1959) or a chartered accountant or any person possessing the prescribed qualifications.

The audit of cost accounts, under the above section, shall be in addition to the regular audit as provided for by the Act. The auditor of cost accounts has the same powers and duties, in relation to his audit, as the regular auditor under Section 227.

The auditor's report must be signed by the auditor or a partner of the firm of auditors.—Sec. 229.

If any auditor's report is made, or any document is signed, otherwise than in conformity with the requirements of Sections 227 and 229, the person concerned shall, if the default is wilful, be punished with fine which may extend to Rs. 1000.—Sec. 233.

If the Central Government is of opinion that a sufficient number of cost accountants within the meaning of the Cost and Works Accountants, 1959, are not available for conducting cost audit the Central Government may by notification in the official gazette, for a specified period appoint a chartered accountant to audit cost accounts of a company.—Sec. 233B, Companies (Amendment) Act, 1974.

Special Audit

The Central Government may direct special audit of a company's accounts of any period if it is of opinion that,

(*a*) its affairs are not being managed in accordance with sound business principles or prudent commercial practices ; or

(*b*) it 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

(*c*) its financial position is such as to endanger its solvency.—Sec. 233A.

Legal decisions on the duties and responsibilities of auditors

The principles laid down in the leading cases can be summarised as follows :

1. *Must have knowledge of memo and articles* : An auditor is expected to know the provisions of the memo and the articles. "Auditors are in my opinion, bound to see what exceptional duties are cast upon them by the articles of the company which they are called upon to audit. Ignorance of the articles or of the exceptional duties enforced by them would not afford any legal justification for not observing them." Per Lindley L. J. in *Re Kingston Cotton Mills Co.*[1] ; *In re Republic of Bolivia Syndicate.*[2]

2. *Should know the terms of engagement* : The measure of an auditor's responsibility depends upon the terms of his engagement. *Re City Equitable Fire Insurance Co.*[3] ; *Registrar* v. *P. M. Hedge.*[4]

3. *Should be cautious and careful* : Per Lopez L. J. : "An auditor is not bound to be detective, or as was said, to approach his work with a suspicion or with a foregone conclusion that there is something wrong. He is a watch-dog but not a blood-hound.....If there is anything calculated to excite suspicion he should probe it to the bottom ; but in the absence of anything of that kind, he is only bound to be reasonably cautious and careful." *Re Kingston Cotton Mills Co.* (See above).

4. *Must examine the affairs of the company* : "The Companies Act, therefore, provides for the employment of an auditor who is the servant of the shareholders and whose duty it is to examine the affairs of the company on their behalf at the end of a year and report to them what he has found. That examination by an independent agency such as the auditor is practically the only safeguard which the shareholders have

[1] (1896) 2 Ch. 279
[2] (1914) 1 Ch. 139
[3] (1925) 1 Ch. 407
[4] AIR (1954) Mad 1080

against the enterprise being carried on in an unbusinesslike way or their money being misapplied or misappropriated without their knowing anything about it." *Deputy Secretary* v. *S. N. Dasgupta.*[1]

5. *Have the position of quasi-trust* : "The auditor holds a position of trust and it is his bounden duty to honour that trust by being candid with the shareholders and talling them frankly and fully everything with regard to the affairs of the company which has come to his knowledge and which it is material for the shareholders to know." (See above para).

6. *Must act reasonably* : Whenever it is necessary to make any enquiry, the auditor must do it in the manner in which an expert in his position would consider it reasonable to make.

7. *Must satisfy valuation of assets* : The auditor is bound to satisfy himself that the valuation of assets is reasonably accurate. Whenever he feels that the assets have been overvalued, it is his duty to say so in his report. There is no similar duty in case of undervaluation, because the directors are at liberty to undervalue the assets as a precautionary measure against future fluctuations in value.

Section 350 of the amended Act provides that the Central Government shall fix the amount of depreciation at the rate specified in Schedule XIV.

8. *Must enquiry into its substantial accuracy* : The auditor must not confine himself to verifying the arithmetical accuracy of the balance sheet but must enquire into its substantial accuracy. *Leeds Estate and Building Co.* v. *Shepherd.*[2]

9. *Protection of shareholders is needed* : The audit of a joint stock company is intended for the protection of the shareholders and the auditor is expected to examine the accounts maintained by the Directors with a view to informing the shareholders of the true financial position of the beneficiaries. *Institute of Chartered Accountants* v. *P. K. Mukherjee.*[3]

10. *Personal inspection is needed* : The auditor is not justified in omitting to make personal inspection of securities in the custody of the company or any person on its behalf. Whenever an auditor discovers that securities of a company are not in proper custody, it is his duty to require that the matter be put right at once.

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[1] AIR (1956) Cal 41 [2] (1887) 36 Ch. D. 787
[3] AIR (1968) Supreme Court 1104

11. *No liability to third parties* : But his liability would not extend to third parties with whom no contractual relationship exists. *Candler* v. *Crane Christmas and Co.*[1]

12. *Advice not required* : The auditor is not required to give advice to the directors regarding loans and investments. His duty is only to find out the true financial position of the company at the time of audit and to disclose it in his report.

13. *Liable to pay damages* : The auditor is liable to pay damages if on account of his breach of the statutory duties or wrongful acts, the company suffers loss. The auditors are also responsible to persons who are misled by a false balance sheet which has been certified by the auditor as correct.

14. *There is criminal liability* : The auditor is criminally liable for any breach of his statutory duties, wilfully made.

EXERCISES

1. State the Statutory Books required by the Company Act. (Page 717)
2. Describe how the accounts of a company are to be kept, who may inspect them, and under what conditions, if any. What are the shareholders' rights in respect of such accounts ? (Pages 717-719)
3. State the law relating to appointment and remuneration of auditors. (Page 723)
4. State the rules of the Companies Act relating to the qualifications, appointment, remuneration and removal of an auditor. (Pages 724-725)
5. What are the powers and duties of an auditor of a company ? (Pages 726-727)
6. Explain the function of an 'Auditor' with respect to a company under the Companies Act, 1956. Describe his powers, duties and liabilities under the Act. (Pages 723-727)
7. What are the provisions of the Companies Act, 1956 relating to the appointment of the first auditor of a company ? (Pages 722-723)
8. State the powers and duties of auditors with reference to leading cases. (Pages 726-727)
9. What is stated in the Auditor's report to the members of a Company ? (Pages 726-729)
10. Should auditors give advice to directors regarding loan without security ? (Page 727)
11. Write notes on (*i*) Special audit and (*ii*) Cost audit. (Pages 728, 729)

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[1] (1951) 2 K.B 164

9 BORROWING POWERS, DEBENTURES

BORROWING POWERS OF A COMPANY

The powers of a company are determined by the memorandum and the articles of association. Therefore a company can borrow money, and if so to what extent, are matters depending upon the interpretation of these two documents. The Companies Act does not contain any section expressly empowering companies to borrow.

In some cases the memo and the articles provide that the company shall be entitled to borrow. Sometimes the power to borrow is given, subject to certain limitations. If so, the limitations must be strictly complied with. Borrowing in excess of the limits laid down or by methods not sanctioned, is *ultra vires* the company and not binding on it. *Re Introduction Ltd.*[1]

It has been held that a trading company has an implied power to borrow, because commercial transactions necessarily involve the giving and taking of credit. *General Auction Estate Co.* v. *Smith.*[2] A non-trading company has no implied powers to borrow. If the memo and the articles of such a company contain no provision empowering the company to borrow, they must be altered to give such power before the company can borrow. *Baroness Wenlock* v. *River Dee.*[3]

Where the memo and the articles give the power to borrow, loans may be taken in any one or more of the following ways (unless any of them is prohibited) : mortgage of immovable properties of the company ; hypothecation or mortgage of movable goods, including stock in trade and, furniture ; charge on uncalled capital ; floating charge on all the assets of the company ; mortgage of book debts ; promissory notes, hundies and bills of exchange ; debentures and debenture stock : charge on patents, licences and copyrights and goodwill ; overdrawing the company's banking accounts.

A company cannot borrow money on the security of its books

[1] (1968) 2 AER. 1221
[2] (1891) 3 Ch. 432
[3] (1885) 10 A.C. 354

of account because such books are required to be kept in the registered office and they are open to inspection. Also, money cannot be borrowed on the security of the reserve capital.

Statutory limitations on Borrowing

1. Sec. 293(1) (d) prohibits the directors to borrow money beyond the aggregate of the paid-up capital and its reserves.

2. Limitations as contained in the Memorandum or the Articles ultra-vires Borrowing : Borrowing by a company may be ultra-vires the Company or intra-vires the company but ultra-vires the directors.

DEBENTURES

Definition

The issue of debentures is a particular mode of borrowing money by companies. A debenture is a document which shows on the face of it, that the company has borrowed a certain sum of money from the holder thereof upon certain terms and conditions. A debenture is generally issued as a part of a series.

Palmer defines a debentures as "any instrument under seal evidencing a deed, the essence of it being the admission of indebtedness". Section 2(12) of the Company Act states that a debenture, "includes debenture stock, bonds and any other securities of a company, whether constituting a charge on the assets of the company or not."

Characteristics

1. Each debenture is numbered.

2. Each contains a printed statement of the terms and conditions, *viz.* the rate of interest, the time of payment of interest, the security against which the debenture is issued and what steps the debenture holder can take in case of non-payment of his dues.

3. A debenture usually creates a *floating charge* on the assets of the companies, *e.g.*,a charge which is enforceable upon non-payment of the interest or principal on the due dates.

4. A debenture may create a fixed charge instead of a floating charge.

5. Sometimes debenture holders are given the right to appoint a receiver in case of non-fulfilment of the terms of the debentures by the company.

6. Sometimes a series of debentures are issued with a trust deed by which trustees are appointed to whom some or all the properties of the company are transferred by way of security for the debenture holders.

FLOATING CHARGE AND FIXED CHARGE

Definition

A 'charge' on a property is created when it is made liable for the payment of money. A charge may be 'fixed' or 'floating'.

A fixed charge is one which creates a legal interest of a specific property of the company or all the properties of the company. Thus a fixed charge is equivalent to mortgage. The company can sell, lease etc. of the property, *subject* to the right of the charge holder.

The floating charge does not amount to mortgage. The owner of such a property can deal with it and the transferee gets it, free of the charge.

"The term 'floating security' and 'floating charge' means a security or charge which is not to be put into immediate operation, but is to float so that the company is to be allowed to carry on its business. A specific charge fastens on ascertained and definite property or property capable of being ascertained. A floating charge moves with the property which it is intended to affect, until some event occurs or some act is done which causes it to settle and faster on the subject of the charge within its reach and grasp. It is of the essence of a floating charge that it remains dormant until the undertaking charged ceases to be a going concern or until the person, in whose favour the charge is created, intervenes".—Halsbury's *Laws of England*, Vol. 6.

Characteristics

A floating charge is an equitable charge. Justice Romer laid down three characteristics of a floating charge *viz.*, (*i*) it is a charge on a class of assets of a company present and future. (*ii*) in the ordinary course of the business of a company such assets would be changing from time to time ; and (*iii*) until some future step is taken by or on behalf of those interested in the charge, the company may carry on the business in the ordinary way by this class of assets. *Re Yorkshire Wool Combers' Association.*[1]

[1] (1903) 2 Ch.. 284

When a floating charge becomes a fixed charge ?

A floating charge becomes a fixed charge when any of the following things occur : (*i*) a company is wound up ; (*ii*) a receiver of the properties of the company is appointed ; (*iii*) the company fails to pay the interest and the instalment of the principal : and, (*iv*) the company ceases carrying on its business.

When the above occurrences or contingencies happen, a floating charge becomes a fixed charge. This is known as crystallization of the floating charge. The crystallization occurs on the moment of crytallization.

CLASSIFICATION OF DEBENTURES

Debentures may be classified in different ways, some of which are mentioned below :

1. *Redeemable Debentures* and *Perpetual Debentures* : Section 120 of the Companies Act provides that debentures may be issued subject to the condition that they are irredeemable or redeemable only on the happening of the contingency, however remote, or on the expiration of a period however long. Thus debentures may be either Redeemable or Perpetual.

2. *Registered Debentures and unregistered or Bearer Debentures* : The money due on the debentures may be *payable only to registered holders or* may be *payable to bearers.*

3. *Debenture* and *Debenture Stock* : The difference between Debenture and Debenture Stock is similar to the difference between shares and stock. A debenture is a document showing a particular debt. There may be a series of debentures. If the entire debt, covered by the debentures is treated as a single unit, it is called Debenture Stock. In the case of debenture stock, the company issues to each creditor a certificate showing what fraction of the entire debt is owned to him. The certificate is called the Debenture Stock Certificate.

4. *Mortgage Debenture* and *Naked Debenture* : The former types of debenture is secured by whole or part of the assets of the company. The latter types of debentures are *not* secured by any of the assets of the company.

CONVERTIBLE DEBENTURES

Debentures may be issued subject to the condition that they or a specified part of them, will be exchanged for, or converted into, shares of the company. The remaining part of the issue continues to be debentures at a stated interest. After a debenture is converted into share it does not yield interest but gets dividend according to the decision of the company.

Example :

A reputed company issued 7 lakhs secured convertible debentures of Rs. 200 each for cash at par aggregating nearly Rs. 15 crores. The highlights of the issue were as follows : 25% conversion in two stages—first within 6 months of the date of allotment of debentures and second 2 years after the first conversion, into 5 equity shares of Rs. 10 each at par ; interest of 13.5% per annum payable half-yearly ; review of interest in accordance with Government guidelines ; fully secured ; liquidity through listing in Stock Exchange ; and, scheme for purchase by the company at par after 4 years.

Comments

In India this type of debenture has become very popular. It can be called convertible debenture or convertible bonds. The debenture holders may have an option to get shares in exchange of debentures. One writer[1] says that in such debentures the holders, "have their cake and eat it too".

RULES RELATING TO DEBENTURES

The Companies Act of 1956 lays down the following rules regarding debentures :

1. No debenture holder is to have any voting rights in company meetings—Sec. 117. This applies to debentures issued after the commencement of the Act of 1956.

2. If there is a trust deed securing the issue of debentures, every debenture holder can have a copy of it on payment of a small fee.—Sec. 118.

3. The trustees in a trust deed securing the issue of debentures must exercise due care and diligence in the performance of their duties. Any provision in the deed exempting them from liability on this account is void.—Sec. 119.

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[1] Samuelson, Economics, (11th edition), p. 103

4. Debenture may be irredeemable, or redeemable on the happening of a contingency.—Sec. 120.

5. Redeemable debentures can be reissued, unless there is any provision to the contrary, whether express or implied, in the articles or in the conditions of the issue of the debentures or in any contract entered into by the company or when the company has passed a resolution to that effect.—Sec. 121.

6. An agreement to take a debenture can be specifically enforced.—Sec. 122.

7. Debts of the company, which by the Act receive preferential payment in case of winding up, shall have priority over the claims of the debenture holders. If, by virtue of the condition of the issue, the debenture holders have taken possession of the properties of the company or have appointed a receiver who has taken possession, the claims of the preferred creditors shall be paid forthwith out of any assets coming into the hands of the receiver or other person on behalf of the debenture holders.—Sec. 123.

8. Full particulars regarding the issue of debentures in series must be sent to the Registrar.—Sec. 128. The particulars must include a statement of the commission paid.—Sec. 129.

9. There are certain limits on the amount of commission and brokerage that can be paid for the sale of debentures. (See under Commission and Brokerage for the sale of shares in p. 630)

10. **Transfer of Debentures.** The rules relating to transfer of shares and share certificates (Sections 108-113) apply to debentures. (See p. 638)

11. **Register and Index of Debenture Holders.** Every company shall keep a Register of debenture holders, entering therein particulars regarding the name, address, and occupation of the debenture holder and the dates on which the holding commenced or ceased.—Sec. 152(1).

Every company having more than 50 debenture holders shall keep an Index of debenture holders unless the Register of debenture holders is itself kept in the form of an index.—Sec. 152(2).

No notice of any trust, express, implied, or constructive, shall be entered in the Register of debenture holders.—Sec. 153. (But, see pages 634)

The Register of debenture holders may be closed for not more than 45 days in the year and not more than 30 days at

a time, by giving at least 7 day's notice through a local newspaper.—Sec. 154.

There may be a Foreign Register of debenture holders analogous to the Foreign Register of members.—Sections. 157 and 158.

RIGHTS AND REMEDIES OF DEBENTURE HOLDERS

If the Company fails to pay the interest or principal on the due date or fails to comply with any of the terms and conditions under which the debenture was issued, the debenture holder can adopt any of the following remedial measures :

1. He may file a suit for the recovery of money by sale of the assets which were charged for the payment of the money.
2. He may file an application for the appointment of a receiver by the court.
3. He may himself appoint a receiver if the terms of the debenture entitled him to do so.
4. The trustees may sell the properties charged, if such a power is given to them under the terms of the debenture.
5. He may apply to the court for the foreclosure of the company's right to redeem the properties charged for the payment of the money.
6. He may present petition for the winding up of the company.

DIFFERENCES BETWEEN SHAREHOLDERS AND DEBENTURE HOLDERS

1. A shareholder has a proprietary interest in the company. A debenture holder is only a creditor of the company.
2. Every share is included in the capital of the company. Debenture is a loan to the company.
3. Debentures generally have a fixed or floating charge upon the assets of the company. Shares do not have any charge on the asset of the company because the shareholders are the proprietors of the company.
4. A debenture holder is entitled to a fixed interest. Equity shareholder is entitled to dividends depending on and varying with the profits earned.
5. A shareholder has voting rights. A debenture holder, after 1956, cannot have voting rights.

6. Debentures may be redeemable. Shares (except preference shares under certain circumstances) are not redeemable. Under special circumstances the court may direct the purchase of shares by the company. (Sections 397 and 398. See Ch. 10)

7. Debenture holders get priority over shareholders when assets are distributed upon winding up.

LOANS TO COMPANIES UNDER THE SAME MANAGEMENT

Subject to the exceptions and conditions noted below, no company shall (*a*) make any loan to, or (*b*) give any guarantee, or provide any security, in connection with a loan made by any other person to, or to any other person by, any body corporate.—Sec. 370 :

1. Such a transaction may be entered into if previously authorised by a special resolution of the lending or guaranteeing company.

2. No special resolution is necessary in the case of loans to other bodies corporate *not under the same management* as the lending company, where the aggregate of such loans does not exceed 10% of the aggregate of the subscribed capital of the lending company and its free reserves.

3. Without the prior approval of the Central Government the aggregate of loans by one company to other bodies corporate shall not exceed the aggregate of its subscribed capital and free reserves by 30% where all such bodies are *not* under the same management, and 20% where they are under the same management, as the lending company.

4. The restrictions stated above do not apply to any *loan* made (*a*) by a holding company to its subsidiary : (*b*) by a banking or insurance company, in the ordinary course of its business ; (*c*) by a private company unless it is a subsidiary of a public company ; and (*d*) by a company established with the object of financial industrial enterprises.

5. The restrictions do not apply to any *guarantee* given or security provided (*a*) by a holding company in respect of a loan given to its subsidiary ; and, (*b*) by a banking company in the ordinary course of its business.

6. The restrictions do not apply to a book debt, unless the transaction was from its inception in the nature of a loan.

Companies under the same management or same group

Companies are said to be under the same management, or within the same group, under the circumstances enumerated in Sec. 370(1B) and Sec. 372(11) respectively. *Examples* : Majority of directors same ; the same individual or body corporate exercises one-third or more of the voting power ; etc.

Loans etc. coming under this section must be recorded by the lending company in a separate register. The register is open to inspection and extracts and copies thereof may be taken.

Definition of 'Group'—See p. 547.

INVESTMENTS IN THE SAME GROUP OF COMPANIES

A company cannot purchase the shares and debentures of another company if both are under the same management, except to the extent noted below.—Sec. 372.

A company can invest, in the manner aforesaid, in any other company *within the same group*, up to 10 per cent of the subscribed capital of the other company, provided such investment is sanctioned at a meeting of the Board of directors of the investing company with the consent of all the directors present and entitled to vote. Notice of such resolution must be given to all directors. The aggregate investment of a company in other companies in the same group must not exceed 20 per cent of the subscribed capital of the investing company. The aggregate investment of a company in all other bodies corporate must not exceed 30 per cent of the subscribed capital of the investing company.

A company can invest more than the amounts mentioned above, if it is sanctioned by a resolution of the members of the investing company and approved by the Central Government.

The restrictions on investment, mentioned above do not apply to the following cases : investments by an investing company, *i.e.*, one whose principal business is the purchase and sale of shares, debentures and other securities ; investments by a banking or insurance company ; a private company, unless it is a subsidiary of a public company ; investments by a holding company in its subsidiary ; and, investments in rights" shares, *i.e.*, purchase of further issue of shares as provided in Section 81.

Particulars of all investments coming within Section 372 must be entered in a separate register which shall be open to inspection by all members of the company. Particulars of the investment shall also be included in the balance sheet.

Section 372 of the amended Act mentions that a Company by itself or together with its subsidiaries shall not be entitled to acquire the shares of any other body corporate except to the extent, and except in accordance with the restrictions and conditions sepcified in this Section.

"The Board of directors of the investing Company shall be entitled to invest in any shares of any other body corporate to such percentage of the subscribed equity share capital, or the aggregate of the paid-up equity and preference share capital, of such other body corporate, whichever is less, as may be prescribed."

This Section shall not apply—

(*a*) to any banking or insurance Company ;

(*b*) to a Private Company, unless it is a subsidiary of a Public Company.

(*c*) to any Company established in order to finance private industrial enterprises.

(*d*) "to investments by a holding Company in its subsidiary, other than a subsidiary within the meaning of Clause (a) of sub-Section (1) of Section 4."

REGISTRATION OF MORTGAGES AND CHARGES

List of Mortgages and Charges

The Companies Act (Sec. 125) provides that all charges and mortgages of the kinds mentioned below, must be registered with the Registrar of Companies by filing with him all particulars concerning them together with a copy of the deed by which the charge or mortgage is created :

1.(*a*) a charge for the purpose of securing any issue of debentures ;

(*b*) a charge on uncalled share capital of the company ;

(*c*) a charge on any immovable property, whether situate, or any interest therein ;

(*d*) a charge on any book debts of the company ;

(*e*) a charge, not being a pledge, on any movable property of the company ;
(*f*) a floating charge on the undertaking or any property of the company including stock-in-trade ;
(*g*) a charge on calls made but not paid ;
(*h*) a charge on a ship or any share in a ship ;
(*i*) a charge on goodwill, on a patent or licence under a patent, on a trade mark, or on a copyright or a licence under a copyright.—Sec. 125(4).

2. A charge created *out of India* comprising solely property situate outside India with particulars and instrument or copy.—Sec. 125(5).

3. A charge created *in India* but comprising property outside India, with verified copy.—Sec. 125 (6).

4. Charges on properties acquired subject to charge.—Sec. 127.

For registration, the term 'charge' includes 'mortgage'—Sec. 124.

Time

All the charges listed above must be registered within 30 days of its creation (7 days more if there is sufficient cause for delay).

Particulars

In case of series of debentures entitling holders *pari passu* to be filed to the Registrar with the following particulars :—
(*a*) the total amount secured by the whole series ;
(*b*) the dates of the resolutions authorising the issue of the series and the date of the covering deed, if any, by which the security is created or defined ;
(*c*) a general description of the property charged ; and
(*d*) the names of the trustees, if any, for the debenture holders ; together with the deed containing the charge, or a copy of the deed verified in the prescribed manner, or if there is no such deed, one of the debentures of the series.—Sec. 128.

Commission

Particulars in case of commission, etc. on debenture, are to be filed for registration.—Sec. 129.

Register

Register of charges is to be kept by Registrar, with respect to each company, containing the following particulars.—Sec. 130 :

(*a*) in the case of a charge to the benefit of which the holders of a series of debentures are entitled, such particulars as are specified in Sections 128 and 129 ;

(*b*) in the case of any other charge—

(*i*) if the charge is a charge created by the company, the date of its creation ; and if the charge was a charge existing on property acquired by the company, the date of the acquisition of the property ;

(*ii*) the amount secured by the charge ;

(*iii*) short particulars of the property charged ; and

(*iv*) the persons entitled to the charge.

Certificate of Registration

The Registrar is to give a certificate of registration. All debentures must be endorsed with a copy of the certificate of registration. The registration may be effected by the company, or by any person interested. Modification of the terms of the charge must be notified to the Registrar.—Sec. 132.

The company is to maintain a Register and Index of Charges. The Registrar also keeps a Register of Charges.—Sec. 131.

The company is to give intimation to the Registrar when a registrable charge or mortgage is satisfied by payment.—Sec. 138.

The Company Law Board may excuse any omission in filing particulars etc. which was accidental or due to inadvertence. The Register may thereupon be rectified.—Sec. 141.

Pending matters will continue to be under the orders of the Court.

The Register and copies of instruments by which a charge is created may be inspected by members, creditors etc.—Sec. 144.

Consequences of failure to register charges

If a charge or mortgage is not registered in accordance with the aforesaid provisions, the following consequences ensue :

1. The charge becomes void as against other creditors and the liquidator in case of winding up (*i.e.*, the charge holder loses priority).—Sec. 125(i).

2. The debt becomes immediately payable.—Sec. 125(3).

3. The officers of the company concerned are liable to punishment.

4. When a charge becomes void for non-registration, no right of lien can be claimed on the documents of title.

Nothing in the above rules shall prejudice any contract or obligation for the repayment of the money secured by the charge.—Sec. 125(2).

EXERCISES

1. Distinguish between a floating charge and a fixed charge. When does a floating charge crystallize ? (Pages 734-735)
2. What do you understand by debentures ? What are the rights of the debenture holders ? (Pages 733, 738)
3. Define a debenture and distinguish it from a share. State the different classes of debenture. (Pages 733, 738, 735)
4. State and explain the rules regarding the issue of debentures. What and how can redeemed debentures be re-issued ? (Pages 736-738)
5. Enumerate the mortgages and charges which have to be registered under the Companies Act. Discuss the effects of non-registration. (Pages 740-744)
6. Write notes on : Convertible Debentures. (Page 736)

(*a*) What is a Debenture ? What are the different kinds of Debentures ? What are the rights and remedies available to a debenture-holder in the Company Law ?(Pages 733, 735)

(*b*) The company *A* has offered to buy all the shares in the *B* company and the holders of nine-tenth in value of the shares in the *B* company have agreed to the sale. The remaining shares are held by *X*, who objects to the sale. May the company *A* acquire all the shares in the *B* Company. (Page 740)

10 CONTROL OVER COMPANIES

THE ADMINISTRATION OF COMPANY LAW

The Companies Act of 1956 and various amendments thereafter have enormously increased the functions of the Central Government in relation to companies. The object of the Act and the Amendment is to give to the Government powers of control which will prevent malpractices, protect the interests of the investing public and ensure social justice. The administration of company law has been placed under the control of the Company Law Board. The Board consists of members appointed by the Central Government up to nine.

REGISTRAR OF COMPANIES

An important official in connection with company law administration is the Registrar of Companies. In almost all the States there is a Registrar, appointed by the Central Government. In some States ,there are Assistant, Deputy or Joint Registrars. There are four Regional Directors with headquarters at Calcutta, Bombay, Madras and Delhi. The States' Registrars work under the Regional Directors.

Since 1956, the office of the Registrars has been greatly expanded. Through the administrative organisation mentioned above, it is expected to secure co-ordination between the different offices of the Registrars and the Central Government and also to provide for a machinery through which the obligations and duties of the Government as regards Company Law may be carried out.

The Registrars have a number of important functions :

1. *The function of registration* : All important documents like the memo and the articles, mortgages and charges must be registered with the Registrar.

2. *The issue of certificates* : The Registrar issues the certificate of incorporation, certificate of the commencement of business etc.

3. *The enforcement of returns* : The companies are bound

to send various kinds of returns and reports. It is the duty of the Registrar to see that the returns and reports and filed in time.

4. *Public information* : From the office of the Registrar members of the public can obtain inspection and copies of documents relating to companies.

5. *Prosecution of delinquent directors and company officials* : It is the duty of the Registrar to prosecute persons guilty of offences against the Company Law.

6. *Enquiry and investigation* : The Registrar can under certain circumstances enquire and investigate into affairs of a company.

INVESTIGATION OF THE AFFAIRS OF A COMPANY

There are six different types of enquiries and investigations into the affairs of a company provided for by the Companies Act of 1956. They are briefly enumerated below :

I. Special Audit

Under certain circumstances the Central Government can direct a special audit of a company's accounts of any period. The Central Government may also direct the audit of cost accounts.—Sec. 233A. (See p. 728)

II. The Registrar's Power of Enquiry (Sec. 234)

If on perusing a document which a company is bound to submit to him under the Act, the Registrar is of opinion that further information or explanation is necessary he may, by an order in writing, call upon the company to submit the same within a fixed date. If the company fails to submit the explanation or information by the due date, the company and every official concerned may be fined. The court can, on the application of the Registrar, direct the company to give inspection of any required document to the Registrar.

If the information or explanation is not given, or if upon perusal of the information and explanation given, the Registrar is of opinion that the document in question discloses an unsatisfactory state of things or that it does not disclose a full and fair statement concerning the matter, the Registrar shall make a report of the matter to the Central Government.

If it is represented to the Registrar on materials placed before him by a creditor, contributory or a person interested, that the business of the company is being carried on fraudulently or unlawfully, he may after giving an opportunity to the company of being heard, direct the company to furnish any information or explanation on the matter. Thereafter the Registrar shall proceed with the matter as described above. If upon enquiry the Registrar is satisfied that the representation on which he took action was frivolous or vexatious, he will disclose the identity of the informant to the company. The company can proceed against him for defamation etc.)

If the Registrar apprehends that the books and papers of a company may be destroyed, falsified or hidden, he may seize them after getting an order from a magistrate of the 1st class or a Presidency Magistrate.—Sec. 234A.

III. Investigation by Inspectors (Sections 235-246).

The Central Government may appoint one or more competent persons as inspectors to investigate the affairs of any company and report thereon, under any of the following circumstances :

1. *On the application of a certain number of members of the Company* : If the company is one having a share capital, the number of members applying must be at least 200 or members holding not less than one-tenth of the total voting power. If the company does not have a share capital, the number of members applying must be not less than one-fifth of the total number of members. The application must be supported by evidence and the Government may require the applicants to give security for costs, not exceeding Rs. 1,000.

2. *On the report of the Registrar* : If the answer to an enquiry by the Registrar under Section 234, is considered to be unsatisfactory, he is to report to the Central Government. On his report the Central Government may appoint inspectors.

3. If the company passes *a special resolution* for such investigation.

4. If the *court declares* that the affairs of the company should be so investigated.

5. If the Central Government is of *opinion* that (*i*) the company is being conducted fraudulently or unlawfully or in a manner oppressive to any of its members or that the company

was formed for a fraudulent or unlawful purpose ; (*ii*) the persons concerned in the formation of the company or the management of its affairs have been guilty of fraud, misfeasance or misconduct ; and (*iii*) the members of the company have not been given all the information with respect to its affairs which they might reasonably expect.

Section 235 of the Principal Act has been amended and the amending provision states that the Central Government on the basis of a report made by the Registrar appoint one or more competent persons as inspectors to investigate the affairs of a Company and to report thereon in such manner as the Central Government may direct.

Section 236 has been amended and the amended section states that an application by members of a Company under Clause (a) or (b) of Section 235 shall be supported by such evidence as the Company Law Board may require for the purpose of showing that the applicants have good reasons for requiring the investigation.

Section 237 has been amended and amended provision declares that the Central Government shall appoint one or more competent persons to investigate the affairs of a Company and to report thereon and may do so if in the opinion of the Company Law Board there are circumstances suggesting that the business of the Company is being run with the intent to defraud it creditors.

***IV.* Investigation of Ownership (Sec. 247)**

Where it appears to the Central Government that there is good reason so to do, it may appoint one or more inspectors to investigate and report on the membership of any company and other matters relating to the company, for the purpose of determining the true persons—

(*a*) who are or have been financially interested in the success or failure, whether real or apparent, of the company, or

(*b*) who are or have been able to control or materially to influence the policy of the company.

The Central Government can investigate the beneficial ownership of shares as to whether the provisions of Sec. 187C have been complied with regarding to any share.—Sec.187D.

(See p. 635)

V. Information about persons having interest in a company (Sec. 248)

Where it appears to the Central Government that there is good reason to investigate the ownership of any shares in or debentures of a company or of a body corporate acting as its managing agents or secretaries and treasurers (now abolished), it may appoint inspectors for the purpose or may call for the information from persons who are interested in the shares and debentures.

VI. Investigation of associateship (Sec. 249)

Where any question arises as to whether any person, firm or body corporate is or is not, or was or was not, an associate of the managing agent or the secretaries and treasurers, the Central Government may appoint inspectors for the purpose or call for the relevant information from any person who is in a position to give information on the point.

INSPECTORS

Powers and duties of the inspectors (Sections 239, 240, 240A)

1. The inspectors appointed by the Government must enquire into the affairs of the company concerned.

2. The officers of the company and the directors and managers etc. must preserve and produce before them all books and documents required.

3. They must also give evidence on oath and answer questions put to them, by the inspectors. The inspectors may examine any other person on oath, if so authorised by the Central Government.

4. If it is considered necessary, the inspectors may also examine the affairs of the holding company of the company concerned, any of its subsidiaries, its managing agents, secretaries and treasurers and their associates and related companies.

5. The inspectors can seize documents and keep them in their custody for six months.

Report

After the investigation is over, the inspectors must submit a report to the Government. They may also submit interim reports if considered necessary.—Sec. 241.

Government action on the report

After considering the report, the Government may take the following steps :

1. Copies of the report may be sent to all interested parties and published.

2. Officials of the company and directors, managing agents etc. who are found to be guilty of any offence, must be prosecuted.

3. If it is found that the company is entitled to proceed against any person for damages, recovery of property, or misfeasance, the Central Government can institute proceeding for the purpose.

4. If the investigation discloses the existence of circumstances which would lead the court to direct winding up of the company on the ground that it is just and equitable to do so, the Central Government can cause the presentation of a petition for winding up of the company.

5. The Central Government may cause an application to be filed before the court for exercise of the discretionary powers which have been given to the court in cases of mismanagement and oppression. (Sections 397 and 398, see below.)

6. The expenses of the investigation may be recovered from the persons guilty of mismanagement or misconduct.

Certain general provisions regarding investigations

Where in connection with any of the investigations mentioned above, there is difficulty in finding out the relevant facts, the Central Government may declare that the shares of the company shall be subject to certain restrictions, *e.g.*, any transfer of the shares to be void ; where the shares are to be issued in the future, such issues are to be stopped ; the holders of the shares not to have any voting rights etc. If any person acts in violation of the above restrictions, he shall be punishable.—Sec. 250.

Section 250 of the amended Act provides that the Company Law Board may impose restrictions upon shares and debentures and may prohibit transfer of shares or debentures in certain cases.

Investigations of the type described under III to VI above can be initiated and continued even if (*a*) an application has been made for an order under Section 397 or 398 (see below) or (*b*) the company has passed a special resolution for voluntary winding up.—Sec. 250A.

During investigation questions may be asked from any person, but legal advisers cannot be forced to disclose privileged communications from their clients. There is protection for bankers as regards confidential information.—Sec. 251.

Legal Decisions :

1. Investigation under section 237 is neither judicial nor quasi-judicial nature. *Raja Narayan Lal Bonsilal* v *Maneck Phiroz.*[1]
2. The inspector's function is equivale· . ·o the function of a fact finding mission. *Ashoka Marketing Ltd.* v. *Union of India.*[2]
3. Unreasonable declaration of dividends is a *prima facie* ground for ordering investigation in the affairs of a company. *Ashoka Marketing Ltd.* Vs. *Union of India.* (Ibid).
4. *Judicial Review* : The power under Sections 235 to 237 has been conferred on the Central Government on the faith that it will be exercised in a reasonable manner. (See under III, para. 5. ps. 747-748). The existence of the circumstances mentioned in Section 237(b) is a condition precedent to the formation of opinion by the Government. The existence of circumstances suggesting that the company's business was being conducted as laid down in sub-clause (*i*) or persons mentioned in sub-clause (*ii*) were guilty of fraud or misfeasance or other misconduct towards the company or towards any of its members is a condition precedent for the Government to form the required opinion. The existence of the circumstances in question is open to judicial review though the opinion formed by the Government is not amenable to review by the Courts. *Rohtas Industries Ltd* v. *S. D. Agarwal.*[3] Hidaytullah and Shelat JJ. in *Barium Chemicals Ltd* v. *Company Law Board.*[4]
5. *When a Court can order an enquiry* ? The Court exercising its powers under Section 237 (a) (ii) of the Act on evidence at least as strong as may be required by the Central Government. *In re Patrakola Tea Co. Ltd.*[5]
6. Under S. 235 of the Companies Act, 1956, it is not obligatory for the Central Government to direct an investigation. It has a discretion to appoint or not to appoint inspectors for investigating the affairs of the company, the word used in the section being "may". *Mool Chand Gupta* v. *Jagannath Gupta and Co. (P) Ltd.*[6]

MISMANAGEMENT AND OPPRESSION BY THE MAJORITY

Companies are managed by directors elected by the majority. As regards matters which are to be decided by resolutions passed

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[1] AIR (1961) Supreme Court 29
[2] (1966) C.W.N. 472
[3] AIR (1969) Supreme Court 707
[4] AIR (1967) Supreme Court 295
[5] (1966) 70 C.W.N. 971
[6] AIR (1979) Supreme Court 1038

in general meeting, it is the opinion of the majority which always prevails. It has been laid down in many cases that the courts will not interfere in matters which are within the powers of the majority to decide. Thus the general rule for company management is that the decisions of the majority bind the minority. *Foss* v. *Harbottle*[1]; *Macdougall* v. *Gardiner*.[2]; *Rajahmundry Electric Supply Company* v. *Negeshar Rao*.[3]

The Court will not interfere in the internal management of the company and it will leave such matters to the wisdom of the directors themselves. *In re Sulekha Works Ltd.*[4] But the Court has the discretion to overrule a resolution of the majority if it finds that the majority are bent upon causing an injustice to the minority of shareholders. *Ramkissendas Dhanuka* v. *Satya Charan Law*.[5]

Sometimes it is found that a group of persons or a particular person obtains control of the majority of the shares and is running the company in a manner prejudicial to the company or against the interests of the minority group of shareholders. In such cases the minority shareholders can adopt the following measures: (*i*) apply to the court for the winding up of the company on the ground that it is 'just and equitable' to do so; (*ii*) apply to the Company Law Boards for appropriate orders giving relief without directing winding up; and (*iii*) apply to the Central Government for relief. The last two remedies are explained below.

I. Powers of the Court

Section 397 provides that *in cases of oppression*, the court may give relief if it is of opinion.

(*a*) that the company's affairs are being conducted in a manner prejudicial to the public interest or in a manner oppressive to any member or members; and,

(*b*) that to wind up the company would unfairly prejudice such member or members, but that otherwise the 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.

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[1] (1843) 2 Hare 461
[2] (1875) 1 Ch. 413
[3] (1955) 2 S.C.R. 1066 (Supreme Court)
[4] AIR (1965) Cal. 98
[5] 77 I.A. 128

Section 398 provides that *in cases of mismanagement,* the court may give relief if it is of opinion,

(*a*) that the affairs of the Company are being conducted in a manner prejudicial to the public interest or the interest of the Company ; or,

(*b*) that a material change (not being a change brought about by or in the interest of the creditors or any class of shareholders) has taken place in the management and control of the Company (by changes in the Board of Directors or Manager), and that by reason of such change, the affairs of the Company are likely to be conducted in a manner prejudicial to the public interest or the interests of the Company.

Who can apply for relief ?

The petitioning member or members must hold not less than one-tenth of the issued share capital of the Company on which all calls due have been paid, or must have obtained the consent in writing of one hundred or one-tenth in number of the members, whichever is less. In the case of a company not having a share capital, the member petitioning must have obtained the consent in writing of not less than one-fifth in number of the members—Sec. 399 (1) to (3).

Under Sec. 397 or 398 not only the members having equity shares but also the persons holding preference shares may apply for the appropriate relief.

The Central Government may authorise a member or members to apply even though the above conditions are not fulfilled, if it considers it just and equitable to do so. In such cases it may ask such members to give security for costs.—Sec. 399 (4) and (5).

The Central Government may itself apply under Section 397 or 398, and authorise any person to apply.—Sec. 401.

Notice of all applications under Sections 397 and 398 must be given to the Central Government and the court shall take into consideration the representations of the Central Government, if any.—Sec. 400.

What orders can be passed ?

Under both the sections the court can pass, "such orders as it thinks fit". So the powers of the court are very wide. Section 402 gives some examples of the type of order which the Court

may pass, *viz.*, orders for regulating the future conduct of affairs of the Company ; orders directing the purchase of the shares of any members by other members or by the Company ; reduction of capital ; the termination of any agreement between the Company and its Manager, Managing Director or any of its other Directors ; orders for the termination or revision of any agreement between the Company and any other person ; and orders for setting aside any transaction which would in the case of an individual be deemed in his insolvency to be a fraudulent preference.

Oppression and Mismanagement

The definition of Oppression and Mismanagement has been discussed in the Supreme Court and High Courts. The cases are cited below :

1. In *Shanti Prasad Jain* v. *Kalinga Tubes Ltd.*,[1] the Supreme Court of India observed that in an application under Sec. 397 it is not enough to show that there is just and equitable cause for winding up of the company. It must further be shown that the conduct of the majority shareholders is oppressive to the minority as members and this requires that events have to be considered not in isolation but as parts of a consecutive story. The conduct must be burdensome, harsh and wrongful and mere lack of confidence between the majority shareholders and the minority shareholders would not be enough. Such oppression must involve at least an element of lack of probity or fair dealing to a member in the matter of his proprietary rights as a shareholder.

2. The word "oppressive" means burdensome, harsh and wrongful. *Re H. R. Harmer Ltd.*[2]

3. In Richardson & Cruddas Ltd., Calcutta High Court removed the directors and others from the management of the company. The company was placed under a Special Officer. *L. I. C. of India* v. *H. D. Mundra & Others.*[3]

4. The House of Lords said, "whenever a subsidiary is formed with an independent minority of shareholders, the parent company must, if it is engaged in the same class of business, accept as a result of having formed such a subsidiary an

[1] (1965) I.S.C.A. 556 (Supreme Court) [2] (1958) 3 All E.R. 689
[3] (1959) 63 C.W.N. 439

obligation so to conduct what are in a sense its own affairs as to deal fairly with the subsidiary". *Scottish Co-operative Wholesale Society Ltd.* v. *Meyer.*[1]

5. Negligence and inefficiency even assuming such are proved, do not amount to mismanagement or oppression as contemplated by the Act. *Mohta Bros.* v. *Calcutta Landing & Shipping Co. Ltd.*[2] *Needle Industries (India) Ltd., and others* v. *Needle Industries Newey (India) Holdings Ltd. and Others.*[3]

6. On a true construction of Section 397, an unwise, inefficient or careless conduct of a Director in the performance of his duties cannot give rise to a claim for relief under that section. The person complaining of oppression must show that he has been constrained to submit to a conduct which lacks in probity, conduct which is unfair to him and which causes prejudice to him in the exercise of his legal and proprietary rights as shareholder. *Needle Industries (India) Ltd., and others* v. *Needle Industries Newey (India) Holdings Ltd., and others.*[4]

Consequences of an order under Sections 397 and 398

If the order of the court makes an alteration of or addition to the company's memorandum or articles, then (subject to the provisions of the order) the Company concerned shall not make any further alteration or addition which is inconsistent with the order, without the leave of court.

A certified copy of any such order altering or adding to or giving leave to alter or add to, the memorandum or articles, must be filed with the Registrar within thirty days and default in compliance with this requirement renders the Company and every officer in default liable to a fine which may extend to five thousand rupees.

Any termination or revision of any agreement made by the order of court shall not give rise to any claim for damages or for compensation. Further, no Director shall, without the leave of the court, be appointed or re-appointed or be entitled to act for and under the Company for a period of five years from the date of the order. Any contravention of this provision is punishable with imprisonment for a term which may extend to one year or with fine up to Rs. 5000/- or with both.

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[1] (1958) 3 A.E.R. 66
[2] (1969) 73 C.W.N. 425
[3] AIR (1981) Supreme Court 1298
[4] AIR (1981) Supreme Court 1293

1. *Powers of the Company Law Board*: The Company Law Board in empowered to end oppression of minority and to prevent mismanagement. It has the power

(*a*) to regulate the conduct of company's affairs in future,
(*b*) to purchase the shares and interests of any members of the company,
(*c*) to reduce consequently the share capital of the company, if the company purchases shares,
(*d*) to terminate, set aside or modify any agreement between the company and management upon such terms and condition which company thinks to be just and equitable,
(*e*) to set aside any fraudulent preference made within three months before the date of application,
(*f*) to provide far any other matter which Company Law Board thinks to be just and equitable,
(*g*) the Company Law Board may order that no change will be made in the Board of Directors or membership or the company without securing its prior approval.

II. Powers of the Central Government

A. *Under Sections 388B to 388E. Power to remove managerial personnel.*

The above Sections empower the Central Government to make a reference to the High Court when it is of opinion that there are circumstances suggesting the following :

(*a*) any person connected with the management of a company is guilty of fraud, misfeasance, persistent negligence or default in carrying out his obligations and functions under the law, or breach of trust ; or,
(*b*) the business of the company is not or has not been managed by such person in accordance with sound business principles or prudent commercial practices ; or,
(*c*) the management of the company by such person caused or is likely to cause serious injury or damage to the interest of the trade, industry or business to which such company pertains ; or,
(*d*) the business of the company has been conducted by a person with intend to defraud its creditors, members or any other person or otherwise for a fraudulent or unlawful purpose or in a manner prejudicial to public interest.

The person against whom the case is referred will be joined as a respondent. The High Court may pass interim orders, such as, stopping the respondent from carrying on his duties and appointing a suitable person in his place.

If the High Court records a decision that the respondent is not a fit and proper person to take part in the management of the company, the Government can remove him from office. The person so removed, cannot hold any office of management in any company for the next five years. He cannot also receive any compensation for loss or termination of office.

B. *Under Section* 408, *as amended in* 1974. *Power to prevent oppression or mismanagement.*

If an application is made by not less than 100 members of a Company or members holding not less than 1/10th of the voting power, complaining of oppression and mismanagement and the Central Government is satisfied that the allegations are true it can appoint such number of persons as the Central Government may, by order in writing, specify as being necessary to effectively safeguard the interests of the company, or its shareholders or the public interest. Such directors are to hold office of the company for a specified period, not exceeding 3 years.

The Central Government can issue such orders of its own motion.

Where any person is appointed by the Central Government to hold office as director or additional director of a company in pursuance of the above rule, the Central Government may issue such direction to the Company as it may consider necessary or appropriate in regard to its affairs.

The directors or additional directors so appointed, is to report to the Central Government from time to time with regard to the affairs of the company.

A person appointed director under the aforesaid provision need not hold any qualification shares, not is he liable to retire by rotation. But he may be replaced by another person by the Central Government any time. So long as such a person holds office, no change in the Board of Directors has any effect unless confirmed by the Central Government.

Section 408 of the amended Act provides that "the Central Government may appoint such number of persons as the Company Law Board may, by order in writing, specify as being necessary to effectively safeguard the interests of the Company or its

shareholders, as directors thereof for such period, not exceeding three years on any occasion.

C. *Under Section 409. Power to prevent change in board of directors* : If any Director or Manager complains to the Central Government that as a result of a change in the ownership of the shares of the Company, the Board of Directors of the Company is likely to change in a manner prejudicial to the Company and the Central Government is satisfied that the allegation is true, it can direct that no change in the Board shall have effect until confirmed by the Central Government. This section does not apply to a private company, unless it is a subsidiary of a public company.

D. *By the amendment of Companies Act in* 1974 : The Central Government has been given power to frame rules regarding investment and dividends of companies. Secs. 108A to 108H, provide restrictions upon shares designed to prevent taking control of companies by groups or combine which will be prejudicial to public interest. (See pages 641-642 and 740)

"LIFTING THE VEIL" OF THE COMPANY

An incorporated Company has a legal personality. But a Company, as a legal person, can be distinguished from the individual persons who own the shares of the company. A company can be used for lawful activities. On the other hand, the owners and managers of the company can use it as a clock for fraudulent activities.. The human agency which works a company can use it as a device or as a veil or as a stratagem for illegal and unsocial activities.

It is sometimes necessary to find out the ownership of the shares. It is also necessary to find the persons who control the company. This is called, "Lifting or piercing of the Corporate veil". It can be done by the Courts :

1. *Relationship* : The relationship between holding company and its subsidiaries can be investigated. According to Sec. 212 of the Companies Act the balance sheet of a holding company includes the particulars of subsidiaries.

2. *Reduction of membership* : If the number of membership is reduced to below seven in a public company and below two in a private company, the remaining members become liable to the creditors of the company to an unlimited extent (Sec. 45). The number of membership and their names can be investigated.

3. *Ownership* : It is sometimes necessary to find out the ownership of the shares and the extent of the controlling power or interest in a company relating to taxes. The Court has power to disregard the corporate personality if it is used for tax evasion or to dodge tax obligation. *Apthorpe* v. *Peter Schenhofen Brewing Co. Ltd.*[1] "Though a company has a separate juristic personality, Income-Tax authorities and Courts are entitled to lift the veil of corporate entity of a company and pay regard to economic realities behind legal facade". *Commissioner of Income Tax, Madras* v. *Sri Meenakhsi Mills.*[2]

4. *Illegality* : If a company is formed for an improper or unlawful object, the Court can lift the veil of the corporate entity so that the guilty person can be punished. *Jones* v. *Lipman.*[3]

5. *Abuse of power* : A Court can enquire into abuse of power by controlling interest in a company under Sec. 395. (Mismanagement and Oppression.—See p. 751)

6. *Trading with enemies* : A company can be investigated if it is carrying on trade with enemy aliens. *Daimler & Co. Ltd.* v. *Continent Tyre and Rubber Co.*[4]

7. *Monopoly* : A company can be investigated if it was creating a monopoly.

MISCELLANEOUS PROVISIONS

Information and Statistics : The Central Government may, by order, require companies to furnish information and statistics regarding their constitution and working.—Sec. 615.

Annual Report by Government : The Central Government is required to prepare an annual report regarding company law administration and submit it before the Parliament.—Section 638.

Protection : No suit, prosecution or other legal proceeding shall lie against officers of Government for anything which is in good faith done or intended to be done in pursuance of this Act or any rules made thereunder, or for the publication of any report or paper by the authority of the Government.—Sec. 635A.

Condonation of Delay : If any application to the Central Government or the filing of any document with the Registrar is

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[1] (1899) 4 Tax Cas 41
[2] AIR (1967) Supreme Court 819
[3] ((1962) 1 W.L.R. 483
[4] (1916) 2 A.C. 307

not made within the time prescribed by the Act, the delay may be condoned by the Central Government for reasons to be recorded in writing.—Sec. 637B.

EXERCISES

1. Explain the jurisdiction of the courts to interfere with the management of a company at the instance of the minority of shareholders. (Page 751)
2. Discuss the powers of the Court for the prevention of oppression and mismanagement of a company. (Page 752)
3. Show how the Central Government can remove managerial personnel of a company. (Page 756)
4. "The conduct must be burdensome, harsh and wrongful and the mere lack of confidence between the majority shareholders and the minority shareholders would not be enough". Discuss. (Pages 753-758)
5. State the powers of Central Government when oppression and mismanagement is complained of. State who can made such a complaint to the Central Government. (Pages 753-758)
6. Under what circumstances the law would disregard the legal personality of a company. (Pages 758-759)
7. What are the powers and duties of an Inspector appointed by the Central Government to investigate into the affairs of a company? (Page 749)
8. What are the conditions under which the Central Government may appoint inspectors for investigation of affairs of a company? (Pages 749-751)
9. State the provisions of the Companies Act, 1956 for prevention of oppression and mismanagement in a company. (Page 751)
10. Comment on : 'Majority must prevail' is the principle of company management. (Page 751)
11. Give an outline of the organisational machinery through which administration of Companies Act of India is carried out. (Pages 745-746)