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COMPANY MEETINGS

MEANING AND IMPORTANCE

ORDINARILY, a meeting may be defined as assembly of people for a lawful purpose or the coming together of at least two persons for the same reason. A company meeting may be defined as a concurrence or coming together of at least a quorum of members in order to transact either the ordinary or special business of the company. Thus on the basis of the above two definitions it can be said that a meeting can no more be constituted by one person than it could if no shareholders at all had attended.

One member to constitute a meeting. However, there are certain circumstances where one person can constitute a valid meeting:

(*i*) where one person held all the shares of a particular class, that person alone was held to constitute a valid meeting of that class of shareholders;

(*ii*) where the rules permit, it is possible to appoint a committee of one and thus hold a committee meeting of one;

(*iii*) where the Company Law Board calls an annual general meeting under Section 167 of the Companies Act, it may direct that one member of the company ppresent in person or by proxy shall constitute the meeting;

(*iv*) where the Company Law Board calls a meeting under Section 186 of the Companies Act (other than an annual general meeting), it can direct that one member present in person or by proxy shall constitute a valid meeting.

Importance of company meetings. Company meetings are of considerable importance. Since a company is an artificial person, it cannot act on its own. It is the directors, the elected representatives of shareholders, who are vested with the powers of control and management of the company. The directors are to act as a team and for this purpose directors' meetings are held frequently. It is at these meetings that important matters relating to the business of the company are deicded.

Similarly, shareholders' meetings are also important as it is here that shareholders can look after their interests by exercising the powers conferred on them by statute. These meetings provide an opportunity to shareholders to come together and take decisions for their welfare by controlling the board of directors and their activities. Besides, there are certain matters which can be decided only by the shareholders and shareholders' meetings are therefore held from time to time.

KINDS OF COMPANY MEETINGS

The meetings of a company can be classified as below:

1. Meetings of shareholders:
   (*i*) statutory meetings;
   (*ii*) annual general meetings;
   (*iii*) extra-ordinary general meetings, and
   (*iv*) class meetings.
2. Meetings of directors:
   (*i*) meetings of the board of directors, and
   (*ii*) meetings of committees of directors.
3. Meetings of debenture holders.
4. Meetings of creditors.
5. Meetings of creditors and contributories on the winding up of the company.

STATUTORY MEETING

The first meeting of the shareholders of a public company is known as a statutory meeting. Every company limited by shares and every company limited by guarantee and having a share capital shall, within a period of not less than one month and not more than six months from the date on which the company is entitled to commence business, hold a general meeting of members of the company, which shall be called the statutory meeting. This meeting is held only once in the life-time of a company. A private limited company, an unlimited company or a public guarantee company having no share capital are not to hold statutory meetings. [Sec. 165(1)]

Under Section 43A, private companies satisfying certain conditions are deemed to be public companies. If a private company becomes a deemed public company within a period of six months of its being entitled to commence business (i.e., the date of its incorporation), it must hold a statutory meeting. But if a private company becomes a deemed public company after six months of its incorporation, it will not be

required to hold a statutory meeting.

Notice

The directors are required to send notice of the meeting to every member of the company at least 21 days before the date of the meeting stating that it is the statutory meeting of the company.

If the notice convening this meeting does not name it as the 'statutory meeting,' it will not amount to compliance with the provisions of this section.[1]

Object of the Meeting

The object of holding a statutory meeting is to acquaint shareholders of the progress of the company since incorporation and to discuss matters arising out of the promotion and formation of the company. Professor Palmer has defined the importance of statutory meetings in the followings words: "The object of the statutory meeting is to put the shareholders of the company, at as early a date as possible, in possession of all the important facts relating to the new company."[2]

Statutory Report

In order that the shareholders can make the best use of this opportunity, the board of directors are required to send a statutory report to every member of the company at least twenty-one days before the date of the statutory meeting. The statutory report shall be certified as correct by at least two directors of the company, one of whom shall be a managing director, where there is one. The report must also be certified as correct by the auditors of the company regarding the shares alltted by the company, the cash received in respect of such shares and the receipts and payments of the company. A copy of this report must be filled with the Registrar for registration. [Sec. 165(4)(5)]

The statutory report must set out:

(*i*) the total number of shares issued, distinguishing shares allotted as fully or partly paid-up otherwise than in cash, the extent to which they are partly paid up and the consideration for which they have been allotted;

(*ii*) the total amount of cash received in respect of all the shares allotted;

(*iii*) an abstract of the receipts and payments up to a date within seven days of the date of the report and the balance of cash in hand;

[1]*Gardner v Iredale* (1912) 1 Ch. 700.

[2]*Palmer's Company Law,* London, Stevens and Sons Ltd., 1959 (20th Ed.), pp. 455-56.

(*iv*) the names, addresses and occupations of the company's directors, auditors, managing director, manager and secretary of the company;

(*v*) the particulars of any contract and modification of any contract to be submitted to the meeting for approval;

(*vi*) the extent to which the underwriting contract has not been carried out and the reasons therefor;

(*vii*) the details of arrears, if any, due from directors, the managing director or manager; and

(*viii*) the particulars of any commission or brokerage paid or to be paid to directors and the manager in connection with the sale of shares or debentures of the company. [Sec. 165(3)]

Proceedings at the Meeting

The board shall place at the meeting a list showing the names, addresses and occupations of the members of the company and the number of shares held by them respectively. This list shall remain open and accessible to any member of the company during the continuance of the meeting. [Sec. 165(6)]

The members present may discuss any matter relating to the formation of the company or arising out of the statutory report but no resolution can be passed unless notice has been given in accordance with the provisions of the Act. [Sec. 165(7)]

The meeting, however, may adjourn from time to time and a resolution may be passed at any such adjourned meeting if due notice thereof has been given in the meantime. The adjourned meeting shall have the same powers as the original meeting. [Sec. 165(8)]

Consequences of Default

Default in complying with the above provisions shall make every director or other officer of the company liable to a fine of up to five hundred rupees. [Sec. 165(9)]

Besides, the company may be wound up the court under Section 433. Instead of making a winding up order, the court may direct that the statutory report shall be delivered or that the meeting shall be held. The directors may be held personally liable for costs.

ANNUAL GENERAL MEETINGS

The annual general meeting is regarded as the most important of all company meetings. The purpose of this meeting is to give full information to members of progress made by the company during the year. The business transacted at such meetings is very important.

Holding the Meeting

As per Section 166, the first annual general meeting shall be held within eighteen months of its incorporation and if a meeting is so held, it shall not be necessary for a company to hold any annual general meeting in the year of its incorporation or in the following year. Subsequent annual general meetings must be held by the company each year within six months of the closing of the financial year [Sec. 210 (3)(*b*)], but the interval between any two annual general meetings must not be more than fifteen months. In this connection it was held that "year" means calender year starting from 1st January to 31st December and not twelve months from the date of registration of the company.[3]

At least one meeting in each calender year. The Act requires that a separate and distinct annual general meeting should be held each year and there must be as many meetings as there are years. In *Meenakshi Mills Company Ltd. v Asst. Registrar of Joint Stock Companies,*[4] an annual general meeting was called in December, 1934. This was adjourned and held in March, 1935. The next meeting was held by the company in February, 1936. The company was prosecuted for not holding any meeting of the company in 1935. It was contended on behalf of the company that there was a meeting in 1934, 1935 and 1936 and as such there was no default. But the court held that the meeting of March, 1935 was not a different meeting from the one which began in December, 1934; it was the same meeting. The company was accordingly convicted.

Considering the importance of annual general meeting to shareholders it has been held that the directors must call the meeting even though the accounts are not ready[5] or the company is not functioning[6] or the management of the entire controlled business of the company is vested in the Central Government.[7]

Extension of time by the Registrar. The Registrar is empowered to extend the time up to three months within which any annual general meeting (other than the first) should be held. The discretionary power with the Registrar is exercised in cases of proved hardship and when special reasons exist. [Sec. 166(1)]

Time and Place of Meeting

The annual general meeting must be held at the registered office of the company or at some other place within the city, town or village in which

[3] *Gibson v Barton* (1875) L.R. 10 Q.B. 329; *Park v Lawton* (1911) 1 K.B. 588.
[4] A.I.R. (1938) Mad. 640.
[5] *Re El Sombrero Ltd.,* (1958) 3 A.E.R. 1.
[6] *Madan Gopal Dey v State of West Bengal* (1968) 2 Comp. L.J. 22.
[7] *Re Hindustan C-op. Insurance Society Ltd.,* ILR (1961) Cal. 443.

the registered office of the company is situated. Further, the meeting should be held during business hours on a day which is not a public holiday. The Central Government may exempt any class of companies from the provision subject to such conditions as it may impose. [Sec. 166(2)]

Adjourned annual general meeting on a public holiday. Whereas an annual general meeting cannot be held on a public holiday, the Department of company Affairs has clarified that there is no contravention of Section 166(2) if an adjourned annual general meeting, which has been adjourned for want of quorum, comes to be accidently held on a public holiday.

Notice

At least twenty-one days' written notice must be given to members for calling an annual general meeting. However, such a meeting may be called with shorther notice if it is agreed to by all the members entitled to vote in the meeting. (Sec. 171)

Consequences of Default

Company Law Board's power to call the meeting. If default is made in holding an annual general meeting in accordance with the above provisions, any member of the company may apply to the Company Law Board and the Company Law Board may call or direct the calling of the meeting of the company and give such directions for the purpose as it thinks proper. The directions may include that one member of the company present in person or by proxy shall be deemed to constitute the meeting. (Sec. 167)

Penalty for default. If default is made in holding a meeting of the company in accordance with the above provisions, the company and every officer of the company who is in default shall be punishable with a fine which may extend to five thousand rupees and, in a case of continuing default, with a further fine which may extend to two hundred and fifty rupees for every day during which such default continues. (Sec. 168)

Business Transacted at the Meeting

The annual general meeting is an important protection to members for it is one occassion when they can be sure of having an opportunity of meeting the directors and of questioning them on the accounts, and on their report on the company's position and prospects. It is at this meeting that the shareholders are able to exercise real control by refusing to re-elect those retiring directors whose actions and policy they disapprove. It is at this meeting that auditors retire and this enables the shareholders to consider whether they should be reappointed or replaced. Dividends are

also declared at this meeting. The annual general meeting is held annually for the purpose of transacting a company's ordinary business which is identified by section 173(1) as follows: (*a*) consideration of the accounts, balance sheet and reports of the board of directors and auditor; (*b*) declaration of dividends; (*c*) appointment of directors in place of those retiring; and (*d*) the appointment and fixing of remuneration of the auditors.

The meeting may take any other business which will be deemed to be special business. It may be noted here that if any special business is to be transacted, the notice convening the meeting must contain a statement setting out all facts concerning each such item of business, including the nature and extent of interest of every director or manager in it. [Sec. 173(2)]

EXTRAORDINARY GENERAL MEETINGS

All general meetings of a company other than annual general meetings and statutory meetings are called extraordinary general meetings. These meetings are called in emergencies or on special occassions. They are convened when it is found necessary to transact certain business which cannot conveniently be postponed until the next annual general meeting. All business transacted at an extraordinary general meeting is deemed to be special business, of which notice has been duly given before hand. An extraordinary meeting is usually called for such purposes as alteration of the memorandum and articles of the company, increase or decrease of share capital or reorganisation of capital.

Convening Extraordinary General Meetings

Extraordinary meetings may be called in the following ways:

(*i*) **By directors.** Regulation 48 of Table A provides that the directors may, whenever they deem fit, convene an extraordinary general meeting. However, the board has to pass resolutions for convening such meetings.

(*ii*) **By directors on the requisition of shareholders.** The members may also compel the directors to call an extraordinary meeting. Section 169, provides that it becomes necessary for the directors to call an extraordinary general meeting on the requisition signed by a given number of shareholders. The requisition must be signed by the holders of at least one tenth paid-up capital having the right to vote on matters of requisition. If the company has no share capital, the requisition must be signed by members having at least one-tenth of the total voting power of all members having a right to vote in regard to such matters. The requisition must set out the matters for the consideration of which the

meetings is to be called and should be signed by the requisitionists and deposited at the registered office of the company. When a requisition is deposited at the registered office of a company the directors should, within twenty-one days, move to call a meeting and the meeting should actually with held within forty-five days from the date of requistion.

(*iii*) **By requisitioning shareholders.** If the directors fail to arrange for the meeting within twenty-one days of the date of deposit of requistion to be held on a day within forty-five days of the date of deposit of requisition, the requisitionists may themselves proceed to call the meeting and claim the necessary expenses from the company and the company can indemnify itself out of the remuneration due to the directors in default. But the meeting must be called before the expiration of three months from the date of deposit of requistion. (Sec. 169)

If the meeting is called by the requisitionists, it may only transact the business mentioned in the requisition, even though additional matters are specified in the notice calling the meeting.[8] The requisitionists may hold the meeting at any suitable place if the registered office is not made available to them.[9]

(*iv*) **By the Company Law Board.** If for any reason it is impracticable to call, hold or conduct an extraordinary general meeting according to the provisions of the Act or the articles, the Company Law Board may order a meeting of the company to be called, held and conducted in accordance with its directions. The directions may include a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting. The Company Law Board may call such a meeting either on its own motion or on the application of a director of the company or of any member of the company who would be entitled to vote at the meeting. (Sec. 186)

The word 'impracticable' means impracticable from a reasonable point of view. It is not to be constructed as impossible.[10] However, the discretion granted under Section 186 should be used sparingly with caution. Before exercising its discretion the Company Law Board must be satisfied that the application has been made *bona fide* in the larger interest of the company for removing a deadlock otherwise irremovable.[11] It was held that it is impracticable to hold a meeting in these circumstances and the Company Law Board could intervene in the following cases:

(*i*) Where there was a dispute between the shareholders of a company as to who were the lawful directors of the company entitled to call a

[8]*Ball v Metal Industries Ltd.,* (1975) S.C. 315.

[9]*Rathanveluswami Chettiar v Manickavelu Chettiar* (1951) 1 M.L.J. 55;

[10]*Shrimati Jain v Delhi Floor Mills Co. Ltd.,* (1974) 44 Comp. Cas. 228.

[11]*In re Ruttonjee & Co. Ltd.,* (1968) 2 Comp. L.J. 155.

meeting.[12]

(*ii*) Where a person not holding qualification shares of a director was appointed chairman, and some of the directors had transferred shares to him to satisfy the requirement and this was alleged by a group of shareholders to be invalid and was a subject matter of a suit.[13]

(*iii*) Where there was only one surviving member.[14]

(*iv*) Where a meeting already called by the company has become disorderly or otherwise impossible to be proceeded with.[15]

But where an extraordinary general meeting is held in violation of the order of the court, the court will put back the parties in the same position as they stood prior to the holding of the meeting.[16]

It may be noted here that before the amendment of 1974, the power to convene an extraordinary general meeting was vested in the court. But now this power has been vested in the Company Law Board.

Notice of the Meeting

Section 173 provides that all business transacted at an extraordinary general meeting shall be deemed to be special business. The notice convening an extraordinary general meeting must specify the special business to be transacted thereat and must be accompained by an explanatory statement. The statement must set out all material facts relating to such items of business and the nature and extent of concern or interest therein of every director or manager, if any. The requisite notice for an extraordinary general meeting is twenty-one clear days.

Time and Place of the Meeting

Unlike any annual general meeting, an extraordinary general meeting may be held at any time, on any day including a public holiday and at a place other than the registered office of the company or even outside the city, town or village limits in which the registered office of the company is situated.

CLASS MEETINGS

Where the share capital of a company is divided into different classes of shares, meetings of different classes of shareholders may have to be called

[12]*In re Lothian Jute Mills Ltd.,* (1950) 55 CWN 646.

[13]*Indian Spinning Mills Ltd. v His Excellency, The King of Nepal* A.I.R. (1953) Cal. 355.

[14]*Jarvis Motor Harrow Ltd v Carabott* (1964) 3 AM.E.R. 89.

[15]*Rangachari v Subbiah* (1975) Comp. Cas. 641 (S.C.)

[16]*Century Floor Mills Ltd., v S. Suppirah* (1975) 45 Comp. Cas. 444.

whenever the company wants to make any variation in the rights attached to shares of any particular class. The procedure for variation of rights of a particular class of shares is discussed in the chapter on 'Share Capital.' It may be noted here that a class meeting is an exception to the general rule that there must be two people to constitute a meeting because a class of shares, say preference shares, may all be held by one person.

MEETINGS OF THE BOARD OF DIRECTORS

Wide powers have been vested in the board in regard to management of companies. The company is entitled to the combined wisdom of the directors and the directors are required to meet together as a board. Under the circumstances, directors must hold their meetings as frequently as possible. These meetings of the directors are known as Board meetings.

The Board meetings are the most important as well as the most frequently held meetings of the company. It is at these meetings that all important matters relating to the company and its policy are discussed and decided upon.

Frequency of Board Meetings

Section 285 lays down that a board meeting must be held at least once in every three calender months and atleast four such meetings must be held in every year. The Central Government may exempt any specified class of companies from the above provisions, if they do not have enough work to justify expenditure on quarterly meetings of the board.

Notice of the Meeting

Notice of every meeting of the board of directors of a ccompany 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)

The Companies Act does not specify any period of notice for Board meetings. Where the articles provide a definite period of notice, the secretary must ensure that the notice must be of a length prescribed by the articles. In the absence of any provision in the articles as to the length of the notice, a reasonable notice must be given to enable directors to attend the meeting.

The notice should state the date, time and place of the meeting. Though it is not obligatory in law to state in the notice the business to the transacted at the meeting, the usual practice is for the secretary to send along with the notice a copy of the agenda.

Such notice must be given even to a director who has expressed his

inability to attend the meeting.[17]

Any business put through at a meeting not duly convened will be invalid. But transaction at such a meeting can be ratified at a subsequent meeting of the board validly convened.[18]

Quorum

The quorum for a meeting of the board of directors of a company shall be one third of its total strength (any fraction contained in that one-third being rounded off as one) or two directors, whichever is higher. Where the number of interested directors exceeds or is equal of two-thirds of the total strength, then remaining directors who are not interested, being not less than two, shall be the quorum. (Sec. 287)

If a meeting cannot be held for want of quorum, it stands adjourned till the same day in the next week, at the same time and place. [Sec. 288(1)]

Where a meeting of the board of directors is called but could not be held for want of quorum, it shall be counted towards the minimum number of meetings which must be held every year under Sec. 285. [Sec. 288(2)]

It is necessary that the quorum must be present throughout the conduct of the meeting. The decisions of the Board meeting will be invalid if the quorum is not maintained throughout the meeting, unless the articles of the company make specific provisions to get over this contingency.

Chairman

Every meeting of the Board must have a chairman to preside over it. The articles usually name the chairman who shall preside over the Board meeting. If the articles do not name the chairman, the directors may elect a chairman of their meetings and also determine the period for which he is to hold office. If no such chairman is elected, or if at any meeting the elected chairman is not present within 15 minutes after the time appointed for holding the meeting, the directors present may choose one of those present as the chairman of the meeting. The chairman of the Board presides also at general meetings of the company and is usually referred to as the chairman of the company.

Resolution by Circulation

Generally, decisions are taken by directors by passing resolutions on

[17]*Re Portuguese Consolidated Copper Mines* (1889) 42 Ch. D. 160.
[18]*Parmeshwari Prasad v Union of India* (1974) 44 Comp. Cas. 1.

matters presented before them for consideration. However, if it is not possible to hold a broad meeting for some reason, the board may pass a resolution by circulation. Section 289 provides that no resolution shall be deemed to have been duly passed by circulation by the board unless, (*a*) the resolution has been circulated in draft together with the necessary papers among all directors present in India, and the number of directors among whom it is circulated must not be less than the quorum fixed for the board meeting; and (*b*) it has been approved by a majority of them as are entitled to vote on the resolution.

Certain Resolutions at Meetings Only

Section 292 provides that the following powers of the company can be exercised only by means of resolutions passed at a meeting of the board: (*i*) the power to make calls; (*ii*) th power to issue debentures; (*iii*) the power to borrow money; (*iv*) the power to invest the funds of the company; and (*v*) the power to make loans.

In addition to the above powers, there are certain other powers under different sections which can be exercised only by means of resolutions passed at a meeting of the board of directors. These are (*a*) the power to fill up a casual vacancy in the board of directors under Section 262; (*b*) the power to accord consent to a director to enter into certain contracts with the company under Section 297; (*c*) the power to appoint a person as managing director who is already the managing director or manager in another company under Section 316; (*d*) the power to appoint a person as manager who is already the managing director or manager of another company under Section 386; (*e*) the power to invest in shares and debentures of other companies under Section 372.

Voting

Unless the articles otherwise provide, questions arising at an meeting of the board of directors shall be decided by a single majority. Each director has one vote for each resolution put to vote at the meeting. In case of an equality of votes, the chairman shall have a second or casting vote. However, the Act requires unanimous consent of all the directors in certain matters under Sections 316, 372 and 386. These matters have already been mentioned in the previous paragraph.

Validity of Acts of Directors

Section 290 provides that the acts committed by a director are valid although it may afterwards be discovered that his appointment was invalid by reason of any defect or disqualification, or had terminated by virtue of any provision contained in this Act or in the articles. This

provision is intended particularly, to protect outsiders dealing with the company who are entitled to presume that appointments have been duly made. Also no act of a director will be held valid after his appointment has been shown to the company to be invalid or to have terminated.

MEETINGS OF COMMITTEES OF DIRECTORS

In case of large companies, the board of directors usually find it convenient, and often necessary, to delegate certain matters to a committee of their number, but may only delegate their powers in this manner if the articles of association so provide. By doing so, the full board will probably not need to meet more frequently. Regulation 77 of Table A provides that the board may, subject to the provisions of the Act, delegate any of its powers to committees consisting of such member or members of its body as it thinks fit. The committee so formed may consist of a single director. Any committee so formed shall, in the exercise of the powers so delegated, conform to any regulation that may be imposed on it by the board. Regulation 78 of Table A provides that a committee may elect a chairman of its meetings. If no such chairman is elected, or if at any meeting the chairman is not present within five minutes of the time fixed for the meeting, the members present may choose one of their numbers to be the chairman of the meeting. Regulation 79 of Table A further provides that a committee may meet and adjourn as it thinks proper. Questions arising at any meeting of a committee shall be determined by a majority of votes of the members present, and in case of an equality of votes, the chairman shall have a second or casting vote.

The committees may be either standing or ad hoc committees. Standing committees such as share transfer or finance committees, are usually formed to conduct routine business. A committee formed to consider the inauguration of a pension scheme for the company's employees is an example of an ad hoc committee.

MEETINGS OF DEBENTURES HOLDERS

These meetings are held in accordance with the rules and regulations that are either entered in the trust deed or endorsed on the debenture bond so that they are binding upon both, the holders of debentures and the company. These meetings are called from time to time where the interests of debenture holders are involved at the time of the reconstruction, reorganisation, amalgamation or winding-up of the company. The rules and regulations entered in the trust deed relate to notice of the meeting, appointment of a chairman of the meeting, passing the

resolutions, quorum of the meeting and the writing and signing of minutes.

MEETINGS OF CREDITORS

These meetings are called when the company proposes to make a scheme or arrangement with its creditors. Companies, like individuals, may sometimes find it necessary to compromise or make some arrangement with their creditors. Sections 391 to 393 of the Companies Act not only give powers to the company to compromise with the creditors but also lay down the procedure for doing so.

MEETINGS OF CREDITORS AND CONTRIBUTORIES ON WINDING UP

The meetings are held when the company has gone into liquidation. These meetings are held to ascertain the total amount due by the company to its creditors and also to appoint either liquidators to wind up the affairs of the company or a committee of inspection. The term 'contributory' covers every person who is liable to contribuite to the assets of a company in the event of its being wound up.

REQUISITES OF A VALID MEETING

Every meeting of the board of directors and every meeting of the shareholders must be properly convened and duly constituted. A meeting is said to be properly convened when proper notice of the meeting is issued by a proper authority to all persons entitled to receive the notice. A meeting is said to be duly constituted when there is a proper person in the chair to preside over it, and a requisite quorum of persons, entitled to attend and vote at the meeting, is present.

Sections 171 to 186 of the Act contain provisions for the holding of general meetings of a company. The provisions embodied in these sections apply to general meetings of a public company and a private company which is a subsidiary of a public company, notwithstanding anything to the contrary contained in its articles. However, these companies may include in their articles additional rules for the conduct of meetings, subject to the provisions of the Act. An independent private company is free to make its own rules by its articles in respect of general meetings and the provisions of the Act will apply to an independent company only when articles do not provide otherwise.

The following are the requisitics of a valid meeting:

(1) **Proper authority.** The first essential requisite of a valid meeting is that is should be convened by a proper authority, otherwise it will not be a valid meeting. A general meeting of the shareholders of a company may be convened by the following:

(*i*) *By the board of directors.* In case of a general meeting of shareholders of the company, the power to convene the meeting is vested in the board of directors. This authority is exercised through the medium of a secretary and is derived by directors acting collectively as a board. The directors may call a meeting of the shareholders by passing a resolution at a meeting of the board.

Once a meeting has been called or convened, directors have no power to postpone it and the meeting may be held even though they purport to do so.[19] But in a recent case it has been held by the Allahabad High Court that directors may postpone an annual general meeting, but they must exercise their discretion *bona fide* for the benefit of the company in appropriate cases.[20]

(*ii*) *By directors on the requisition of shareholders.* Where a requisition is deposited at the registered office of a company, the directors should, within twenty-one days, move to call a meeting and the meeting should be held within forty-five days of the date of the requisition. If the directors fail to do so, the requisitionists may themselves proceed to call a meeting within three months of the date of requisition. This is applicable in the case of an extraordinary general meeting. (Sec. 169)

(*iii*) *By the Company Law Board.* If default is made in holding an annual general meeting in accordance with Section 166, the Company Law Board may call or direct the calling of such a meeting. (Sec. 167)

The Company Law Board can also convene a general meeting (other than an annual general meeting) either of its own motion or on the application of any director or member entitled to attend and vote at the meeting, if for any reason it is impracticable to call a meeting of the company. (Sec. 186)

(2) **Notice.** A company is not corporately assembled so as to transact any business unless the meeting is convened by a proper notice. Notice is an advance intimation of the meeting so as to give the person receiving it an opportunity to prepare himself for it.

Length of notice. Under Section 171, every member of a company is entitled to a notice of every general meeting and a notice of not less than twenty-one days must be given in writing to every member. An annual general meeting may, however, be called by giving shorter notice, if it is

[19]*Smith v Paringa Mines Ltd.,* (1906) 2 Ch. 193.

[20]*Rajpal Singh v State of U.P.,* (1968) 1 Comp. L.J. 21.

agreed upon by all the members entitled to vote at the meeting, and any other meeting may be so held if the holders of ninety-five per cent of the paid-up share capital or the total voting power, consent to the shorter notice. The consent to a shorter notice may be given either before or after the meeting. A consent given subsequently validates a resolution passed at a meeting on shorter notice.[21]

Twenty one days are to be computed from the date of receipt of notice by members and notice shall be deemed to have been received at the expiration of forty-eight hours from the time of posting (Sec. 53). It may be noted here that as law requires 21 days' clear notice, the day on which notice is served or deemed to be served and the day of holding the meeting shall be excluded in counting 21 days.[22]

Contents of notice. Every notice of a meeting must specify the place and the day and hour of the meeting and shall contain a statement of business to be transacted at the meeting. [Sec. 172(1)]

In every notice calling a meeting of a company which has a share capital or the articles of which provide for voting by proxy at the meeting there shall appear with reasonable prominence a statement that a member entitled to attend and vote is entitled to appoint a proxy or where that is allowed, one or more proxies, to attend and vote instead of himself and that proxy need not to be a member. [Sec. 176(2)]

Ordinary business and special business. As we have already seen, the notice must state the business to be transacted at the meeting. Section 173 places the business in two categories:

(*i*) *General business:* in case of annual general meetings, all business relating to the consideration of annual accounts, declaration of dividend, appointment of directors in place of those retiring and appointment of auditors and fixing their remuneration.

(*ii*) *Special business:* any other business at annual general meetings and all business at extraordinary general meetings.

Where any items of business to be transacted at the meeting are deemed to be special business, there shall be annexed to the notice of the meeting a statement setting out all material facts concerning each such item of business including the nature and extent of interest of every director or manager in it.

Failure on the part of the company to give all the relevant facts in the aforesaid manner in the case of special business will invalidate the

[21]*Self Helf Industrial Estate Private Ltd., In re* (1972) 42 Comp. Cas. 605; *Parikh Engineering and Boat Building Co. Ltd., In re* (1975) 45 Comp. Cas. 157.

[22]*Bharat Kumar Dilwali v Bharat Carbon and Ribbon Mfg. Co. Ltd.,* (1973) 43 Comp. Cas. 197.

resolutions passed on the basis of such a notice.[23] But non-inclusion of facts, not having a direct bearing on the matter to be considered at the meeting shall not affect the validity or sufficiency of notice.[24] Similarly if the notice is misleading or the explanatory note is insufficient in respect of certain items then resolutions in respect of those items are invalid but not in respect of those items of which due notice and explanatory note have been given.[25] However, a shareholder who, by his own conduct, shows that he knew the real effect of the business to be transacted cannot complain of the notice on grounds of insufficiency.[26]

Person entitled to notice. Notice of every meeting shall be given (*a*) to every member of the company, (*b*) to persons entitled to a share in consequence of the death or insolvency of a member; and (*c*) to the auditor or auditors, for the time being of the company. [Sec. 172(2)]

Notice shall also be given to the public trustee as he is legally entitled to represent the members of the company. [Sec. 187B(1)]

Mode of giving notice. Notice of a meeting may be served on any member either personally or by sending it by post to him to his registered address, or if he has no registered address in India, to the address within India supplied by him to the company for the serving of notices to him. A notice advertised in a newspaper circulating in the neighbourhood of the registered office of the company shall be deemed to be duly served on the day on which the advertisement appears, on every member of the company who has no registered address in India and has not supplied to the company an address within India for the serving of notices to him. (Sec. 53)

Omission to give notice. Deliberate omission to give notice to a single member may invalidate the meeting although an accidental omission to give notice to, or non-receipt of notice by, any member or other person to whom it should be given shall not invalidate the proceedings of the meeting. [Sec. 172(3)]

Notice of an adjourned meeting. It may be noted here that fresh notice need not be given for holding an adjourned meeting because such a meeting is merely a continuation of the original meeting in law.[27] But fresh notice of the adjourned meeting must be given if the original meeting was adjourned *sine die* or was adjourned for 30 days or more or if fresh business, other than such business as is left uncompleted at

[23]*Narayan Lal Bansi Lal v The Maneck Ji Petit Manufacturing Co. Ltd.,* (1931) 33 Bomb. L.R. 556.

[24]*Sitaram Jaipuria v Banwari Lal Jaipuria* (1972) 76 C.W.N. 161.

[25]*Carruth v Imperial Chemical Industries* (1937) A.C. 707.

[26]*Parshuram v Tata Industrial Bank Ltd.,* (1928) A.I.R., P.C. 180.

[27]*Seadding v. Lorant* (1857) C.H.L.C. 418.

original meeting, was to be discussed.

(3) **Quorum.** Another requirement of a valid meeting is that a quorum of members must be present. Quorum is the minimum number of members required to be present for validly transacting the business of the meeting.

Quorum for general meetings. Generally, a quorum is fixed by the articles. Unless the articles provide for a larger number, five persons personally present in the case of a public company and two persons personally present in the case of a private company will be the quorum for a general meeting of the company. Unless the articles otherwise provide, if within half an hour from the time fixed for holding a meeting of the company, a quorum is not present, the meeting shall stand dissolved, if it is called upon the requisition of members. In any other case, the meeting shall stand adjourned to the same day in the next week, at the same time and place. If at the adjourned meeting also a quorum is not present within half an hour from the time appointed for holding the meeting, members present shall constitute a quorum. (Sec. 174)

Proxy not to be counted. It may be noted that the presence of a proxy will not suffice for the propose of a quorum.

Joint holders as single member. Joint holders of shares are treated as one member for the purpose of quorum.

Representatives as members. Where a company is a member of another company or where the President or the Governor holds shares in a company, their duly appointed representative is deemed to be personally present and shall be counted for the purposes of a quorum. [Sec. 187(2) and 181-A]

One member can not constitute a meeting. One person, even though he holds proxies from all shareholders, cannot form a quorum and no valid business can be transacted by a single member since there is no meeting.[28]

Exceptions. However, there are certain circumstances where even a single member present may form the quorum and constitute a valid meeting.

(*i*) Where all the preference shares are held by one shareholder, it was held that a meeting of preference shareholders attended by him was proper.[29]

(*ii*) Where the Comapny Law Board calls or directs the calling of an annual general meeting under Section 167, it can direct that one member present in person or by proxy shall constitute a valid meeting.

(*iii*) Where the Company Law Board orders a meeting of the company

[28]*Sharp v Dawes* (1867) 8 Q.B.D. 26.
[29]*East v Bennet Bros. Ltd.* (1911) 1 Ch. 163.

to be held (other than an annual general meeting), it can direct that one member present in person or by proxy shall constitue a valid meeting.

When should quorum be present? Regulation 49 of Table A states that no business shall be transacted at a general meeting unless the quorum of members is present at the time when the meeting preceeds to business. Where the relevant articles in company's articles of association is similar to Regulation 49 of Table A, the quorum must be present at the beginning of the meeting when it proceeds to business and it need not be present throughout or at the time of taking the vote on any resolution.[30]

However, if a provision on the lines of Articles 49 of Table A is not included in the articles, it appears that a quorum must remain present throughout the meeting and not merely at the beginning. In a recent case it was held that the quorum must be present not only at the beginning of the meeting but throughout the meeting. Thus where the number of members present is less than the quorum fixed for the meeting, no business can be transacted and if transacted, it will be a nullity.[31] This view seems to be correct and logical.

Quorum for board meetings. The quorum for a meeting of the board of directors of a company shall be one-third of its total strength (any fraction contained in that one-third being rounded off as one) or two directors, whichever is higher. Where the number of interested directors exceeds or is equal to two-thirds of the total strength, then remaining directors who are not interested, being not less than two, shall be the quorum (Sec. 287). Where at the meeting of board of directors there is no quorum, the meeting automatically stands adjourned till the same day in the next week at the same time and place. (Sec. 288)

(4) **Chairman.** The successful conduct of any meeting is largely dependent upon the personality of the chairman. He is the chief authority in the meeting and is the umpire of debate, the judge of admissibility and the upholder of order and decorum.

Appointment of Chairman. Generally the articles provide for the appointment of a chairman. But if there is nothing in the articles, the members personally present at the meeting shall elect one among themselves to be the chairman on a show of hands. If a poll is demanded on the election of the chairman, it must be taken forthwith and the chairman elected by a show of hands can exercise all the powers in this connection. If some other person is elected chairman as a result of the poll, he shall be the chairman for the rest of the meeting. (Sec. 175)

It may be noted that the provisions of Section 175 are applicable only

[30]*Re Hartley Baird Ltd.*, (1953) 3 A.E.R. 695.
[31]*Re London Flats Ltd.*, (1962) 2 A.E.R. 744.

if the articles do not provide otherwise. It thin connection it is worth noting Regulations 50-52 of Table A regarding the appointment of a chairman.

The chairman, if any, of the board shall preside as chairman at every general meeting of the company. (Regn. 50)

If there is no such chairman or if he is not present within fifteen minutes of the time fixed for holding the meeting, or is unwilling to act as chairman of the meeting, the directors present shall elect one of their number to be the chairman. (Regn. 51)

If at any meeting no director is willing to act as chairman or if no director is present within fifteen minutes of the time appointed for holding the meeting, the members present shall choose one of their number to be the chairman. (Regn. 52)

Chairman's duties. The important duties of a chairman may be enumerated as follows:

(*i*) He must act at all times *bona fide* and in the interests of the company as a whole.

(*ii*) He must ensure that the meeting is properly convened and constituted.

(*iii*) He must also see to it that order is maintained during the meeting.

(*iv*) He must ensure that the proceedings at the meeting are properly and regularly conducted.

(*v*) He must ensure that the provisions of the Act and the articles are observed.

(*vi*) He must decide whether the motions and amendments are in order and within the scope of the meeting.

(*vii*) He must see to it that no discussion is allowed except when threre is a specific motion before the meeting, duly proposed and seconded.

(*viii*) He must ensure that the sense of the meeting is properly ascertained with regard to any question which properly comes before the meeting.

(*ix*) He must also ensure that all members, including the minority, get an equal opportunity to express their views;

(*x*) He must exercise his casting vote, *bona fide* in the interests of the company.

(*xi*) He must exercise correctly his power of adjournment and of demanding a poll. If he dissolves or adjourns a meeting arbitrarily, his act will be irregular and it will be open to the meeting to select another chairman and proceed with the business.[32]

Chairman's powers. In order to enable the chairman to perform his

[32]*Seth Sobhag Mal Lodia v Edward Mills Ltd.*, (1972) Comp. Cas.1.

duties properly, he has been given a number of powers. A chairman has the powers to:

(*i*) decide points of order;

(*ii*) maintain his ruling on points of order;

(*iii*) decide the priority of speakers;

(*iv*) expel any unruly member;

(*v*) adjourn the meeting if it becomes impossible to conduct and complete the business;

(*vi*) demand poll;

(*vii*) regulate the talking of poll;

(*viii*) appoint two scrutineers to scrutinize the votes given on the poll;

(*ix*) sign and date the proceeding of the meeting; and

(*x*) in addition to a deliberative vote as a member, the chairman may have a casting vote if the articles so provide. This casting vote is to be exercised if there is an equality of affirmative and negative votes.

PROXY

A proxy may be defined as a person authorised to act and vote for another at a meeting, though the expression is commonly applied to the document by which the proxy is appointed.

Appointment of proxy and his rights. Section 176 states that any member of a company entitled to attend and vote shall be entitled to appoint another person (whether a member or not) as his proxy to attend and vote instead of himself. But a proxy so appointed shall have no right to speak at the meeting.

Unless the articles otherwise provide: (*a*) a proxy cannot be appointed in the case of a company which has no share capital; (*b*) a member of a private company cannot appoint more than one proxy to attend on the same occassion; and (*c*) a proxy cannot vote except on a poll.

Statement in the notice. In every notice calling a meeting of a company which has a share capital or articles of which provide for voting by proxy at the meeting, there shall appear a statement that a member entitled to attend and vote is entitled to appoint a proxy and that the proxy need not be a member of the company.

Instrument of proxy. The instrument appointing a proxy must be in writing and duly signed by the appointer or by his authorised agent. An instrument appointing a proxy, if in any of the forms set out in Schedule IX, shall not be questioned on the ground that it fails to comply with any special requirements specified for such instrument by the articles. Even a misprint or some palpable mistake on the face of instrument appointing the proxy will not entitle the company to refuse it. Where a proxy

intended to be used at an extraordinary general meeting had misdescribed the meeting as the annual general meeting, it was held to be valid.[33]

Deposit of proxy. A proxy may be lodged at the company's office forty-eight hours before the commencement of the meeting. If the articles require that the proxy has to be deposited more than forty-eight hours before the meeting, that will be inoperative and the shareholder will have the right to deposit proxies forty-eight hours before the meeting. However, a company may require less than forty-eight hours for the deposit of proxies.

As poll is an enlargement or continuation of the meeting at which it was demanded, so that fresh proxies cannot be lodged after the date of the meeting for the purpose of a poll taken subsequently.[34] Nor can such proxies, if deposited, be used at an adjourned meeting, whether for the purpose of taking a poll or otherwise.[35] However, this problem is duly removed by Regulation 61 of Table A which is usually adopted by the companies in their articles of association. Regulation 61 states that the instrument appointing a proxy shall be deposited at the registered office of the company not less than 48 hours before the time for holding the meeting or adjourned meeting, or in case of a poll not less than 24 hours before the time appointed for taking the poll.

Invitation to members prohibited. No inviation to appoint any person as proxy shall be sent at the expense of the company and if any such inviation is sent, it is an offence liable to a fine extending to one thousand rupees.

Inspection of proxies by members. Every member entitled to vote at the meetings is entitled to inspect the proxies lodged at any time during the business hours of the company during the period beginning twenty four hours before the time fixed for the commencement of the meeting and ending with its conclusion. For such inspection the member must make an application to the company at least three days before the meeting.

Relationship between member and proxy. The relationship between a member and his proxy is that of a principal and agent. The proxy is bound to vote according to the directions of the member appointing him.[36]

Revocation of proxy. Proxy is revocable at any time by giving notice of revocation to the company before the proxy has acted. Where a shareholder who, having appointed a proxy, personally attends and votes at the meeting, the proxy is revoked thereby.[37] Again, the death of a

[33] *Oliver v John Dalgleish* (1963) 3 All. E.R. 303.
[34] *Shaw v Tati Concessions* (1913) 1 Ch. 292.
[35] *McLaren v Thomson* (1917) 2 Ch. 261 C.A.
[36] *Naryan v Kaleswara Mills Ltd.* A.I.R. (1952) Mad. 515.
[37] *Cousins v Internation Brick Co.*, (1931) 2 Ch. 90.

shareholder after he has appointed a proxy revokes the authority of a proxy, but not until the company receives notice of the death.

Article 63 of Table A provides that a vote given in accordance with the terms of a proxy shall be valid notwithstanding previous death or insanity of the principal or the revocation of proxy or authority or transfer of shares, provided that the company has no intimation of such events before the meeting.

Position of representatives of companies and government. Where a company is a member of another company or where the President or the Governor holds shares in a company, their duly appointed representative shall be deemed to be personally present and shall enjoy all the rights of a member. The representative is not a proxy. He can take part in discussions, vote by show of hands, demand a poll. He may appoint a proxy to attend and vote at the meeting instead of himself. [Secs. 187(2) and 187-A]

VOTING

Matters relating to the company's working are discussed in the general meetings of the company and it is very rare to have unanimity of members' opinions on such matters. In order to ascertain in the sense of the meeting, the chairman has to put the matters to vote before the meeting. The voting may be by show of hands or by taking a poll.

(1) **Voting by show of hands.** This is the most common method of asscertaining the sense of a meeting and it is commonly used at company meetings. Those for and against a motion are requested in turn to indicate their views by raising their hands. The teller counts the hands and reports to the chairman. The chariman then declares the result of the voting, indicating whether the motion has been carried or lost.

At any general meeting when a motion is put to the vote, it shall be decided on a show of hands unless a poll is demanded. (Sec. 177)

On a show of hands, each member shall have one vote. Unless the articles otherwise provide, proxies are not entitled to vote in case of such a voting. An alien enemy cannot vote.[38]

Position of representatives of companies and government. Where a company is a member of another company or where the President or the Governor holds shares in a company, their duly appointed representative is deemed to be personally present and can vote on show of hands. [Secs. 187(2) and 187-A]

Chairman's declaration on show of hands conclusive. A declaration by

[38] *Robson v Premier Oil Co,.* (1915) 2 Ch. 124.

the chairman that on a show of hands a resolution has or has not been carried and its entry in the minutes is a conclusive proof of the fact. (Sec. 178)

But the chairman's declaration would not be conclusive where the declaration that the resolution is passed, shows on the face of it that the statutory majority had not voted in favour if it.[39]

Rough and ready method. A vote by show of hands is only a rough and ready method of ascertaining the sense of meeting. It is not a very accurate method of ascertaining the wishes of the majority holders of the shares of the company because it does not pay due regard to the wishes of a member holding a large number of shares since each member has one vote, irrespective of the number of shares held by him. Moreover, votes of those members who are absent from the meeting but have appointed proxies to vote for them are also not counted under this method.

(2) **Voting by poll.** This method is different from the show of hands method for two reasons. First, each member is entitled to cast a number of votes according to the number of shares held by him. Secondly, votes of those numbers who are absent from the meeting but have appointed proxies to vote for them can also be exercised.

Demand for poll. Before or on the declaration of the result of the voting on any resolution on a show of hands,a poll may be taken by the chairman of the meeting of his own motion and it must be taken on a demand made in that behalf by the persons specified below:

(*i*) in the case of a public company having a share capital, by any member or members present in person or by proxy, holding at least one-tenth of the total voting power in respect of the resolution or having shares on which an aggregate sum of not less than rupees fifty thousands has been paid-up;

(*ii*) in the case of a private company, by one member having the right to vote on the resolution and present in person or by proxy if not more than seven such members are personally present, and by two such members present in person or by proxy if more than seven such members are personally present;

(*iii*) in the case of any other company, by any member or members present in person or by proxy and having not less than one-tenth of the total voting power in respect of the resolution.

The demand for a poll may be withdrawn at any time by the person or persons who made the demand. (Sec. 179)

[39]*Dhakeshwari Cotton Mills Ltd., v Neel Kamal Chakarbarti* (1938) I.L.R. 1 Cal. 9.

In this connection it is important to note that the chairman shall put each resolution to the poll separately if poll in demanded on more than one resolution.[40]

Time of taking poll. A poll demanded on a question of adjournment or the appointment of a chairman must be taken forthwith. In any other case, the poll must be taken within forty-eight hours of the demand for one. (Sec. 180)

Restrictions on exercise of voting rights. If the articles so provide, members holding shares on which calls are in arrear or in regard to which the company has right of lien, may not be allowed to vote in a poll (Sec. 181). Apart from the restrictions imposed by Section 181, a public company or a private company which is a subsidiary of a public company must not impose any other restrictions on the voting rights of a member. (Sec. 182)

Where the articles provided that no member shall be entitled to vote nor be reckoned in the quorum when his name had not been on the register of the company for a period specified in the articles, these were held to be invalid.[41]

However, a member is free to split his votes for and against the same resolution. (Sec. 183)

Appointment of scrutineers. The chairman of the company shall appoint two scrutineers to scrutinise the votes given on the poll and to report thereon to him. One of such scrutineers shall always be a member (not being an officer or employee of the company) present at the meeting provided such a member is available and willing to be appointed. (Sec. 184)

The chairman of the meeting shall have the power to regulate the manner in which a poll shall be taken. The result of the poll shall be deemed to be a decision of the meeting on the resolutions on which the poll was taken. (Sec. 185)

RESOLUTIONS

The method of transacting business at any meeting is to be submit to those present for their considered decision, definite proposals or porpositions pertaining to the particular matters of business in hand. Each proportion is discussed and debated and finally put to vote, where-

[40]*Blair Open Heath Furnace Co. Ltd., v Reigart* (1913) 108 LT 665.

[41]*Ananta Lakshmi v Hindustan Investment and Financial Trust Ltd.* A.I.R. (1951) Mad 927; *Vishwanthan v Tiffins Barytes Asbestos and Paints Ltd.*, A.I.R. (1953) Mad. 520.

upon, if it is carried by the requisite majority, it becomes the resolution of the meeting on that particular matter. Thus, a resolution may be defined as the formal expression of decision of a meeting on any proposal before it and provided it conforms with law, is binding on all members.

Kinds of Resolutions

The Companies Act recognises three types of resolutions: (*i*) ordinary resolution; (*ii*) special resolution; and (*iii*) resolution requiring special notice.

1. Ordinary resolution. An ordinary resolution is one which requires a simple majority, that is, the votes in favour should exceed the votes against the resolution. Section 189(1) states that a resolution shall be an ordinary resolution when the votes at a general meeting cast by members in its favour are more than the votes cast against it. The votes may be cast on a show of hands or on a poll in general meeting of which due notice as required by the Act has been given. Those remaining neutral will not be counted either way. All matters which are not required by the Companies Act or the company's articles to be done by a special resolution, are done by means of an ordinary resolution.

Business transacted by ordinary resolutions. The following business may be transacted by an ordinary resolution:

(*a*) Issue of shares at a discount. (Sec. 79)

(*b*) Adoption of statutory report. (Sec. 165)

(*c*) Adoption of annual accounts. (Sec. 210)

(*d*) Appointment of auditors and fixing their remuneration. (Sec. 224) However, where 25 per cent or more of the the subscribed capital of a company is held jointly or singly by a public financial institution, a Government company, a nationalised bank or an insurance company carrying on general insurance business, the appointment of an auditor shall be by a special resolution of the annual general meeting. (Sec. 224A)

(*e*) Appointment of directors at the annual general meeting unless the articles contain contrary provisions. (Sec. 255)

(*f*) Variation in the number of directors of the company within the limits fixed by the articles. (Sec. 258)

(*g*) Declaration of dividends.

(*h*) Issue of bonus shares in accordance with the provisions of the articles.

(*i*) Authorising voluntary winding up under specified circumstances. (Sec. 484)

(*j*) Appointing and fixing remuneration of liquidators in members' voluntary winding up. (Sec. 490)

2. Special resolution. A resolution shall be a special resolution when (*a*) the intention to propose it as a special resolution has been specifically mentioned in the notice calling the general meeting; (*b*) the notice required under this Act for convening the general meeting has been duly given; and (*c*) the number of votes cast in favour of the resolution is three times the number cast against it. [Sec. 189(2)]

Thus, a special resolution is one which is passed at a general meeting of a company by a majority of three-fourths of the members present and entitled to vote.

The idea of a special resolution is to ensure that every important matter is decided after due deliberation and with the consent of a large number of shareholders present at the meeting, in person or by proxy.

Business transacted by special resolutions. The business of a general meeting must be transacted by means of a special resolution when so required by the Act or by the articles. The following are the matters which require special resolution under the Act:

(*a*) Alteration of the memorandum in the matter of shifting of registered office from one State to another and also alteration of the objects clause subject to confirmation of the Company Law Board. (Sec. 17)

(*b*) Alteration of the name of the company with the approval of the Central Government. (Sec. 21)

(*c*) Alteration of the articles of association. (Sec. 31)

(*d*) Authorising the offer of right shares to non-members. (Sec. 81)

(*e*) Creation of reserve capital. (Sec. 99)

(*f*) Reduction of capital. (Sec. 100)

(*g*) Variation in the rights of holders of any class of shares. (Sec. 106)

(*h*) Removal of registered office outside the local limits of the city, town or village in which it is situated. (Sec. 146)

(*i*) Authorising payment of interest out of share capital. (Sec. 208)

(*j*) Declaration of investigation into the affairs of the company. (Sec. 237)

(*k*) Authorising voluntary winding up of the company. (Sec. 484)

3. Resolution requiring special notice. Where special notice of a resolution is required by the Act or the articles of a company, notice of the intention to move the resolution should be given to the company not less than fourteen days before the meeting at which it is to be moved. The company on receipt of such special notice will give the notice of the resolution to the members at least seven days before the meeting in the same manner in which notice for a meeting is given. Where that is not practicable, it may be given by advertisement in a newspaper having an appropriate circulation or in any other mode allowed by the articles. (Sec.

190)

Special notice is required by the Act in the following cases:

(*i*) for a resolution for appointment as auditor of a person other than a retiring auditor (Sec. 225);

(*ii*) for a resolution at an annual general meeting providing expressly that a retiring auditor shall not be reappointed. (Sec. 225)

(*iii*) for a resolution for removal of a director before the expiry of his term (Sec 284);

(*iv*) for a resolution for appointment of another person as a director in place of the director removed (Sec. 284); and

(*v*) for a resolution for the appointment as director of a person other than retiring director. (Sec. 257)

The articles of a company may provide additional matters in respect of which special notice is required.

Circulation of Members' Resolutions

The directors usually decide the agenda of a meeting and the resolutions to be moved thereat. However, Section 188 empowers a specified number of shareholders to introduce resolutions on their own account at the annual general meeting and to inform other members of the purpose for which the resolutions are proposed to be introduced.

Persons entitled to requisition. Section 188 lays down that on the written requisition of any members representing at least one-twentieth of the total voting power of all members entitled to vote on the resolution or on a requisition of one hundred members holding shares on which one lakh rupees in all have been paid-up, the company shall be bound at the expense of the requisitionists to serve notice of any proper resolution intended to be moved by the requisitionists at the annual general meeting on all members entitled to receive notice of such meeting. The requisitionists may also require the circulation of a statement of not more than one thousand words with regard to the said resolution or the business to be transacted at the meeting. Service shall be effected at the same time as the notice of the meeting is served on members or as soon thereafter as practicable. Accidental omission to serve will not invalidate circulation.

Deposit of requisition. The requisition together with a sum reasonably sufficient to meet the company's expenses in giving effect to the requisition must be deposited at the registered office of the company:

(*i*) in case of a requisition requiring notice or resolution, at least six weeks before the meeting; and

(*ii*) in any case, at least two weeks before the meeting.

Company not bound to give effect to the requisition. The company shall

not be bound under this section to circulate any statement in the following cases:

(*i*) if on the application of the company or any other aggrieved person, the Company Law Board is satisfied that the right is being abused to secure needless publicity for defamatory matter; and

(*ii*) a banking company shall not be bound to circulate any statement under this section, if, in the opinion of its board of directors, the circulation will injure the interest of the company.

Registration of Certain Resolutions and Agreements

A certified copy under the signatures of an officer of the company, of the following resolutions and agreements must be registered with the Registrar within 30 days after passing or making thereof:

(*i*) special resolutions;

(*ii*) resolutions which have been agreed to by all the members of a company, but which, in the absence of such an agreement, would have to be passed as special resolutions;

(*iii*) any resolution of the board of directors or an agreement executed by a company relating to the appointment, reappointment or renewal of appointment of a managing director or variation of the terms of a managing director;

(*iv*) all resolutions or agreements binding on all members of any class of shareholders, although they have not been agreed to by all those members;

(*v*) resolutions passed by a company conferring power under Section 293 upon its directors to sell or dispose of the whole or any part of company's undertaking, to borrow money beyond the limits of the paid-up capital and free reserve of the company, and to contribute to charities beyond fifty thousand rupees or five per cent of the profits, whichever is greater;

(*vi*) any resolution approving the appointment of sole selling agents under Section 294 or 294AA;

(*vii*) resolution for voluntary winding up passed under Section 484; and

(*viii*) copies of terms and conditions of appointment of a sole selling agent appointed under Section 294 or Section 294AA. (Sec. 192)

MINUTES

Minutes may be defined as the official record of the proceedings of the meetings of directors or shareholders of a company. They are the written record of the business transacted and decisions taken at the meetings.

They have sometimes been described as a record of what took place at a meeting. The object of writing minutes is to preserve a concise and accurate official record of the decisions taken at company meetings. Once the minutes have been confirmed and signed by chairman, they can be produced as evidence of the proceedings in court of law.

Statutory Provisions Regarding Minutes

Obligation to maintain minutes. Every company shall maintain minutes of all proceedings of general meetings and of all proceedings at meetings of its board of directors or committees of the board. Entries of the proceedings must be made in the books kept for that purpose within thirty days of every such meeting. [Sec. 193(1)]

Numbering of pages. The pages of the minutes book must be consecutively numbered. In no case shall the minutes of proceedings of a meeting be attached to any such book by pasting or otherwise. [Sec. 193(1B)]

Signing of minutes. Each page of the minutes book shall be initialled or signed and the last page of the record of proceedings of each meeting in such books shall be dated and signed:

(*i*) in the case of a board meeting or a committee thereof, by the chairman of the meeting or next succeeding meeting; and

(*ii*) in the case of a general meeting, by the chairman of the same meeting within a period of thirty days or in the event of death or inability of the chairman, by a director duly authorised by the board for the purpose. [Sec. 193(1A)]

Fair and correct summary. The minutes of each meeting shall contain a fair and correct summary of the proceedings of the meeting. All appointments of officers made at any such meetings shall be included in the minutes. [Sec. 193(2), (3)]

Contents of minutes of board meetings. In the case of a meeting of the board of directors or a committee of the board, the minutes shall also contain the names of the directors present and the names of the directors dissenting from or not concurring in respect of each of the resolutions. [(Sec. 193(4)]

Defamatory and irrelevant matters to be excluded. The minutes need not include any matter which is defamatory or irrelevant or deterimental to the interest of the company. The discretion in regard to such inclusion or non-inclusion of any matter in the minutes lies with the chairman. [Sec. 193(5)]

Minutes as evidence of proceedings. Minutes of meetings kept in accordance with the above provisions shall be evidence of proceedings recorded therein. (Sec. 194)

The accuracy of minutes can not be disputed unless they are shown to

have been written fraudulently,[42] or where the minutes on their face are wrong.[43] If something is not recorded in the minutes that can be proved by proper evidence.[44]

Where the minutes of a meeting have been kept in accordance with above provisions, a presumption will arise that the meeting was duly called and held. The proceedings of the meeting shall be deemed to have duly taken place and all appointments of directors and liquidators made at the meeting shall be deemed to be valid. (Sec. 195)

Location and inspection of minute books. The minutes of the shareholders' meetings are required to be kept at the registered office of the company and must be open to inspection by members without charge for at least two hours every day. A member is entitled to be furnished within seven days after he has made a request in that behalf to the company, with copies of minutes on payment of rupee one for every one hundred words or fractional part thereof. Any denial of this right of members is punishable with a fine which may extend to five hundred rupees in respect of each such offence. Further, the Company Law Board may compel an immediate inspection of the minutes book or direct that the copy required shall forthwith be sent to the person requiring it. (Sec. 196)

Publication of reports. No report of the proceedings at a general meeting shall be circulated or advertised at the expense of the company unless all matters required to be included in the minutes are included therein. (Sec. 197)

QUESTIONS

1. What is a statutory meeting? What are the consequences of not holding a statutory meeting? [*Delhi, B. Com. (Hons.), 1980*]

2. What is a statutory meeting of a company? Is it necessary for all kinds of companies to hold a statutory meetings? [*Company Secretary (Inter), April 1976*]

3. What is a statutory meeting? What is the procedure provided by law for holding it? What particulars must a statutory report contain? What remedy has a shareholder if the meeting is not held or the report not filed? [*Agra, M.Com. (Hons.), 1976*]

4. What are the legal provisions for holding the annual general meeting of a company? What business is transacted at the meeting? [*Delhi, B.Com. (Hons.), 1972*]

5. What is annual general meeting? State the legal provisions regarding calling

[42] *Kerr v Mottram* (John) Ltd., (1940) Ch. 657.

[43] *Re Caratal (New) Mines Ltd.*, (1902) 2 Ch. 498.

[44] *Re Fire Proof Doors* (1916) 2 Ch. 142.

of such a meeting. [*Delhi, B.Com. (Hons.), 1990*]

6. What is an extra-ordinary general meeting? When and how it can be called? [*C.A. (Final), May 1978*]

7. (*a*) Who can call an extra-ordinary general meeting?

(*b*) What is an ordinary resolution? Give some instances which require ordinary resolution? [*Delhi, B.Com. (Hons.), 1973*]

8, (a) What is a special resolution? For what purposes are such resolutions necessary?

(*b*) What is an extra-ordinary meeting and how can it be convenced? [*Meerut, M. Com. 1975*]

9. Explain the different types of resolutions which may be passed in the general meeting of the shareholders. Under what circumstances do special resolutions becomes necessary? [*Delhi, B. Com. (Hons.), 1980*]

10. (*a*) What are the requisites of a valid general meeting?

(*b*) How can general meetings be called at 'shorter notice'?

(*c*) What is your interpretation of 'not less than 21 days' used in Section 171 of the Act. [*Company Secretary (Inter), October 1974*]

11. State the law relating to the contents of the notice and the persons on whom it must be served. What is the position of a notice advertised in a newspaper in the neighbourhood of the registered office of the company? [*Company Sectetary (Final), April 1970*]

12 What is a notice of a meeting? Outline the rules governing the issue of notice for a company's general meeting. Under what circumstances can the length of notice of a general meeting be reduced? [*Company Secretary (Inter), April 1973*]

13. (*a*) What do you mean by quorum? Why quorum is necessary? Explain.

(*b*) What is the quorum required for (*i*) a public company meeting, (*ii*) a private company meeting, (*iii*) an adjourned meeting, (*iv*) a board meeting with seven directors on the board. [*Company Secretary (Inter), June 1977*]

14. What is a quorum and how it is determined at general meeting of a company? Are there any circumstances when one person may constitute a meeting? [*company Secretary (Inter), April 1973*]

15. Write a note on the quorum at a company meeting. [*Meerut, M. Com. 1975*]

16. Write a short note on 'demand for poll'. [*Company Secretary (Final) April 1973*]

17. How does 'voting by show of hands differ from voting on a poll'? When and by whom can a demand for poll be made? Has a proxy the same right in relation to a meeting attended by him as the member by whom he is appointed?

18. (*a*) Can a member use his votes differently?

(*b*) How does a company which is a member of another company exercise its vote at a meeting of the latter? [*Company Secretary (Inter), April 1973*]

19. Define a proxy. Discuss the provisions relating to proxies.

20 What are the statutory provisions relating to 'Minutes'? [*Company Secretary (Inter), April 1972*]

PRACTICAL PROBLEMS

1. Which of the following companies must hold a statutory meetings?

(*a*) A private company.

(*b*) A public company limited by shares.

(*c*) A guarantee company not having a share capital.

(*d*) An unlimited company.

2. A public company limited by shares convenes a statutory meeting of the members of the company, but the notice convening the meeting does not name it as the statutory meeting. Would it amount to compliance with the provisions of the Act relating to the holding of statutory meeting?

3. An annual general meeting called on 30th December 1934, was adjourned to 31st March 1935, and was held on that date. The next meeting was held in February 1936. Can the company be held liable for not holding any meeting in 1935?

4. An annual general meeting is called on a fixed day. After the sending of the notice of the meeting, the Government notifies that date as a public holiday. Can the meeting proceed as scheduled?

[*Company Secretary (Final), June 1978*]

5. The board of directors of a company do not expect that the final audited accounts of the company would be ready to be circulated amongst the company's members in time but if they do not convene the annual general meeting in due time, the retiring directors would be deemed to have retired on the date on which the annual general meeting ought to have been held. What advice would you give in such a situation? [*C.A. (Final), November 1969*]

6. Can an adjourned annual general meeting (which has been adjourned for want of quorum) be held on a public holiday?

[*Company Secretary (Inter), June 1978*]

7. A company is registered in Bombay and it wishes to hold its fifth annual general meeting in Delhi. Can the company hold the meeting in Delhi?

8. Default has been made in holding the annual general meeting of a company, more than 18 months having elapsed since the date of the last such meeting. What can be done in the circumstances by any member who wishes that the meeting should be held? [*C.A., November 1967*]

9. A company failed to send notice of annual general meeting to 20 shareholders of the company which has 500 shareholders. Does it invalidate the business transacted at the meeting? [*Company Secretary (Inter), June 1977*]

10. A meeting was properly convened and was subsequently adjourned by the chairman. No fresh notice is given for the adjourned meeting which is held subsequently. State whether the adjourned meeting is valid.

[*I.C.W.A., June 1978*]

11. In a general meeting of shareholders a special resolution was put to vote, 90 voted in favour, 20 voted against and 40 abstained. Has the resolution been validly passed? [*Delhi, B. Com. (Hons.), 1973*]

12. What type of resolution is required to transact the following business:

(1) Consolidation of shares;

(2) Appointment of retiring auditors of a public company in which 30% of the

subscribed capital of the company is held by public financial institutions;

(3) Adoption of statutory report;

(4) Appointment of the additional director as regular director;

(5) Changing registered office of the company from one State to another?

[*Company Secretary (Inter), December 1977*]

13. Indicate the type of meeting--Board, Shareholders, Miscellaneous--at which the following items of business can be transacted: (*i*) to re-elect a director (*ii*) to alter the articles of association; (*iii*) to adopt statutory report; (*iv*) to recommended dividends; (*v*) to appoint a new trustee for debenture-holders; (*iv*) to reduce the rate of dividend on preference shares.

[*Company Secretary (Inter), June 1978*]

14. *X*, the Chairman, at an annual general meeting, declares a motion carried after a show of hands and says "5 in favour, 25 against it but 60 voting by proxy." Is he right in his judgement? [*I.C.W.A., December 1975*]

15. *X* Co. Pvt. Limited, under its articles, requires every resolution to be passed by a majority of 75 per cent of the members present in order that it may be effective. A newly formed company, *viz. Y* Co. Ltd., acquires 30 per cent of the shares of *X* Co. Private Ltd. Discuss the effect of such acquisition and consider particularly whether the clause of the articles of *X* Co. Pvt. Ltd., referred to here requires modification. [*Delhi, M. Com., 1975*]

16. A company held its Board meeting on 1st January 1977 and the next Board meeting on 2nd April 1977. The auditors are of the view that the company has violated Section 285 of the Companies Act, 1956. What is your opinion?

[*Company Secretary (Final) December 1979*]

17. Will a person representing one company under Section 187 of the Companies Act, 1956 in addition to representing himself as a member of general meeting of a company be counted as two persons for purposes of quorum?

[*Company Secretary (Inter), June 1978*]

18. Forty out of 100 members of a company submitted a requisition for holding of an extra-ordinary general meeting in order to remove the managing director from office. On the failure of the company to call the meeting, the requisitionists themselves called the meeting at the registered office of the company. On the appointed day, they could not hold the meeting at the registered office, as it was kept under lock and key by the managing director himself. The members held the meeting elsewhere and adopted a resolution removing the managing director from office. Is the resolution valid? [*I.C.W.A., December 1976*]

19. The Board of Directors of *X* Ltd. met only three times in the previous year. A fourth meeting was adjourned twice for lack of quorum. Discuss whether provisions of the Companies Act have been contravened?

[*I.C.W.A., December 1976*]

20. The Governor of a State is a member of a company and has appointed *X* as his representative for the purpose of attending meeting of a company. Both the Governor and his representative are unable to attend the forthcoming general meeting though they are anxious to do so. Can anything be done in these circumstances? [*I.C.W.A., June 1976*]

21. A proxy was appointed by a member on an instrument duly executed. Will the vote cast by the proxy be valid in the following cases, vix, (*i*) When the member himself attended and cast his vote at the meeting without revoking the authority of the proxy; and (*ii*) When the member died in the meantime?

[*Company Secretary (Inter), June 1977*]

22. A proxy duly executed by one of the joint shareholders was lodged 48 hours before the commencement of an adjourned general meeting of a public limited company. Is the proxy so lodged valid?

[*Company Secretary (Inter), December 1977*]

14

BORROWINGS POWERS AND DEBENTURES

BORROWING POWERS

THE Companies Act does not contain any provision empowering companies registered under it to borrow. But trading companies have implied powers to borrow, even without any specific power to do so in their memorandum or articles, because borrowing can be regarded as properly incidental to the conducting of their business. Not only this, it also has an implied power to give security on its property for the loans raised.[1] Non-trading companies have no implied powers to borrow. In such companies, the memorandum must state specifically whether or not the company shall be entitled to borrow. If such a company by its constitution has no express or implied power to borrow, its memorandum must be altered to give such power before the company can do so.

A private company can exercise its borrowing powers immediately after obtaining the certificate of incorporation. But a public company can exercise its borrowing powers only after obtaining the certificate of commencement of business. [Sec. 149(1)]

However, the provisions do not prevent a simultaneous offer for subscription or allotment of any shares and debentures in the case of public companies. [Sec. 149(5)]

Where the company has express or implied powers to borrow, its directors may borrow any amount from time to time subject to the restrictions imposed by its memorandum or articles. Section 292(1) provides that the directors must exercise the power to issue debentures only by means of resolutions passed at meetings of the board. But Section 293(d) provides that directors of a public company or of a private company which is a subsidiary of a public company shall not borrow money exceeding the aggregate of the paid-up capital of the company and

[1] *General Auction Estate Co. v. Smith* (1861) 3 Ch. 432; *Bryon v. Metropolitan Etc. Co.* (1858) 3 De G & J. 123.

its free reserves, except with the consent of the company in general meeting. This limit will not include temporary loans obtained from the company's bankers in the ordinary course of business.

Directors must exercise the power to borrow in the name of the company. Where a loan has not been taken in the name of the company, it will not be liable even though it may have been benefited.[2]

ULTRA VIRES BORROWING

(1) **Borrowing ultra vires the company.** Where a company borrows without or in excess of the power conferred on it by the memorandum, the borrowing is *ultra vires* the company.

(2) **Borrowing ultra vires the directors.** Any borrowing which is *intra vires* the company but beyond the authority of the directors is *ultra vires* the directors.

Consequences of Borrowing Ultra Vires the Company

(1) **No debt.** Any act which is *ultra vires* the company is void and, as such, any borrowings which are *ultra vires* the company are also void. The lender cannot sue the company for the return of the loan. The securities given for such *ultra vires* borrowing are also void and inoperative. It was held in the *Re National Permanent Building Society*[3] that borrowing *ultra vires* the company is void and the lender cannot sue to recover its loan. Even subsequent power to borrow and subsequent issue of securities will not make *ultra vires* loans binding on the company.[4] This is so even where the company's memorandum empowers it to borrow, if the loan, to the lender's knowledge, is to be used for an *ultra vires* activity. But the lender would not be prejudiced simply because the company has used the borrowed money for *ultra vires* activity if the borrowing is within the powers of the company and the lender has no knowledge of intended misuse.[5] Thus, for example, where the managing director of a company borrowed large sums of money under the authority given to him and misappropriated the amount the company was nevertheless held liable.[5a]

(2) **Injunction.** The lender can restrain the company from spending the money by an injunction. But he must obtain the injunction against the company before it spends the money.

[2]*Suraj Balu v. Jaitly and Co.* A.I.R. 1946 All. 372.

[3](1869) 5. Ch. 309.

[4]*Re Ex. P. Watson* (1888) 21 Q.B. 301; *Sinclair v. Broughman* (1914) A.C. 398.

[5]*Dived Payne & Co.* (1904) 2 Ch. 608.

[5a]*V.K.R.S.T. Firm v. Original Investment Trust Ltd.* A.I.R. 1944 Mad. 532.

(3) **Personal liability of directors for breach of warranty of authority.** The lender can sue the directors to whom the money has been lent on behalf of the company for breach of warranty of authority.[6]

(4) **Subrogation.** If the *ultra vires* borrowings have been used to pay off lawful debt of the company, then the second creditor (lender) steps into the shoes of the creditor paid off, and to that extent will have the right to recover its loan from the company.[7] But he cannot claim any right to securities held by the original creditor.[8] However, he is entitled to retain the security, if any; given by the company for such part of the money lent by him as has been used for paying off the lawful debts of the company.[9]

(5) **Identification and tracing.** If the money lent to the company can be traced in the hands of the company in original form or even if it has been employed for the purchase of property which is capable of identification, the company may be ordered to return the money or property purchased to the lender. If the money or property cannot be traced in specie, it becomes a difficult problem. In *Sinclair v. Broughman*[10] a building society started a banking business which was *ultra vires* the society. The fund of the persons who had deposited money as depositors was mixed up with the shareholders' fund. The assets of the company were not enough to pay both in full. It was held that surplus assets after payment of valid debts must be distributed *pari passu* among the depositors and shareholders in proportion to the amounts paid for or subscribed by them.

Consequences of Borrowing Ultra Vires the Directors

Borrowings which are *ultra vires* the directors (beyond the authority of directors) but *intra vires* the company, are irregular and securities given by the directors are inoperative. However, the company may elect to ratify the directors' act and in this case the loan shall be binding on the company.[11] Similarly, the lender can also make the company liable for such borrowings *ultra vires* the directors if he can establish that (*a*) he had lent money in good faith; and (*b*) he had no knowledge of the fact that there was internal irregularity, that is, that the directors were exceeding their authority. In such a case the company would be estopped from alleging the invalidity under the rule in *Royal British Bank v. Turquand.*[12]

[6]*Weeks v. Propert* (1873) L.R. 8 C.P. 427.
[7]*Neath Building Society v. Luce* (1889) 43 Ch. D. 158.
[8]*Re Wrexham Rly. Co.* (1889) 1 Ch. 440.
[9]*Blackburn Building Society v. Cunliffe Brooks & Co.* 22 Ch. D. 61
[10]1914 A.C. 398.
[11]*Irvine v. Union Bank of Australia* (1877) 2 App. Cas. 366.
[12](1856) 6E. & B. 327.

MORTGAGES AND CHARGES

Power to Give Security

Where a company has power to borrow, it also has the power to give security for the loan by mortgage or charge of all or any of its property, movable or immovable, present or future.[13] This means that the power to give security is incidental to the power to borrow.

A company cannot borrow money on the security of reserve capital, as the latter cannot be called except at the time of winding up of the company.[14]

Similarly, a company cannot borrow on the security of books of account as such books are required to be kept at the registered office of the company and must be open for inspection.

Again, no charge can be created over the liability of the members of a guarantee company. This is so because the guarantee amount cannot be called except in the case of winding up the affairs of the company.[15]

If the articles or memorandum of a company permit it or if the powers given are wide enough to include a charge on uncalled capital, the company may create a charge on it. Where the memorandum empowered a company to borrow on any security of the company, it was held that the company could create a charge on its uncalled capital.[16] Where it was mentioned that the company could borrow on the security of any property of the company, it was held that it could not create a charge on its uncalled capital as this becomes property only when it is called up and not before. It is only a property potentially.[17] Even where the company had the power to create a charge on "present and future property," it was held not to be sufficient authority to create a charge on uncalled capital.[18]

Where the power to create a charge is not given either by the memorandum or articles of the company, it may be taken by a special resolution.[19]

The power of a company to forfeit shares does not expire by creating a charge on its uncalled capital.[20]

[13]*Re Patent File Co.* (1870) L.R. 6 Ch. App. 83.

[14]*Bartlett v. Mayfair Property Co.* (1898) 2 Ch. 28.

[15]*Re Pyle Works Ltd.* (1890) 44 Ch. D. 534.

[16]*Newton v. Debenture Holders of Anglo Australian Etc. Co.* (1895) A.C. 244.

[17]*Irvine v. Union Bank of Australia* (1877) 2 A.C. 366.

[18]*Re Streatham Estate Co.* (1897) 1 Ch. 15: *Re Russion Spratts Patent Ltd.,* (1898) 2 Ch. 149.

[19]*Newton v. Debentures Holders of Anglo Australian Etc. Co.* (1895) A.C. 244.

[20]*Re Agency Land and Finance Co.* (1903) 20 T.L.R. 41.

Fixed and Floating Charges

Debentures are generally secured by a charge on the property of the company. They may be secured: (*a*) by a fixed or specific charge. or (*b*) by a floating charge.

Fixed charge. A charge is said to be a fixed charge when it covers ascertained and specific property such as land, buildings or heavy machinery. Where any particular property of the company is specifically charged in favour of debenture holders, the company cannot dispose of the property, free of charge, without the consent of the holders of the charge.

Floating charge. A floating charge is a charge which is ambulatory, that is, floating with the property it is intended to cover. It does not attach to any specific property. In a floating charge, the property can be dealt with by the company without consulting the holders of the charge. The company is left free to deal with the property so charged as if no charge has been created. Normally, it covers all the assets of the company, including the assets which are subject to a fixed charge. However, it can be restricted to a class of property. Debentures are generally secured by a floating charge on the assets of the company.

In *Illingworth v. Houldworth,*[21] Lord Macnaghten observed: "A specific charge, I think, is one that without more, fastens on ascertained and specific property or property capable of being ascertained and defined; a floating charge, on the other hand, is ambulatory and shifting in its nature, hovering over and so to speak floating with the property it is intended to affect until some event occurs or some act is done which causes it to settle and fasten on the subject of the charge within its reach and grasp."

In *Government Stock Co. v. Manila Rly.,* [22] the same learned judge observed: "A floating security in an equitable charge on the assets for the time being of a going concern. It attaches to the subject charged in the varying conditions in which it happens to be from time to time. It is of the essence of such a 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. His right to intervene may of course be suspended by agreements. But if there is no agreement of suspension, he may exercise his right whenever he pleases after default."

Characteristics of floating charge. Justice Romer in *Re Yorkshire Woolcombers Association Ltd.,*[23] pointed out three characteristics of a floating charge:

[21](1904) A.C. 355.
[22](1897) A.C. 81.
[23](1903) 2 Ch. 284.

(*i*) it should be a charge upon a class of assets both present and future;

(*ii*) the class of assets charged must be one which in the ordinary course of the company's business would be changing from time to time; and

(*iii*) it should be contemplated by the charge that until some step is taken by the mortgagee, the company shall have the right to use the assets comprised in the charge in the ordinary course of its business.

In order to determine whether a charge is a floating one or not, one must look to the words used in the document creating the charge.

Where a company had issued debentures and charged its "undertaking and all sums of money arising thereform." it was held to be a good floating charge as the term "undertaking" meant all the property, present and future.[24]

Where a company borrowed money on the security of "all its assets, including machinery etc., now lying or that may be brought hereafter until repayment," it was held to be a floating charge as (*a*) it covered all assets both present and future; and (*b*) the company was left free to use them in the course of its business.[25]

In *Bank of Baroda v. H.B. Shivdasani,*[26] the company borrowed money against all its present or future liquid assets but the lender imposed a condition that the company would not pledge or otherwise charge the pledged goods which were kept in a godown, keys of which had been delivered to the lender (the Bank). It was held that the instrument did not create a floating charge. It was a mortgage of specified assets.

Similarly in *J.D. Jones & Co. Ltd. v. Ranjit Roy,*[27] it was held not to be a floating charge as possession was granted to and remained with the lender.

Subsequent mortgages or charges. A company is free to deal with property which is subject to a floating charge. It can even create a specific mortgage of the property already subject to a floating charge without the consent of the holders of the charge, and the registered mortgage shall have priority over the charge.[28] The company may, however, be prohibited from creating subsequent specific mortgages and in such a case a creditor who takes a subsequent specific mortgage with the notice of the prohibition shall not have priority over the floating charge.[29]

But a company cannot create a fixed charge in priority to the floating

[24] *RePanama, New Zealand Etc. , Co.* (1870) L.R. 5 Ch. 318.

[25] *Re Indus Film Corporation Ltd.,* A.I.R. 1939 Sind 100.

[26] A.I.R. 1926 Bomb. 427.

[27] A.I.R. 1927 Cal. 682.

[28] *Theatley v. Silkstone Co.* (1885) 29 Ch. D. 715.

[29] *Wilson v. Kelland* (1901) 2 Ch. 306.

charge after it has csystallised.

Before crystallisation of the floating charge a company may even sell the whole of the undertaking if that is one of the objects specified in the memorandum.[30]

Invalidity of floating charge. Where a company is being wound up, a floating charge on the undertaking or property of the company created within twelve months immediately preceding the commencement of the winding up shall be invalid unless (*a*) the company, immediately after the creation of the charge, was solvent; or (*b*) the company received cash actually at the time of or after the creation of the charge in consideration thereof. The charge shall be valid to the extent of the amount of any cash paid to the company at the time of or after the creation of the charge together with interest on that amount at the rate of five per cent per annum or such other rate as may be notified by the Central Government. (Sec. 534)

Crystallisation of a floating charge. A floating charge leaves the company free to deal with property charged in a way it thinks best until the charge is crystallised. This happens, (*a*) on liquidation of the company; (*b*) when the company ceases to carry on business; (*c*) when the debenture holders intervene to enforce the security in case of default by the company to pay interest or principal or; (*d*) when a receiver is appointed.

In this connection Lord Macnaghten observed: "It is of the essence of a floating charge that it remains dormant untill the undertaking charged ceases to be a going concern or until the person in whose favour the charge is created, intervenes. As long as he does not intervene, the business will be carried on, not as of right, but by the sufferance of the debenture holders and at their mercy."[31]

Section 123 provides that where debenture holders take steps to enforce their security, the preferential payments, in the event of the company being wound up under Section 530 of the Act, get priority over the claims of debenture holders with a floating security.

Registration of Charges

Section 125 provides that the following charges must be registered with the Registrar:

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

(*ii*) a charge for the purpose of securing any issue of debenture;

(*iii*) a charge on any immovable property, wherever situated or any interest therein;

[30]*Re Borax Co.* (1901) 1 Ch. 326.

[31]*Government Stock Co. v. Manila Rly.* (1897) A.C. 81.

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

(*v*) a charge not being a pledge, on any movable property of the company;

(*vi*) a floating charge on the undertaking or any property of the company including stock in trade;

(*vii*) a charge on calls made but not paid;

(*viii*) a charge on a ship or any share in a ship; and

(*ix*) a charge on goodwill, on a patent or a licence under a patent, on a trade mark, or on a copyright or licence under a copyright.

The prescribed particulars of the charge together with the instrument by which the charge is created or a certified copy thereof verified in the prescribed manner, are filed with the Registrar for registration within thirty days of the creation of the charge. The Registrar may allow another thirty days following the expiry of the said period of thirty days if the company satisfies the Registrar that it had sufficient cause for not filing the particulars and instrument of the charge within that period. The company has to pay an additional fee as may be required by the Registrar but it shall not exceed ten times the amount of fee specified in Schedule X. (Sec. 125)

Where any charge on any property of a company required to be registered under the above provisions has been so registered, any person acquiring such property shall be deemed to have acquired the same with the notice of the charge. Such notice is from the date of registration of the charge with the Registrar. (Sec. 126)

Effects on Non-Registration of a Charge

If any charge is to be registered under the provisions of the Act, failure to register such a charge will have the following consequences:

(*i*) the charge shall be void against the liquidator and any creditor of the company [Sec. 125 (1)];

(*ii*) the debt in respect of which the charge was created remains valid as an unsecured debt and the charge-holder becomes an unsecured creditor [Sec. 125 (2)];

(*iii*) money secured by the charge becomes immediately payable [Sec. 125 (3)]; and

(*iv*) the company and every officer of the company who is in default shall be punishable with a fine which may extend to Rs 500 for every day during which the default continues. [Sec. 142(1)]

Registration of Charges on Properties Acquired Subject to Charge

Where a company acquires any property which is subject to a subsisting charge, the company must file the particulars of the charge and

a copy of the instrument creating the charge with the Registrar for registration within thirty days of the date on which the acquisition is completed.

It default is made in complying with the above provision, the company and every officer of the company who is in default, shall be punishable with a fine which may extend to five hundred rupees. (Sec. 127)

Register of Charges to be kept by Registrar

The Registrar shall cause to be kept a register, in respect of each company, containing the particulars of all the charges requiring registration. Section 130, as amended by the Companies (Amendment) Act, 1988 dispenses with the existing procedure of entering by hand the particulars of charges in the register kept by the Registrar. Henceforth, every company shall forward to the Registrar for being entered in the register the particulars of all charges requiring registration in Form No. 13 with a fee of rupees ten. The particulars of charges shall relate to:

1. In case of a charge to the benefit of which the holders of a series of debentures are entitled:

(*i*) the total amount secured by the whole series;

(*ii*) the date of resolution authorising the issue of series;

(*iii*) a general description of the property;

(*iv*) the names of the trustees, if any, for the debenture holders; and

(*v*) particulars of any discount, commission or allowance paid for subscribing or procuring subscription for any debentures of the company. (Secs. 128 and 129)

2. In the case of any other charge:

(*i*) if the charge is created by the company, the date of its creation; and if the charge was 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.

The pages of the register shall be consecutively numbered and the Registrar shall sign or initial every page of the register. The register shall be open to inspection by any person on payment of rupees ten for each inspection. (Sec. 130)

The Registrar shall keep a chronological index, in the prescribed form and with the prescribed particulars, of the charges registered with him. (Sec. 131)

Certificate of Registration

The Registrar shall give a certificate of registration stating the amount

secured by the charge. The certificate shall be conclusive evidence that the legal requirements have been complied with. (Sec. 132)

A copy of every certificate of registration shall be endorsed on every debenture or certificate of debenture stock which is issued by the company and payment of which is secured by the charge so registered. Default is punishable with a fine which may extend to one thousand rupees. (Sec. 133)

Duty of Company Regarding Registration

Section 134 provides that it shall be the duty of a company to file with the Registrar for registration, the particulars of every charge created by it. But registration of any such charge may also be effected on the application of any interested party, who shall be entitled to recover from the company the amount of any fees properly paid by him. (Sec. 134)

When the terms or conditions or the extent or operation of any such charge are modified, it shall be the duty of the company to send to the Registrar the particulars of such modification. (Sec. 135)

Entry of Appointment of Receiver or Manager

If any person obtains an order for the appointment of a receiver or manager from the court or if any person appoints such a receiver or manager under any powers contained in any instrument in respect of any property of a company, he shall give notice of the fact to the Registrar within thirty days of the passing of the order or of making the appointment. The Registrar shall, on payment of the prescribed fee, enter the fact in the register of charges. A similar notice must be given when such a person ceases to act. A defaulter shall be punishable with a fine which may extend to fifty rupees for every day during which the default continues. (Sec. 137)

Registration of Satisfaction of Charge

Section 138 provides that the company shall give intimation to the Registrar of payment or satisfaction in full of any charge registered with him within thirty days of the date of such payment or satisfaction. The Registrar shall send a notice to the holder of the charge calling upon him to show cause within fourteen days why payment or satisfaction should not be recorded. If no cause is shown, the Registrar shall record a note to that effect in the register and shall inform the company that he has done so.

The Registrar is also empowered to record a memorandum of satisfaction even if no intimation has been received by him from the company provided he is satisfied that the debt for which charge was given

has been paid or satisfied in whole or in part, or that part of the property has been released from the charge or has ceased to form part of the company's property. (Sec. 139)

Where the Registrar enters a memorandum of satisfaction in whole or in part, he shall furnish the company with a copy of the same. (Sec. 140)

Rectification of Register of Charges

Section 141 empowers the Company Law Board to direct the rectification of the register of charges or to extend time for registration of the charges on an application by the company or any interested party in cases where the omission to register a mortgage within the required time is accidential or due to inadvertence or to some other sufficient cause or is not of nature to prejudice the position of creditors or shareholders of the company or where it is just and equitable to grant relief.

The Company Law Board may make such order as to the costs of an application as it thinks fit.

Where the Company Law Board extends time for the registration of a charge, the order shall not prejudice any rights acquired in respect of the property concerned before the charge is actually registered.

Company's Register of Charges

Every company shall keep at its registered office a register of charges and enter therein all charges specifically affecting property of the company including all floating charges on the undertaking or on any property of the company, giving in each case (*a*) a short description of the property charged; (*b*) the amount of the charge; and (*c*) except in the case of bearer securities, the names of the persons entitled to the charge.

A defaulter shall be punishable with a fine which may extend to five hundred rupees. (Sec. 143)

Right to Inspect Instruments Creating Charges

A copy of every instrument creating any charge requiring registration under the Act should be kept at the registered office of the company. In case of a series of uniform debentures, a copy of one debenture of the series shall be sufficient. (Sec. 136)

The copies of instruments creating charges and the company's register of charges shall be open during business hours (at least two hours in each day should be allowed for inspection) to the inspection of any creditor or member of the company without fee, at the registered office of the company. To any other person it shall be open to inspection on payment of a fee of rupees ten for each inspection.

If inspection of the said copies or register is refused, the company and every officer of the company who is in default, shall be punishable with a fine which may extend to fifty rupees, and with a further fine which may extend to twenty rupees for every day during which the refusal continues.

The Company Law Board may also, by order, compel an immediate inspection of the said copies or register. (Sec. 144)

DEBENTURES

The issue of debentures is the most popular mode of borrowing by companies. Uniform parts of a loan raised by a company are known as debentures. Section 2(12) states that a 'debenture includes debenture stock, bonds and any other securities of a company whether constituting charge on the assets of the company or not.' According to Palmer, the word "debenture" signifies "any instrument under seal, evidencing a deed, the essence of it being the admission of indebtedness." Chitty J. defines a debenture in the following words: "Debenture means a document which either creates a debt or acknowledges it, and any document which fulfils either of these conditions is a debenture.[32]

In simple words a debenture may be defined as an instrument in writing, signed by the company under its common seal, acknowledging the debt due by it to its holders. It may also be mentioned in the instrument that the company shall pay back the money at a specified date and that till the specified date, the debenture holder shall be entitled to interest on the amount lent to the company at a fixed rate. However, in the case of perpetual debentures, no date of repayment is mentioned in the instrument. A debenture usually gives a charge by way of security, but it is not essential that it carries a charge because debentures may be unsecured. Again, a debenture is often expressed to be one of a series of like debentures. But there may also be a single debenture issued to one person.[33]

On the basis of the above discussion, we can lay down certain guidelines to determine whether an instrument is a debenture or not. The following points must be kept in mind in this connection:

(*i*) it is an acknowledgement of indebtedness by the company to its holder for the amount stated in it;

(*ii*) it is issued under the common seal of the company;

(*iii*) it provides for a fixed rate of interest to the debenture holder until the amount is paid back;

[32] *Levy v. Abercorris Co.* (1887) 37 Ch. D. 260, 264.

[33] *Robson v. Smith* (1895) 2 Ch. 118.

(*iv*) it is often one of a series of like debentures, but there may be a single debenture issued to one person;

(*v*) it generally provides for repayment of money at a fixed date. But this is not essential as a company may issue perpetual or irredeemable debentures; and

(*vi*) debentures are generally secured but this is not an essential condition. Section 2(12) provides the following words in this connection, "whether constituting a charge on the assets of the company or not."

Kinds of Debentures

(1) **Registered debentures and bearer debentures.** Registered debentures are made out in the name of a particular person who is registered as the holder of particular debentures in the register of debenture holders. Such debentures are transferable in the same way as shares. The amount due on this type of debenture is payable only to registered holders who again are the only persons entitled to receive interest. These debentures are not negotiable instruments.

On the other hand, bearer debentures are transferable by mere delivery. The company need not be informed about the transfer of such debentures from one hand to another. A bearer debenture is a negotiable instrument and a person who acquires it in good faith and for value gets a good title irrespective of any defect in the title of the transferor.[34] The company keeps no records of debenture holders in this case. Coupons for interest are attached to bearer debentures and the interest will be payable to the bearer of the coupon, as and when it falls due.

(2) **Redeemable and irredeemable debentures.** In the case of redeemable debentures, the money is to be paid back either at a fixed date or upon demand.

Section 120 provides for the issue of irredeemable or perpetual debentures. It lays down that a condition contained in any debenture shall not be invalid by reason of only that debentures are thereby made irredeemable or redeemable in case of a contigency, however, remote, or on the expiration of a period, however long. This does not mean that the company can never pay them off even if it wishes to do so. The effect of issuing irredeemable debentures would be that there would be no time limit within which the company must pay back the money and, at the same time, the debenture holders cannot, at any particular time, compel the company to redeem them. But all debentures become immediately payable when the company goes into liquidation or makes a default in payment of interest. It was held in *Re Crompton & Co.*,[35] that the

[34]*Bechuanaland Exploration Co. v. London Trading Bank* (1898) 2 Q.B. 658.
[35](1914) 1 Ch. 954.

debentures become immediately payable even if liquidation is for the express purpose of reconstruction or amalgamation in spite of any express provision to the contrary.

(3) **Secured and unsecured debentures.** In the case of secured debentures, a charge or mortgage is created on all or some of the assets of a company. The charge may be either a "fixed charge" or a "floating charge." Generally, debentures are secured. A trust deed is entered into between the company and representatives or trustees of debenture holders. Many of the conditions endorsed on debentures are embodied in the trust deed and security is enforced by the trustees rather than by debenture holders.

In the case of unsecured debentures, no charge is created on the assets of a company. Such debentures are a mere acknowledgement of the indebtedness of the company to the holder of debentures and these debentures do not carry any security. All the time of winding up, such debenture holders will rank as ordinary creditors of the company. Such debentures are not common.

(4) **Convertible and non-convertible debentures.** Convertible debentures are those which are issued with an option to the holder to convert them into shares at stated rates of exchange after a few years (say three, five or seven years). Where this option is not given to the debentureholder, it is known as a non-convertible debenture. Convertible debentures are, of course, more popular than non-convertible debentures.

Differences between Shareholders and Debenture Holders

(1) Shareholders are joint owners of the company and have proprietory interest in it. Debenture holders are creditors of the company.

(2) A shareholder enjoys voting rights and the right to attend general meetings and in this way participates in the management of the company. Debentures holders do not have any voting rights. Section 117 provides that no company shall issue any debentures carrying voting rights at any meeting of the company, whether generally or in respect of particular classes of business.

(3) The income of shareholders is known as "dividend." Dividend can be paid only out of profits. The rate of dividend is not fixed in the case of equity shares. This will depend upon the profits and the dividend policy followed by the company. Even if there are profits, no dividend may be declared.

In the case of debenture holders, their income is known as "interest," which is always fixed. Interest must be paid whether there are profits or not. If there are no profits, it may be paid out of the capital.

(4) Debentures are generally secured. They carry a charge on the assets of the company. Shares have no such security.

(5) Shareholders cannot be paid back during the life-time of the company except in the case of redeemable preference shares. Debenture holders must be paid back according to the terms of issue and may be paid back during the life-time of tne company.

(6) Out of the profits of the company, debenture holders shall receive payment of fixed interest before any dividend can be paid to preference or equity shareholders. If anything is left after payment of interest, preference shareholders will get their fixed dividend and the balance will belong to equity shareholders.

(7) Debenture holders will have priority over shareholders when assets are distributed upon winding up, whether debentures are secured or unsecured.

(8) Share cannot be issued at a discount unless the conditions of Section 79 of the Companies Act are satisfied, while there are no such restrictions on the issue of debentures.

Issue of Debentures

A private company can issue debentures immediately after obtaining the certificate of incorporation. But a public company can issue debentures only after obtainbing a certificate of commencement of business. [Sec. 149(1)]

The power to issue debentures rests with the board of directors, but the power must be exercised by the board only by means of a resolution passed at a meeting of the board. [Sec. 292(1)]

Debentures can be issued by directors for any amount authorised by the articles, but the amount shall not exceed the aggregate of the paid up capital of the company and its free reserves except with the consent of the company in general meeting. [Sec. 293(d)]

Debenture can be issued at par, at discount or at premium. The Companies Act does not lay down any restrictions in this respect. Debentures may be redeemable at par or at premium, but their redemption at discount is prohibited.

The Companies Act provides that no company can issue debentures carrying voting rights. However, debentures issued before commencement of this Act may continue to have voting rights. (Sec. 117)

The legal requirements as to prospectus, allotment, issue of certificates, etc., applicable to shares apply to debentures as well, and the procedure on public issue of debentures follows much the same line as a public issue of shares. However, the condition of minimum subscription is not applicable in the case of debentures.

Where the company has redeemed any debentures previously issued, the company shall have the right to keep the debentures alive for the purpose of reissue if there is no provision to the contrary in the articles or in the conditions of the issue of debentures. The company shall have the power to reissue the same debentures or issue other debentures in their place. The persons entitled to such debentures shall have the same rights and priorities as if the debentures had never been redeemed. (Sec. 121)

A contract with a company to take up and pay for any debentures of the company may be enforced by a decree for specific performance. (Sec. 122)

The company is required to complete and despatch the debenture certificates within three months of allotment. (Sec. 113)

No return as to allotment under Section 75 is required to be filed in the allotment of debentures.

Transfer and Transmission of Debentures

Bearer debentures are transferable by mere delivery. The company keeps no records of transfers. A bearer debenture is a negotiable instrument and a person who acquires it in good faith and for value gets a good title irrespective of any defect in the title of the transferor. If the debentures are registered debentures, they can be transferred only in the manner laid down by the conditions on the back of the debenture bond or in the articles. Other provisions for the transfer of debentures are similar to those applicable to the transfer of shares as mentioned in Sections 108 to 112. The same is true for the transmission of debentures.

Register and Index of Debenture Holders

Every company shall keep a register of the holders of its debentures and enter therein the following particulars, namely: (*a*) the name, address and the occupation of each debenture holder; (*b*) the debentures held by each holder, distinguishing each debenture by its number and the amount paid or agreed to be considered as paid on those debentures; (*c*) the date on which each person was entered in the register as a debenture holder. and (*d*) the date on which any person ceased to be a debenture holder. [Sec. 152(1)]

Every company having more than fifty debenture holders shall keep an index of debenture holders unless the register of debenture holders is in such form as in itself constitutes an Index. The company shall make necessary alteration in the index within fourteen days of the date on which any alteration is made in the register of debenture holders. The index shall contain a sufficient indication to enable the entries relating to

a particular debenture holder to be readily found. [Sec. 152(2)]

If default is made in complying with the above provisions, the company and every officer of the company who is in default shall be punishable with a fine which may extend to fifty rupees. [Sec. 152(3)]

Provisions of this section shall not apply with respect to debentures which are payable to the bearer. [Sec. 152(4)]

The following provisions shall also be applicable to the register of debenture holders: (*a*) the power to close the register of members or debenture holders (Sec. 154); (*b*) power of the Company Law Board to rectify the register of members (Sec. 111); (*c*) power of a company to keep a foreign register of members or debenture holders ((Sec. 157). and (*d*) provisions as to foreign registers. (Sec. 158)

These provisions have already been discussed in detail in the chapter on "Members."

Debenture Trust Deed

Debentures are generally secured by a charge on the company's assets. Where there are a considerable number of debenture holders who are scattered over a wide area, a trust deed is created in favour of trustees who are appointed to safeguard their interests. Properties of the company are charged to trustees in favour of debenture holders. Many of the conditions endorsed on the debenture are embodied in the trust deed and the security is enforced by the trustees instead of the debenture holders. Where the company issuing debentures is finacially very sound or where the debentures are issued temporarily for a short term, a deed may not be issued. But where the amount borrowed by the company is considerable and for a long period, a trust deed becomes essential.

The prime advantage of a trust deed is that the trustees look after the interests of debenture holders far better than a large number of disconnected holders could do, and, in the event of default on the part of the company, the trustees can immediately take steps to protect the interests of debenture holders. The trustees can also see to it that the assets mortgaged are insured by the company and properly maintained. Moreover, the trust deed creates a legal mortgage over the company's property and this prevents subsquent legal mortgage from getting priority.

Section 119 provides that trustees must act with a reasonable degree of care and diligence in the performance of their duties under the trust deed. Any provision contained in the trust deed shall be void in so far as it would have the effect of exempting a trustee from or indemnifying him against liability for breach of trust where he fails to show a degree of care and diligence required of him as a trustee.

A copy of any trust deed for securing any issue of debentures shall be forwarded to the holder of any such debentures or any member of the company within seven days of his request on payment (*a*) in the case of a printed trust deed, of the sum of one rupee; and (*b*) in the case of a trust deed which has not been printed, of rupee one for every one hundred words or fractional part thereof, required to be copied. [Sec. 118(1)]

The trust deed shall also be open to inspection by any member or debenture holder of the company in the same manner, to the same extent and on payment of the same fees, as if it were the register of members of the company. [Sec. 118(4)]

Debentures with Pari Passu Provision

A debenture is generally one of a series of like debentures. In case the debentures carry a charge on the assets of the company, the *pari passu* clause is also incorporated in them. The effect of a *pari passu* clause is that all the debentures of the series will be discharged rateably. This clause becomes operative when the assets are insufficient to pay off all the debentures of the series and as such, when the security is enforced, whatever is realised from it shall be divided amongst them rateably proportion to the amounts paid up on each debenture.[36]

But in the absence of a *pari passu* clause, debentures shall be payable according to the date of issue. If all the debentures have been issued on the same date, they shall be payable according to serial number.[37]

A company is not permitted to issue a new series of debentures so as to rank *pari passu* with a prior series. However, this can be done if the power to do so is reserved and contained in the debentures of the prior series.[38]

In this connection Section 121 provides that where the company has redeemed any debentures, it has the power to keep them alive for reissue, if the articles do not provide to the contrary. Upon such reissue, the debentures shall rank *pari passu* with the original debentures as if they had never been redeemed.

Remedies of Debenture Holders

Debenture holders may be secured or unsecured. If a debenture holder is not secured by any mortgage or charge on the assets of the company, he stands in the position of an unsecured creditor and he may sue the

[36]*Re Smelting Corporation* (1915) 1 Ch. 472.
[37]*Re New Clydach Etc., Co.,* (1868) L.R. 6 Eq. 514.
[38]*Lister v. Henry Lister & Sons* (1893) 41 W.R. 330.

company for principal and interest, when in arears, and execute the decree against the property of the company. Section 439 also entitles him to present a petition for widing up the company on the ground that it is unable to pay its debts. In case the winding up is already in progress, he can prove for the amount due to him like any other unsecured creditor.

A secured debenture holder is in a much stronger position. In addition to the above two remedies of the unsecured debenture holder, he also has the following:

(1) When the company is in default as regards principal or interest, the debenture holder may sue on behalf of himself and other debenture holders of the same class to obtain payment and enforce his security. This is also known as "debenture holder's action." In such a case, the court will usually appoint a receiver, and a manager may also be appointed if it is necessary for the business of the company. The court will also declare debentures to be a charge on the property of the company and direct an inquiry as to who the debenture holders are and order a sale of property.

(2) The debenture holder can himself appoint a receiver if the power to that effect is contained in the conditions of issue of debentures.

(3) He may sue for the enforcement of the security by a foreclosure. The court will grant this remedy only when all debenture holders have joined hands.[39]

(4) If such a power is given by the debenture trust deed, he may sell the property through the trustees.

In case the company is insolvent, he may realise his security and, should it not cover the whole debt, he may prove for the balance. Alternatively, he may surrender the security and prove for the whole debt. Where the debentures contain a *pari passu* clause, the debenture holder cannot set off his debt which he owes to the company against the amount due to him on his debentures where the sale proceeds are not sufficient to pay off all the debentures in full. The rule is that a person who claims a share in a fund must pay up everything he owes to the fund before he can claim a share.[40]

ACCEPTANCE OF PUBLIC DEPOSITS

Acceptance of deposits from public as well as from shareholders has existed in India for many years. In fact, this has been a very popular method of borrowing funds by the companies on short-term basis. It had become the practice of many companies to accept deposits from public at

[39] *Wallace v. Evershed* (1899) 1 Ch. 891.
[40] *Re Brown & Greogry Ltd.*, (1904) 1 Ch. 627.

high rates of interest and in many cases deposits taken by the companies were not refunded on due dates. In many such cases either the companies had gone into liquidation or the funds were depleted to such an extent that the companies were not in a position to refund the deposits. Therefore, it became necessary to place some control on companies inviting and accepting deposits from the public. The Companies (Amendment) Act, 1974 has introduced Sections 58A and 58B so as to regulate and control the acceptance of deposits by companies other than banking companies. The provisions of these sections are given below:

1. *Limits and conditions of deposits.* The Central Government, in consulation with the Reserve Bank of India, is empowered to prescribe the limits upto which, the manner in which and the conditions subject to which deposits may be invited or accepted by a company either from the public or from its members. [Sec. 58A(1)]

2. *Deposits in accordance with the rules framed by the Central Government.* No company shall invite either directly or indirectly deposits from the public except in accordance with the rules framed by the Central Government. The company will also issue an advertisement, in the prescribed form, including therein a statement showing the financial position of the company. [Sec. 58A(2)]

Section 58B provides that the provisions of the Act relating to prospectus shall also apply to such advertisement inviting deposits from the public.

3. *Past deposits.* Every deposit accepted by a company at any time before the commencement of Companies (Amendment) Act, 1974, in accordance with the directions made by Reverse Bank of India, shall be repaid in accordance with the terms and conditions of such deposit unless it is renewed. No deposit shall be renewed by the company unless the deposit is such that it could have been accepted if the rules framed by the Central Government were in force at the time when the deposit was intially accepted by the company. [Sec. 58A(3)]

4. *Compulsory repayment of deposits unless renewed.* Every deposit accepted by a company after the commencement of the Companies (Amendemnt) Act, 1988 shall be repaid in accordance with the terms and conditions of such deposits, unless the deposit is renewed in accordance with the rules framed by the Central Government. [Sec. 58A(3A)]

5. *Repayment of deposits accepted in contravention of rules.* Where any deposit is accepted by a company in contravention of the rules framed by the Central Government, repayment of such deposits shall be made by the company within thirty days from the date of acceptance of such deposit or within further thirty days if allowed by the Central Government on sufficient cause. [Sec. 58A(4)]

6. *Failure to repay deposits.* Where a company omits or fails to make repayment of a deposit within thirty days or the extended time, the company shall be punishable with fine which shall not be less than twice the amount of the deposit not refunded. Out of the fine realised, the court shall refund the un-refunded deposit to the depositor. Moreover, every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to five years and shall also be liable to fine. [Sec. 58A(5)]

7. *Penalty for contravention of rules.* Where the company accepts or invites either directly or indirectly any deposit either in excess of the limits prescribed by the rules or without making proper advertisement, the company shall be punishable with fine which shall not be less than an amount equal to the amount of deposit so accepted. If the contravention relates to invitation of deposits, the fine may extend to one lakh rupees but shall not less than five thousand rupees. Further, every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to five years and shall also be liable to fine. [Sec. 58A(6)]

8. *Exceptions.* The provisions of Section 58A shall not apply to a banking company or such company as the Central Government may, after consulation with the Reserve Bank of India, specify in this behalf. [Sec. 58A(7)]

9. *Exemption.* The Companies (Amendment) Act, 1977 empowers the Central Government to grant partial relaxation like extension of time to any company or class of companies for the repayment of deposits or exemption from one or more of the provisions of Section 58A in deserving cases. [Sec. 58A(8)]

10. *Appeal to the Company Law Board.* Section 58A, as amended by the Companies (Amendment) Act, 1988, empowers the Company Law Board to take cognizance of any case of non-repayment of deposits on maturity, either on its own motion or on the application of any depositor(s). The Company Law Board may direct the company to make repayment of such deposits within such time and subject to such conditions as may be specified in its order. Failure to repay the deposits with the period extended by the Company Law Board is punishable. [Sec. 58A(9), (10)]

11. *Definition of the term 'deposit'.* The term 'deposit' for the purpose of this section means any deposit with the company. It will also include any amount borrowed by the company. But it shall not include such categories of amount as may be prescribed in consultation with the Reserve Bank of India. (Explanation to Sec. 58A)

QUESTIONS

1. What are different kinds of debentures? How do the debentures differ from shares? [*Delhi, B.Com., (Hons.), 1972*]

2. What are the restrictions on the borrowing powers of a company? State the different types of debentures that can be issued by the Company. [*Agra, M.Com., 1979*]

3. Discuss the borrowing powers of a company. If a company borrows beyond its powers, what remedies are open to a person who has lent money to the company? [*Meerut, M.Com., 1975*]

4. What are the restrictions imposed on the borrowing powers of the board of directors? If a company borrows beyond its powers, examine the remedies open to such creditor (*i*) when the money has not been spent (*ii*) when the money has been spent to pay the debts of the company. [*Company Secretary (Final), October 1985*]

5 (*a*) What is a floating charge?

(*b*) How does it differ from a fixed charge?

(*c*) When does a floating charge cease to be a floating charge? [*Delhi, B.Com., (Hons.), 1985*]

6. What do you understand by fixed and floating charges attached to the loans contracted through mortgage debentures? Explain the circumstances when the floating charge becomes fixed. [*Delhi, B.Com., (Hons.), 1979*]

7. Distinguish a floating charge from a specific charge. In what events does it crystallise? What is the position of the holders of debentures of a company secured by a floating charge when a receiver is appointed on their behalf vis-a-vis payment of debts of a company such as rent, rates, taxes and wages? [*C.A. (Final), May 1973*]

8. What is a charge? Enumerate the statutory provisions for their registration. State the circumstances under which certain charges may be void, against the liquidator or the creditors of a company. [*Company Secretary (Final), October, 1975*]

9. Mention the 'charges' which require registration under the Companies Act. Explain the effects of non-registration of such charges. [*Company Secretary (Final), October 1974*]

10. What remedies are available to a debentureholder on default by the company? What is the effect of *pari passu* clause in the repayment of debentures? [*Company Secretary (Final), October 1960*]

11. Can a company create a charge on (*a*) its book debts, (*b*) its uncalled capital, (*c*) its reserve capital and (*d*) its books of accounts?

PRACTICAL PROBLEMS

1. The memorandum and articles of a company contain no provision empowering the company to borrow. Can such a company borrow money?

2. A company declared Rs 5, out of each Rs 10 share as reserve capital by

passing a special resolution. Thereafter, debentures were issued charging the said reserve capital. Is the charge on reserve capital valid?

3. A company has exhausted its borrowing powers by issuing three different series of debentures, *A* and *B* and *C*. Debentures *A* had priority over debentures *B* and debentures *B* over debentures *C*. The company took a fresh loan over and above its borrowing power to pay interest on debentures *A*. Explain the rights of *ultra vires* lender against the company.

4. A railway company invited applications for a loan on debentures. At the time of inviting the applications, the company had already exhausted the limit of £ 60,000 which it was authorised to borrow by its memorandum. On the basis of this advertisement, the plaintiff offered a loan of £ 500 which was accepted by the directors and a debenture was issued to him. Can the plaintiff lender recover the money from the company or its directors?

5. On 15 April 1968, a company, in consideration of a past debt of Rs 50,000 and a further advance of Rs 20,000 issued debentures to a creditor accompanied by a floating charge over its assets. On 25 September 1968 the company is put into liquidation. State the rights of the creditor in winding up.

[*C.A., November, 1968*]

6. A public company obtained a loan by mortgage of its plot of land. No one concerned with the transaction remembered that the mortgage required registration with the Registrar of Companies within 30 days of its creation.

(*i*) What should be done to rectify the omission to register the mortgage?

(*ii*) What consequences will ensue if no step is taken to rectify the omission?

[*C.A. (Inter), November 1978*]

15

ACCOUNTS AND AUDIT

BOOKS OF ACCOUNT

SECTION 209(1) of the Act provides that every company shall keep at its registered office proper books of accounts with respect to (*a*) all sums of money received and expended by the company and matters in respect of which the receipt and expenditure take place; (*b*) all sales and purchases of goods by the company; (*c*) all assets and liabilities of the company; and (*d*) in the case of companies engaged in production, processing, manufacturing or mining activities, such particulars relating to utilisation of material or labour or to other items of cost as may be prescribed.

The books of account must give a true and fair view of the state of affairs of the company and explain its transactions. The Companies (Amendment) Act, 1988, makes it compulsory for every company to keep its books of account on actual basis and according to the double entry system of accounting, popularly known as mercantile system of accounting. [Sec. 209(3)]

Location. The books of account are to be kept at the registered office of the company or at such other place in India as the board may decide and when the board of directors so decides, the company shall send the address of that place to the Registrar within seven days of any such decision. [Sec. 209(1)]

Where a company has a branch office whether in or outside india, proper books of account relating to the transactions effected at the branch office are kept at the office and proper summarised returns, made up to date at intervals of not more than three months, are sent by the branch office to the registered office. [Secc. 209(2)]

Preservation. The books of account of every company relating to a period of not less than eight years immediately preceding the current year together with vouchers relevant to any entry in such books shall be preserved in good order. [Sec. 209(4A)]

Responsibility. Section 209(6) provides that the managing director or

manager, if the company has any, shall be responsible for keeping the accounts. In all others cases, the directors will be responsible for the same. These persons may charge any other competent and reliable person with the duty of seeing that the requirements in respect of books of account are complied with.

Penalty for default. If any of the above persons charged with this responsibility fails to take reasonable steps to secure compliance by the company with the requirements of this section or has, by a wilful act, been the cause of any default by the company, he shall be punishable with imprisonment for a term which may extend to six months or with a fine which may extend to one thousand rupees or with both, in respect of each such offence.

However, no person shall be sentenced to imprisonment for any such offence unless it was committed wilfully. [Sec. 209(5)]

Inspection of Books of Account

The books of account and other books and papers shall be open to inspection by any director during business hours. [Sec. 209(4)]

Section 209A(1) lays down that the Registrar or any officer authorised by the Central Governmemt may also inspect books of account and other books and papers of every company during business hours.

Duty of directors and officers to help. It is the duty of every director, other officer or employee of the company to produce to the person making an inspection, all such books of account and other books and papers of the company in his custody and control [Sec. 209A(2)]. It is also the duty of every director, other officer or employee of the company to give all assistance to the person making the inspection. [Sec. 209A(3)]

Powers of inspecting officer. The person making the inspection under this section may make copies of books of accounts and other books and papers and may also put any marks of identification in token of inspection having been done. He shall have all the powers that a Registrar has in relation to the making of inquiries under this Act. Similarly, he shall have all the powers vested in a civil court under the Code of Civil Procedure, 1908 as regards discovery and production of books of account and other documents, summoning and enforcing attendance of persons and examining them on oath and inspection of any books, registers and other documents of the company at any place. After such inspection the person making inspection shall make a report to the Central Government. [Sec. 209A(4) to (7)]

ANNUAL ACCOUNTS AND BALANCE SHEET

At every annual general meeting of the company, the board of directors of the company shall put before the company, (*a*) a balance sheet as at the end of each financial year; and (*b*) a profit and loss account for that period.

In the case of a company not conducting business for profit, an income and expenditure account shall be laid before the company at its annual general meeting, instead of a profit and loss account.

Period of accounts. The profit and loss account shall relate, in the case of the first annual general meeting of the company, to the period from the date of incorporation to a date not later than nine months previous to the date of meeting, and in the case of any subsequent annual general meeting of the company, to the period beginning with 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.

The period of accounts which is called the 'financial year' of the company may be less or more than a calendar year. It shall not exceed fifteen months but it may extend to eighteen months if special permission has been granted in that behalf by the Registrar. (Sec. 210)

Form and Contents of a Balance Sheet and Profit and Loss Account

Form of balance sheet. Every balance sheet of a company shall give a true and fair view of the state of affairs of a company as at the end of the financial year. It must be in the form set out in Part I of Schedule VI or as near thereto as circumstances admit, or in such other form as the Central Government may approve.

Form of profit and loss account. The profit and loss account shall give a true and fair view of the profit and loss of the company for the financial year and shall comply with the requirements of Part II of Schedule VI.

Companies exempted. The provisions shall not be applicable to any banking or insurance company or any company engaged in the generation or supply of electricity or any other class of company for which a form of balance sheet as well as profit and loss account has been specified in or under the Act governing such a class of company.

The Central Government may, be notification in the Official Gazette, exempt any class of companies from compliance with any of the requirements in Schedule VI if, in its opinion, it is necessary to grant such an exemption in the public interest. (Sec. 211)

Authentication of Balance Sheet and Profit and Loss Account

The balance sheet and profit and loss account of a company shall be

signed on behalf of the board of directors:

(*i*) in the case of a banking company, by the persons specified in Section 29 of the Banking Companies Act. This section provides that the balance sheet and profit and loss account of a banking company shall be signed by the manager or the principal officer of the company and where there are more than three directors by at least three of those directors, or where there are not more than three directors, by all of them;

(*ii*) in the case of any other company, by its manager or secretary, if any, and by not less than two directors of the company one of whom shall be a managing director where there is one. Where only one of its directors is in India, for the time being, the balance sheet and profit and loss account shall be signed by him. But in such a case there shall be attached to the balance sheet and the profit and loss account, a statement signed by him explaining the reasons for non-compliance with the provisions of this section.

The balance sheet and the profit and loss account shall be approved by the board of directors before they are signed on behalf of the board and before they are submitted to the auditors for their report thereon. (Sec. 215)

The profit and loss account shall be annexed to the balance sheet and the auditor's report is to be attached thereto. (Sec. 216)

Board's Report

A report by the board of directors shall be attached to every balance sheet laid before the comapny in general meeting.

Contents of board's report. The board's report shall contain the following particulars: (*a*) the state of the company's affairs; (*b*) the amounts, if any, which it proposes to carry to any reserves in such a balance sheet; (*c*) the amount, if any, which it recommends should be paid by way of dividends; (*d*) material changes and commitments, if any, affecting the financial position of the company which have occurred between the end of the financial year to which the balance sheet relates and the date of the report; (*e*) conservation of energy, technology absorption and foreign exchange earnings and outgo. [Sec. 217(1)]

The board's report shall also deal with any changes which have occurred during the financial year (*a*) in the nature of the company's business; (*b*) in the nature of business carried on by the company's subsidiaries; and (*c*) generally in the classes of business in which the company has an interest. [Sec. 217(2)]

Particulars of employees in board's report. The board's report shall also include a statement showing the name of every employee of the company who (*a*) if employed throughout the financial year, was in receipt of

remuneration for that year which, in the aggregate, was not less than six lakhs rupees; or (b) if employed for a part of the financial year, was in receipt of remuneration for any part of that year at a rate which, in the aggregate, was not less than fifty thousand rupees per month.

The statement shall also indicate whether any such employee is a relative of any director or manager of the company and if so, the name of such a director. (Sec. 217(2A)]

Fullest information to be given in the report. The board is also bound to give the fullest information and explanations in its report or in an addendum to that report on every reservation, qualification or adverse remark contained in the auditor's report. [Sec. 217(3)]

Signatures on the report. The board's report and any addendum thereto shall be signed by its chairman if he is authorised, in that behalf by the board. Where he is not so authorised it shall be signed by such number of directors as are required to sign the balance sheet and profit and loss account. [Sec. 217(4)]

Members' Right to Copies of the Balance Sheet and Auditor's Report

Persons entitled to balance sheet. Section 219 requires that a copy of every balance sheet together with a copy of the profit and loss account, the auditor's report and board's report, which is to be laid before a company in general meeting, shall be sent not less than twenty-one days before the general meeting, to every member of the company, to every trustee for the holders of any debentures issued by the company and to all other persons entitled to receive notice of general meeting.

Balance Sheet, etc. on demand With a view to reducing the cost of servicing the shareholders, the Companies (Amendment) Act, 1988, dispenses with the requirement of sending detailed accounts to the shareholders of a listed company. It will now be enough in the case of listed companies, if the company sends abridged form of accounts in the prescribed form alongwith the notice of the meeting and the detailed annual accounts, auditor's report and annual report of directors are made available for inspection at its registered office during business hours for a period of 21 days before the date of the meeting.

However, any member or debenture holder or depositor is entitled to obtain copy of the detailed annual accounts at his request, free of cost. The company must fulfil the demand within seven days of making the demand.

Default. If default is made in complying with the above provision, the company and every officer of the company who is in default shall be punishable with a fine which may extend to five hundred rupees. The

Company Law Board may also order that the copy demanded must forthwith be furnished to the person concerned.

Filing Copies with the Registrar

Filing three copies within the prescribed time. After the balance sheet and the profit and loss account have been laid before a company at an annual general meeting, three copies of balance sheet and the profit and loss account have to be filed with the Registrar within thirty days of the date on which the balance sheet and the profit and loss account were so laid in the meeting. The Companies (Amendment) Act, 1977 has made it very clear that even where the annual general meeting of a company for any year has not been held on account of any reasons, the annual accounts have still to be filed with the Registrar within thirty days from the latest day on or before which that meeting should have been held.

If the annual general meeting of a company before which a balance sheet is laid does not adopt the balance sheet or is adjourned without adopting the balance sheet, or, if the annual general meeting of a company for any year has not been held, a statement of that fact and of the reasons therefor should be annexed to the balance sheet and to the copies required to be filed with the Registrar. Each such copy of the balance sheet and the profit and loss account must be signed by the managing director or manager or secretary of the company or in their absence by a director of the company.

Default. If default is made in complying with the above requirements, the company and every officer who is in default shall be punishable with a fine which may extend to fifty rupees for every day during which the default continues.

Private company. In case of an independent private company, copies of the balance sheet and copies of the profit and loss account shall be filed with the Registrar separately. This is because a non-member shall not be entitled to inspect or obtain copies of the profit and loss account. (Sec. 220)

ACCOUNTS OF HOLDING AND SUBSIDIARY COMPANIES

Sections 212 to 214 contain special provisions regarding accounts of holding and subsidiary companies.

Balance sheet of holding company. Section 212 provides that there shall be attached to the balance wheet of a holding company the following documents in respect of its subsidiary company or each of its subsidiary companies as the case may be: (*a*) a copy of the balance sheet of the subsidiary; (*b*) a copy of its profit and loss account; (*c*) a copy of

the report of its board of directors; (*d*) a copy of report of its auditors; (*e*) a statement of the holding company's interest in the subsidiary company; (*f*) if the board of directors of the holding company is unable to obtain information on any of the above matters, a report in writing to that effect must be attached to the balance sheet of the holding company; and (*g*) where the financial year of a subsidiary company does not coincide with the financial year of the holding company, a statement shall be attached to the balance sheet of the holding company showing any change in the latter's interest in the subsidiary between the end of the financial year of the subsidiary and the end of the holding company's financial year. The statement shall also show any material change that has taken place during this time in respect of the subsidiary's fixed assets, its investments, the money lent by it and borrowed by it for any purpose other than that of meeting current liabilities.

Financial year of holding company and subsidiary. Section 213 empowers the Central Governemtn to direct a holding company or its subsidiary company to postpone the annual general meeting or the making of the annual return so that the financial year of the subsidiary company may end with the financial year of the holding company.

Rights of holding company's representatives. Section 214 lays down that a holding company's representatives appointed by a resolution at a general meeting may inspect the books of account of its subsidiaries. The books of account of any such subsidiary shall be open to inspection by those representatives at any time during business hours.

AUDIT

The Companies Act makes it compulsory for every company to have its accounts audited by qualified auditors. The desirability of this provision can be based on the fact that shareholders who contribute the capital of the company leave its management and control in the hands of directors. Auditors are there to safeguard the interest of share-holders.

Qualifications of a Company Auditor

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 the auditor of a company. In such a case any partner so practising may act in the name of the firm. [Sec. 226(1)]

Disqualifications

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 comapny; and (*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. [Sec. 226(3)]

A person shall also not be qualified for an appointment as auditor of a company if he is disqualified for such an appointment of any other company which is that company's subsidiary or holding company or a subsidiary of that company's holding company. [Sec. 226(4)]

After his appointment if an auditor becomes subject to any of the disqualifications mentioned above, he shall be deemed to have vacated his office from the date he has become so disqualified. [Sec. 226(5)]

Appointment of Auditors

(1) **First auditors.** The first auditor or auditors of company shall be appointed by the board of directors within one month of the date of registration of the company. The auditor or auditors so appointed shall hold office until the conclusion of the first annual general meeting.

The company may at general meeting remove the auditors appointed by the board and appoint others in their place of which notice has been given to the members of the company not less than fourteen days before the date of the meeting.

If the board fails to make such an appointment, the company in general meeting may make it. [Sec. 224(5)]

(2) **Subsequent auditors.** The auditors are appointed at every annual general meeting of the company and they hold office from the conclusion of that meeting till the conclusion of the next annual general meeting. The company shall give intimation of appointment to every auditor within seven days of the appointment. [Sec. 224(1)]

Every auditor so appointed must give notice of his appointment to the Registrar of Companies within thirty days of receipt of the intimation informing the Registrar that he has accepted or refused to accept the appointment. [Sec. 224(1A)]

Special resolution for appointment of auditors in certain cases. The appointment of auditors is made by an ordinary resolution passed at the annual general meeting of the company. But where twenty-five per cent or more of the subscribed share capital of the company is held jointly or singly by a public financial institution, a government company, Central

Government, any State Government, a nationalised bank or an insurance company carrying on general insurance business, the appointment or re-appointment of an auditor shall be made by a special resolution at each annual general meeting.

It is further provided that if a special resolution has not been passed, it shall be deemed that the appointment has not been made and the Central Government will appoint a person to fill the vacancy. (Sec. 224-A)

Restriction on number of companies for appointment as an auditor. No company shall appoint or reappoint any person as its auditor if such person is at the date of appointment or reappointment holding appointment as auditor of 20 companies. This means that a person cannot be an auditor of more than 20 companies at a time. As a result of the Companies (Amendment) Act, 1988, a person in whole-time employment elsewhere will not be eligible to be appointed as auditor of a company. Similarly, any partner of a firm of Chartered Accountants, who is in full-time employment elsewhere, shall not be taken into account for computing the ceiling on number of companies that can be under audit with the firm. Out of these 20 companies not more than 10 companies should have a paid-up share capital of Rupees twenty-five lakhs or more. This limit of 20 is for each auditor. Where a firm has five partners, the total number of companies that firm can audit will be 100, provided no partner of the firm is in full-time employment elsewhere and no particular partner is assigned more than 20 companies. If a person is a partner in four firms, he will not be entitled to audit more than 20 companies in aggregate. If a person is appointed in his individual capacity as well as a partner in a firm, the total number of companies in both capacities cannot exceed 20. Partial audit or joint audit will be treated as one appointment of auditor and should be taken into the limit of 20 in respect of each of such auditor. [Sec. 224(1B)]

Before any appointment or reappointment is made, a written certificate shall be obtained from the auditor proposed to be appointed to the effect that the proposed appointment will be in accordance with the limits specified above. [Sec. 224(1)]

Reappointment of retiring auditors. Subject to the limit of 20 companies in which an individual or a firm can be appointed auditor and also subject to such cases where the appointment or reappointment can be made by special resolution, a retiring auditor, by whatsoever authority appointed, shall be reappointed, unless (*a*) he is not qualified for reappointment; (*b*) he has given the company notice in writing of his unwillingness to be reappointed; (*c*) a resolution has been passed at that meeting appointing somebody instead of him or providing expressly that

he shall not be reappointed; or (*d*) where notice has been given of an intended resolution to appoint someone else in the place of a retiring auditor but by reason of the death, incapacity or disqualification of that person the resolution cannot be proceeded with. [Sec. 224(2)]

(3) **Casual vacancy.** The board may fill any casual vacancy in the office of an auditor. Where such a vacancy is caused by the resignation of an auditor, it shall only be filled by the company in general meeting. Any auditor appointed in a casual vacancy shall hold office until the conclusion of the next annual general meeting. [Sec. 224(6)]

(4) **Central Government to appoint auditors in certain cases.** Where at the annual general meeting, no auditors are appointed or reappointed, the Central Government may appoint a person to fill the vacancy. [Sec. 224(3)]

It is the duty of the company to inform the Central Government within 7 days if it fails to appoint or reappoint auditors at an annual general meeting. If the company fails to give notice, the company and every officer of the company who is in default, shall be punishable with a fine which may extend to five hundred rupees. [Sec. 224(4)]

Similarly, where the appointment or reappointment is to be made by a special resolution as per Section 224A(1) and the company fails to pass, at its annual general meeting, any special resolution appointing an auditor or auditors, it shall be deemed that no auditor or auditors had been appointed by the company at its annual general meeting and the Central Government may appoint a person to fill the vacancy in such a case. [Sec. 224(2)]

(5) **Appointment a auditors of a government company.** The auditor of a government company shall be appointed or reappointed by the Central Government on the advice of the Comptroller and Auditor General of India. [Sec. 619(2)]

Section 619-B also empowers the Central Government to appoint auditors on the advice of the Comptroller and Auditor General of India, in the same manner as is now adopted for government companies under Section 619, in all companies in which not less than fifty-one per cent of the paid-up share capital is held by one or more of the following or any combination thereof: (*a*) Central Government, (*b*) State Government, (*c*) Government Companies, (*d*) corporations owned or controlled by the Central Government or the State Government.

Remuneration of Auditors

If the auditors are appointed by the board of directors or the Central Government, their remuneration may be fixed by the board or Central Government, as the case may be. If the auditors have been appointed by

the shareholders in general meeting, their remuneration shall be fixed by the company in general meeting or in such manner as the company in general meeting may determine.

Any sums paid by the company in respect of the auditors' expenses shall be deemed to be included in the expression "remuneration." [Sec. 224(8)]

Removal of auditors

First auditors. The company may, at general meeting, remove the first auditors, appointed by the board and appoint in their palce any other persons who have been nominated for appointment by any member of the company and of whose nomination notice has been given to the members of the company not less than fourteen days before the date of the meeting. [Sec. 224(5)(a)]

Subsequent auditors. Subsequent auditors may be removed from office before the expiry of their term only by the company in general meeting, after obtaining the previous approval of the Central Government in that behalf. [Sec. 224(7)]

Special notice of at least fourteen days shall be required for a resolution at an annual general meeting appointing, as auditor, a person other than a retiring auditor or providing expressly that a retiring auditor shall not be reappointed. [Sec. 225(1)]

On receipt of notice of such a resolution, the company shall forthwith send a copy thereof to the retiring auditor who shall be entitled to make representations, in writing and not exceeding a reasonable length to the company. The company must send a copy of the representation to the shareholders provided such a representation is received in time. If a copy of the representation is not sent to the members because it was received too late or because of the company's default, the auditor may require that the representation be read out at the meeting.

If the court is satisfied that provisions of this section are being abused to secure needless publicity for defamatory matter, it may order that copies of the representation need not be sent out and that it need not be read out at the meeting. [Sec. 225(2, 3)]

Rights and Powers of Auditors

(1) *Right of access to books of account.* Every auditor of a company shall have the right of access at all times to the books and accounts and vouchers of the company, whether kept at its head office or elsewhere.

(2) *Right to call for information and explanations.* He shall be entitled to require from the officers of the company such information and explanations as the auditor may think necessary for the performance of

his duties as auditor. [Sec. 227(1)]

(3) *Right to receive notice of general meeting.* All notices of, and other communications relating to, any general meeting of a company which any member of the company is entitled to have sent to him shall also be forwarded to the auditor of the company.

(4) *Right to attend general meetings.* He shall be entitled to attend any general meeting and to be heard at any general meeting which he attends on any part of the business which concerns him as auditor. (Sec. 231)

(5) *Right to visit branches.* Where the accounts of any branch office are audited by a person other than the company's auditor, the latter shall (*a*) be entitled to visit the branch office, if he deems it necessary to do so for the performance of his duties as auditor; and (*b*) have a right of access at all times to the books and accounts and vouchers of the branch office. [Sec. 228(2)]

(6) *Right to sign the audit report.* Section 229 provides that only the person appointed as auditor of the company or where a firm is so appointed, only a partner of the firm practising in India, may sign the auditors's report or sign or authenticate any other document of the company required by law to be signed or authenticated by the auditor.

(7) *Right to claim remuneration.* He is also entitled to claim his remuneration on completion of audit of the accounts of the company.

(8) *Right of lien.* The auditors's right of lien is a controversial one. But it was held that the auditor has no lien on books of accounts in respect of audit work. But if he has worked on the books of accounts in the capacity of an accountant, he has a right of lien on such books.[1]

The working papers necessary for preparing a balance sheet on behalf of a client for audit purposes belong to the auditor, but the correspondence between an accountant on behalf of a company and third parties belongs to the company.[2]

Duties of an Auditor

The duties of an auditor may be discussed under the two heads, namely: (*a*) statutory duties; and (*b*) general duties.

Statutory duties. Following are the statutory duties of an auditors:

(1) *Duty to make a report to the members.* 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 every document declared to be part of or annexed to the balance sheet or profit and loss account, which are laid before the company in general meeting

[1]*Burleigh v. Ingram Clarke Ltd.* (1901) 27 Acct. L.R. 65.
[2]*Chantry Martin & Co. v. Martin* (1953) 2 Q.B. 286.

during his tenure of office. The report shall state whether, in his opinion and to the best of his information and according to the explanations given to him, the said accounts give the information required by this Act in a manner so required and give a true and fair view, (*a*) of the state of the company's affairs at the end of its financial year in the case of the balance sheet; and (*b*) of the profit or loss for its financial year in the case of its profit and loss account.

The object of this provision is to secure to the shareholders, independent and reliable information respecting the true financial position of the company at the time of audit. If the auditors feel that proper books of account have not been maintained as required by the Act or the accounts do not represent a true and fair view, they must mention it in their report to the shareholders. Lindley L.J. in *Re London and General Bank (No.2)* observed as follows: "A person whose duty it is to convey information to others does not discharge that duty by simply giving them so much information as is calculated to induce them, or some of them, to ask for more ... An auditor who gives shareholders means of information, instead of information, in respect of a company's financial position does so at his peril and runs the very serious risk of being held, judicially, to have failed to discharge his duty."[3]

In this connection it must be noted that the auditor shall be considered to have complied with his duty to report to the members, if he signs his report and the balance sheet and sends them to directors. It is not the auditor's duty to see that the directors call a meeting and that his report is sent or placed in the hands of shareholders.[4]

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 and proper returns adequate for the purposes of his audit have been received from branches not visited by him; (*c*) whether the report on the accounts of any branch office audited by some person other than the company's auditor has been forwarded to him and how he had dealt with the same in preparing the auditor's report; and (*d*) 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. [Sec. 227(3)]

Where any of the above mentioned matters is answered in the negative or with a qualification, the auditor's report shall state the reason for the

[3](1895) 2 Ch. 673, 684.

[4]*Re Allen Craig & Co. (London) Ltd.* (1934) All E.R. Rep. 301.

answer. [Sec. 227(4)]

Section 227(4A) empowers the Central Government to direct that in the case of such class or description of companies as may be specified in the order, the auditor's report shall also include a statement on such matters as may be specified therein. In exercise of the power conferred by the above section, the Company Law Board issued on 7 September 1988 an order called "The Manufacturing and Other Companies (Auditor's Report) order, 1988 and it came into force on 1 November, 1988.

The auditor's report shall be read before the company in general meeting and shall be open to inspection by any member of the company. (Sec. 230)

(2) *Duty to make enquiries.* Section 227(1A) introduced by the Companies (Amendment) Act, 1965, has imposed a duty on auditors to inquire:

(*i*) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to the interests of the company or its members;

(*ii*) whether transactions of the company which are represented merely by book entries are not prejudicial to the interests of the company;

(*iii*) where the company is an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they are purchased by the company;

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

(*v*) whether personal expenses have been charged to revenue account;

(*vi*) where it is stated in the books and papers of the company that any shares have been allotted for cash, whether cash has actually been so received, whether the position, as stated in the account books and the balance sheet is correct, regular and not misleading.

(3) *Duty to assist inspectors.* It shall be the duty of the auditor to preserve and produce for an inspector all books and papers of the company which are in his custody or power. He shall also give the inspector all assistance in connection with the investigation as he is reasonably able to give. [Sec. 240(1)]

(4) *Duty to certify statutory report.* The auditor has to certify the statutory report as correct, insofar as the report relates to the shares allotted by the company, the cash received in respect of such shares and the receipts and payments of the company. [Sec. 166(4)]

(5) *Duty in relation to the issue of prospectus.* Section 56(1) provides that every prospectus issued by an existing company shall contain a report

by the auditors of the company relating to the profit and loss and assets and liabilities of the company. The report must refer to the rates of dividends, if any, paid by the company in respect of each class of shares for each of the five financial years before the issue of the prospectus. The report of the auditor must also state separately the profits and losses of the company's subsidiaries and also its combined profits and losses.

(6) *Duty in relation to the declaration of solvency.* In case of members' voluntary winding up, the declaration of solvency must be accompanied by a copy of the auditors' report on the profit and loss account and the balance sheet of the company prepared upto the date of the declaration and should embody a statement of the company's assets and liabilities as on that date. [Sec. 488(2(b)]

The statutory duties of the auditors can be expanded but they cannot be restricted by the articles or the directors of the company.[5]

General Duties

In addition to the above statutory duties, there are certain other duties of an auditor which have been recognised by courts. These general duties are stated below:

1. An auditor must be honest, that is, he must not certify what he does not believe to be true.

In *Deputy Secretary to the Government of India, Ministry of Finance v. S.N. Das Gupta,*[6] it was observed: "Vis-a-vis the shareholders the auditor holds a position of trust and it is his bounden duty to honour that trust by being candid with shareholders and telling them frankly and fully everything with regard to the affairs of the company which have come to his knowledge and which it is material for the shareholders to know...his duty is to make a full, careful and truthful report in default of which he must be held to have failed in the discharge of his obligations."

2. He must exercise reasonable care and skill in the discharge of his duties. What is reasonable care and skill depends upon the circumstances of each case. Where there is nothing to excite suspicion, very little enquiry will be reasonable and sufficient; and when suspicion is aroused, more care is obviously necessary but still an auditor is not bound to exercise more than reasonable care and skill even in case of suspicion. He is perfectly justified in acting on the opinion of an expert where special knowledge is required. If he fails to exercise reasonable care and skill, he may be held liable for damages.[7]

[5] *Newton v. Birmingham Small Arms Co. Ltd.* (1906) 2 Ch. D. 378.
[6] A.I.R. (1956) Cal. 414.
[7] *Re London and General Bank* (No. 2) 1892 2 Ch. 673.

3. It is the duty of an auditor to verify not merely, the arithmetical accuracy of the balance sheet but its substantial acccuracy. An auditor is not to be confined to mechanics of checking vouchers and making arithmetical computations. He must see that the books show a true and correct representation of company's affairs.

The auditor must check cash in hand and also bank balance at bank by inspecting the pass-book or by obtaining certificate from the bank.[8] Similarly, he should verify the existence of assets and not assume as true the particulars given in earlier balance sheets or the words of persons in management of the company.[9]

The professional standards have undoubtedly risen in recent years. In *Controller of Insurance v. H.C. Das,*[10] it was held that an auditor should not merely rely upon the statements of persons who constitute the management in matters capable of direct vertification by him from books, accounts and vouchers.

4. An auditor is a watchdog, not a bloodhound. He is not a detective nor is he to approach his work with suspicion. He is justified in believing tried servants of the company in whom confidence is placed by the company. He is entitled to assume that they are honest, and to rely upon their representations, provided he takes reasonable care. If there is anything calculated to excite suspicion, he should probe into the bottom, but in the absence of anything of that kind, he is only bound to be reasonably cautious and careful.

It was held that it was no part of an auditor's duty to take stock and that he is not guilty of negligence if he accepts a certificate of the manager as to the value of stock in the absence of suspicious circumstances.[11]

5. An auditor must report all material facts and points to the shareholders. He is not bound to give advice either to directors or shareholders as to what they ought to do. He is not concerned with the policy of the company.

6. An auditor not only owes a duty of protecting shareholders but also owes a duty of care even to a non-member if he knows that his audited accounts are going to be produced in order to attract someone to invest in the company, unless there is an express disclaimer of responsibility.[12]

[8] *Fox v. Morrih & Grant Co.* (1918) 35 T.L.R. 126.

[9] *Council of Institute of Chartered Accountants of India v. Rajaram* (1960) Comp. Cas. 67.

[10] A.I.R. 1957 Cal. 387.

[11] *Re Kingston Cotton Mill Co. Ltd.* (No. 2) (1896) 2 Ch. 279.

[12] *Hedley Byrne and Co. Ltd. v. Hellers and Partners Ltd.* (1946) A.D. 465.

Auditing Branch Office Accounts

Where a company has a branch office, the accounts of that office shall be audited by the company's auditor or by a person qualified for appointment as auditor of the company. Where the branch office is situated in a country outside India, the accounts shall be audited either by the company's auditor or by a person a qualified according to the provisions of the Act, or by an accountant duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country. [Sec. 228(1)]

Audit of branch accounts by a person other than the company's auditor. Where the accounts of any branch office are audited by a person other than the company's auditor, the latter shall (*a*) be entitled to visit the branch office, if he deems it necessary to do so for the performance of his duties as auditor; and (*b*) have a right of access at all times to the books and accounts and vouchers of the company maintained at its branch office.

In the case of a banking company having a branch office outside India, it shall be sufficient if the auditor is allowed access to such copies of and extract from, the books and accounts of the branch as have been transmitted to the company's principal office in India. [Sec. 228(2)]

Where a company in general meeting decides to have the accounts of a branch office audited otherwise than by the company's auditor, the company in that meeting shall, for the audit of those accounts, appoint a person qualified for appointment as auditor of the company or, where the branch office is situated in a country outside India, a person who is either qualified as aforesaid or an accountant duly qualified to act as an auditor of the branch office accounts in accordance with the laws of that country, or authorise the broad of directors to appoint such a person in consultation with the company's auditor. [Sec. 228(3)(a)]

Powers and duties of branch auditor. The person so appointed (hereafter referred to as the branch auditor) shall have the same powers and duties in respect of audit as the company's auditor has in respect of the same. [Sec. 228(3)(b)]

The branch auditor shall prepare a report on the accounts of the branch office examined by him and forward the same to the company's auditor who shall, in preparing the auditor's report, deal with the same in such manner as he considers necessary. [Sec. 228(3)(c)]

Remuneration of branch auditor. The branch auditor shall receive such remuneration and shall hold his appointment subject to such terms and conditions as may be fixed either by the company or by the board of directors, if so authorised, in general meeting. [Sec. 228(3)(d)]

Exemption of branch audit. The Central Government may make rules

providing for the exemption of any branch office from the provisions of this section and, in making such rules, the Central Government shall have regard to all or any of the following matters, namely:

(*i*) the arrangement made by the company for auditing the accounts of branch office by a person otherwise qualified for appointment as branch auditor, even though such a person may be an officer or employee of the company;

(*ii*) the nature and quantum of activity carried on at the branch office during the preceding three years;

(*iii*) the availability at a reasonable cost of a branch auditor; and

(*iv*) any other matter which in the opinion of the Central Government justifies the grant of exemption. [Sec. 228(4)]

Special Audit

Circumstances of special audit. Where the Central Government is of the opinion that (*a*) the affairs of any company are not being managed in accordance with sound business principles or prudent commercial practices; or (*b*) that any company is being managed in a manner likely to cause serious injury or damage to the interests of the trade, industry or business to which it pertains; or (*c*) that the financial position of any company is such as to endanger its solvency, the Central Government may direct that a special audit of the company's accounts be conducted. The Central Government shall appoint either a chartered accountant or the company's auditor to conduct such special audit. [Sec. 233A (1)]

The chartered accountant or the company's auditor appointed for the purpose of special audit shall be known as a special auditor. [Sec. 233A(2)]

Powers and duties of special auditor. The special auditor shall have the same powers and duties as the auditor of the company has under the Act, except that he shall make his report to the Central Government and not to the members of the company. [Sec. 233A(3)]

Report by special auditor. His report shall include all matters required to be included in an auditor's report under Section 227 and, if the Central Government so directs, shall also include a statement on any other matter which may be referred to him by that Government. [Sec. 233A(4)]

Action on the report. On receipt of the report of the special auditor, the Central Government may take such action as it considers necessary. If it does not take any action on the report within four months of the date of its receipt, a copy of the report shall be sent to the company requiring it to circulate or read the report to members at the next annual general meeting. [Sec. 233A(6)]

Expenses of special audit. The expenses of any special audit shall be

determined by the Central Government and shall be payable by the company. [Sec. 233A(7)]

Cost Audit

Audit of cost accounts. Section 233B empowers the Central Government to order the conducting of cost audits of companies engaged in production, processing, manufacturing or mining activities for which maintenance of cost accounts had been prescribed under Section 209. The auditor must be either a cost accountant within the meaning of the Cost and Works Accountant Act, 1959, or any chartered accountant within the meaning of the Chartered Accountants Act, 1949. The conduct of audit shall take place in such manner as may be prescribed in the order. [Sec. 233B (1)]

Appointment of cost auditor.. The auditor under this section shall be appointed by the board of directors of the company with the provious approval of the Central Government.

The Companies (Amendment) Act, 1988, further provides that the provisions of Section 224(1B) applicable to the statutory auditors in regard to the number of companies in which a person can be appointed as an auditor, shall now apply to cost auditors too. Accordingly, before the appointment of any cost auditor is made by the board of directors, a written certificate shall be obtained from the auditor proposed to be appointed to the effect that the appointment, if made, will be in accordance with the provisions of Section 224(1B). [Sec. 223(B)2]

An audit conducted by an auditor under this section shall be in addition to the usual audit of the company accounts.[Section 223B(3)]

Power and duties of cost auditor. He shall have the same powers and duties in relation to the audit conducted by him as an auditor of the company has under the Act. He shall make his report to the Central Government in such form and within such time as may be prescribed, and shall also forward a copy of the report to the company. [Sec. 233B(4)]

Qualifications of cost auditor. A person who is disqualified for appointment as an auditor according to the provisions of the Act shall not be appointed or reappointed for conducting the audit of the cost accounts of a company.

Any one appointed for conducting such an audit shall cease to do so if, after his appointment he (*a*) attracts any of the disqualifications of a company auditor; or (*b*) is appointed as the auditor of the company. [Sec. 233B(5)]

Assistance to be given to cost auditor. When the Central Government orders a company to conduct the audit of its cost accounts, it shall be the duty of the company to give all facilities and assistance to the person

nted for conducting such an audit. [Sec. 233B(6)]

Information to be given to Central Government. On receipt of a copy of the report from the cost auditor, the company shall furnish the Central Government with full information and explanation on every reservation or qualification contained in such a report. [Sec. 233B(7)]

If the Central Government is of the opinion that any further information or explanation is necessary, the Government may call for such further information and explanations. [Sec. 233B(8)]

Action on the report. On receipt of the report of the cost auditor and the information and explanations furnished by the company, the Central Government may take such action on the report as it considers necessary. [Sec. 233B(9)]

The Central Government may direct the company to circulate the report of the cost auditor to its members, alongwith the notice of the annual general meeting to be held for the first time after the submission of such a report. [Sec. 233B(10)]

QUESTIONS

1. What are the provisions of the Companies Act relating to the maintenance, inspection, authentication and filling of accounts?

2. What are the books of account required to be kept by a company and where? Who are the persons who can inspect these books?

[*C.A. (Final), November 1976*]

3. Distinguish between annual rerturns and annual accounts.

[*Delhi, B.Com. (Hons.), 1975*]

4. "There shall be attached to every balance sheet laid before a company in general meeting a report by its board of directors". What are the matters which are required by law to be mentioned in the Directors' Report?

[*Company Secretary (Final), October 1975*]

5. What are the provisions of the Companies Act relating to the qualifications, appointment, remuneration and removal of auditors?

[*I.C.W.A., January 1970*]

6. Examine the provisions for the appointment and/or reappointment of the auditors by:

(*i*) A new company--appointment of first auditors.

(*ii*) A public company where public financial institutions/government etc., hold not less than twenty-five per cent of the subscribed capital.

(*iii*) Government companies. [*Company Secretary (Final), October 1975*]

7. "An auditor is not bound to be detective, or as was said, to approach his work with suspicion or with a foregone conclusion that there is something wrong". Examine this statement with reference to powers and duties of auditors.

[*I.C.W.A., December 1976*]

8. Discuss the powers and duties of an auditor under the Companies Act.

[*C.A. (Final), May 1978*]

9. Discuss the procedure for removal of an auditor under the Companies Act.

10. State under what circumstances, in which class of companies and by whom cost audit may be conducted under the Companies (Amendment) Act, 1965.

[*I.C.W.A., December 1974*]

11. Under what circumstances may be Central Government direct special audit of a company's accounts? How is the report of a special auditor dealt with?

12. State the provisions of the Companies Act in respect of auditing of accounts of a branch office of a company.

PRACTICAL PROBLEMS

1. Will the fact of not having held the general meeting be a valid defence for failure to file with the Registrar of Companies copies of Balance Sheet and Profit and Loss Account together with the Board's report and the Auditor's report? Discuss. [*Company Secretary (Inter), April 1974*)

2. The auditors of a company made a confidential report to the directors, calling their attention to the fact that the securities of some loans were insufficient and that there was difficulty in realisation. They also stated that, in their opinion, no dividend should be paid for the year. In their report to the shareholders, however, they merely stated that the value of securities was dependent upon realisation. Dividends, for the year, were in due course declared by the company on the directors' recommedations. Are the auditors liable for the above mentioned statement in their report to the shareholders regarding the realisable value of securities?

[*C.A. (Final), May 1978*]

3. Izzat Limited, a public company, in which 30% of the subscribed capital is held by the Central Government wishes to reappoint M/s Large and Co. as its auditors in the Annual General Meeting proposed to be held on 31st March 1976. Advise Izzat Limited about the procedure to be followed in this regard.

[*C.A. (Final), November 1976*]

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DIVIDENDS AND BONUS SHARES

DIVIDENDS

THE ordinary meaning of "dividend" is the receipt by the shareholders of parts of profits of the company. It refers to the share of the net profits of a joint stock company payable to each shareholder or member. It follows from this that dividends can only be paid out of profits.

A trading company is formed for the purpose of earning profits and, as such, the power to declare dividends is inherent or implied in the case of a trading company. It need not be expressly provided for in its memorandum or articles. Of course the articles may regulate the manner in which the dividends are to be paid.

Regulation 85 of Table A provides that the company in general meeting may declare dividends, but no dividend shall exceed the amount recommended by the board. This means that the board of directors recommend a rate of dividend at the annual general meeting which is to be approved by the shareholders. The shareholders may reduce the rate of dividend but in no case do they have the right to increase the rate recommended by the directors. Dividends become payable only when a resolution is passed by shareholders at the meeting.

It may be noted here that it is for the board of directors to recommend the rate of dividend to be declared. The shareholders cannot enforce the distribution of profits and no shareholder can claim the declaration of dividends unless the directors fraudulently decline to pay them.[1]

How much of the profits shall be distributed to the shareholders in the form of dividends is a matter of internal management of the company and it is for the shareholders and directors to decide the issue. The court will not interfere with their discretion.[2]

[1] *Bond v. Barrow Haematite Co.* (1902) 1 Ch. 353.
[2] *Burland v. Earle* (1902) A.C. 83.

STATUTORY PROVISIONS REGARDING DIVIDENDS

1. *Payment of dividend only out of profits.* A company may declare or pay dividend for any financial year out of:

(*a*) the profits of the company for the year for which dividends are to be paid or/and undistributed profits of the previous financial years arrived at after providing for depreciation in accordance with the provisions of the Act and after transferring to the reserves of the company such percentage of its profits as may be prescribed by the Central Government,[3] but not exceeding ten per cent. The company may, however, create greater reserves. [Sec. 205(1)(2-A)]; or

(*b*) accumulated profits earned by the company in previous years and transferred by the company to its reserves. But such declaration must comply with the rules framed by the Central Government.[4] Any declaration of dividend not in accordance with the rules so framed shall require the previous approval of the Central Government. [Sec. 205-A(3)]; or

(*c*) capital profits,[5] provided (*i*) the articles permit such payment, (*ii*) capital profits have been realised in cash, and (*iii*) surplus remains after the revaluation of all the assets and liabilities of the company; or

(*d*) moneys provided by the Central/State Government for the payment of dividends in pursuance of a guarantee given by the Government concerned. [Sec. 205(1)]

It is worth nothing that no dividends can be paid out of capital. Such a payment is *ultra vires,* even if sanctioned by the memorandum or the articles. It was further held in *Flicrofts'* case that directors who are guilty of such payment are jointly are severally bound to repay the amount to the company.[6]

However, a company may pay interest out of capital in certain cases provided for in Section 208.

2. *No dividend on non-compliance with Section 80-A.* Dividends cannot be declared by a company on its equity shares, if it fails to redeem the preference shares as required by Section 80A. [Sec. 205(2B)]

Section 80A, inserted by the Companies (Amendment) Act, 1988, provides that all existing irredeemable preference shares shall be redeemed within a period of five years from the commencement of Amendment Act

[3]Refer to The Companies (Transfer of Profits to Reserves) Rules, 1975, given later in this chapter.

[4]Refer to The Companies (Declaration of Dividend out of Reserves) Rules, 1975, given later in this chapter.

[5]*Foster v. The New Trinidad Lake Etc. Co. Ltd.,* (1901) 1 Ch. 208.

[6](1882) 21 Ch. D. 519.

of 1988, i.e., 15th June, 1988. It further provides that all existing preference shares redeemable after ten years from the date of issue shall be redeemed within ten years from the commencement of the Amendment Act, 1988, unless the same are due for redemption earlier.

3. *Adjustment of depreciation and losses for previous years.* Companies are not entitled to pay dividend unless depreciation has been provided for the current year out of the profits at the rates specified in Schedule XIV. If the company has not provided for depreciation for any previous financial years, that should be deducated from the profits. If the Company has incurred any loss in any previous financial years, such loss should also be deducated from profits. However, the Central Government may allow any company to declare or pay dividend without providing for depreciation if it thinks necessary to do so in public interest. [Sec. 205(1)]

4. *Dividend payable only in cash.* No dividend shall be payable except in cash. However, this provision shall not be deemed to prohibit the capitalisation of profits or reserves of a company for (*a*) the purpose of issuing fully paid-up bonus shares; or (*b*) paying up any amount being unpaid for the time on any shares held by the members of the company. [Sec. 205(3)]

5. *Mode of Payment.* Any dividend payable in cash may be paid by cheque or warrant through the post directed to the registered address of the shareholder entitled to the payment of the dividend. In the case of joint shareholders, it may be sent to the registered address of one of the shareholders first named on the register of members, or to such person and such address as the shareholders or joint shareholders may in writing direct. [Sec. 205(5)]

6. *Dividend payable to the registered shareholder.* No dividend shall be paid by a company in respect of any shares except to the registered holder of such shares or to his order or to his banker. In case of a share warrant, payment should be made to the bearer of the warrant or to his banker. (Sec. 206)

7. *Dividend to be paid within the prescribed time.* Dividends must be paid within forty-two days of their declaration. Every director of the company, if he is knowingly a party to default, shall be punishable with simple imprisonment for a term which may extend to seven days and shall also be liable to a fine except in the following cases: (*a*) where the dividend could not be paid by reason of the operation of any law; (*b*) where the shareholder has given directions to the company regarding the payment of dividend and those directions cannot be complied with; (*c*) where there is a dispute regarding the right to receive the dividend; (*d*) where the dividend has been lawfully adjusted by the company against any sum due to it from the shareholders; or (*e*) where failure to pay dividend

was not due to any default on the part of the company. (Sec. 207)

8. *Declared dividend a statutory debt.* A dividend becomes a debt from the date on which it is declared and becomes payable. The shareholder entitled to it can enforce its payment through court.[7] Even the shareholder can file a petition for winding up the company.[8] However, interim dividend does not become a debt and therefore it can be rescinded by the board before its payment.

9. *Dividends to be declared only at annual general meeting.* Dividends can be declared only at the annual general meeting in respect of the particular financial year for which the annual general meeting has been convened. The profits earned in past years and remaining accumulated may be paid as dividend in respect of the financial year for which the annual general meeting has been convened.[9] Once a company has declared a dividend for a financial year at an annual general meeting, a further dividend cannot be declared in respect of the same year at a subsequent general meeting.[10]

However, dividends may be declared at an extraordinary general meeting if the company could not declared a dividend at an annual general meeting and the articles of association do not provide to the contrary.

10. *Dividend in proportion to paid up capital.* A company may, if so authorised by its articles, pay dividends in proportion to the amount paid up on each share where a larger amount is paid up on some shares than others. (Sec. 93). But in the absence of such a provision in the articles, dividends will be in proportion to the nominal value of the shares irrespective of the paid up amount of each share.[11]

11. *No dividend on advance payment of call.* No dividends can be paid by a company on advance payment of call made by the shareholders, unless it is authorised by the articles.

The Companies (Transfer of Profits to Reserves) Rules, 1975

In exercise of the powers conferred by sub-section (2A) of Section 205 of the Companies Act, the Central Government framed the Companies (Transfer of Profits to Reserves) Rules, 1975. These rules came into effect in July 1975. These rules were amended in 1976 and the rules in their amended form are as follows:

[7] *Re Severn Etc. Rly, Co. L.R.* (1896) 1 Ch. 559.

[8] *Hari Prasad v. A.C. Traders Ltd.* A.I.R. 1964 Mad. 519.

[9] *Raghunathan Neotia v. Swadesh Cloth Dealers Ltd.*, (1964) Comp. Cas. 570.

[10] *Biswa Nath Prasad v. New Central Jute Mills Ltd.* (1961) Comp Cas. 125.

[11] *Re Bridgewater Navigatton Co. (1891)* 2 Ch. 317; *Oakbank Oil Co. v. Crum* (1882) 8 App. Cas. 65.

1. Percentage of profits to be transferred to reserves. No dividend shall be declared or paid by a company for any financial year out of the profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of sub-section (2) of Section 205 of the Act, except after the transfer to the reserves of the company of a percentage of its profits for that year as specified below:

(*a*) Where the dividend proposed exceeds 10 per cent but does not exceed 12.5 per cent of the paid up capital, the amount to be transferred to the reserves shall not be less than 2.5 per cent of the current profits;

(*b*) Where the dividend proposed exceeds 12.5 per cent but does not exceed 15 per cent of the paid up capital, the amount to be transferred to the reserves shall not be less than 5 per cent of the current profits;

(*c*) Where the dividend proposed exceeds 15 per cent but does not exceed 20 per cent of the paid up capital, the amount to be transferred to the reserves shall not be less than 7.5 per cent of the current profits; and

(*d*) Where the dividend proposed exceed 20 per cent of the paid up capital, the amount to be transferred to reserves shall not be less than 10 per cent of the current profits..

Where the dividend proposed is 10 per cent or less of the paid-up capital of the company, no portion of the net profit is compulsorily required to be transferred before declaration or payment of dividend. In such a case it is optional to transfer any profit to the reserves.

2. Conditions governing voluntary transfer of a higher percentage. Voluntary transfer by a company of a percentage higher than 10 per cent of its profits to its reserves is allowed provided that:

(*a*) Where a dividend is declared, a minimum distribution sufficient for the maintenance of dividends to shareholders at a rate equal to the average of the rates at which dividends declared by it over the three year immediately preceeding the financial year is ensured; or

(*b*) Where bonus shares have been issued in the financial year in which the dividend is declared or in the three years immediately preceding the financial year, a minimum distribution sufficient for the maintenance of dividends to shareholders at an amount equal to the average amount (quantum) of dividend declared over the three years immediately preceding the financial year is ensured.

However, where the net profits after tax are lower by 20 per cent or more than the average net profits after tax of the two financial years immediately preceding, it shall not necessary to ensure such minimum distribution.

(*c*) Where no dividend is declared, the amount proposed to be transferred to its reserves from the current profits shall be lower than the average amount of the dividends to the shareholders declared by it over

the three years immediately preceding the financial year.

3. Penalty. If a company fails to comply with any of the provisions contained in these Rules, the company and every officer of the company in default, shall be punishable with fine which may extend to Rs 500, and where the contravention is a continuing one, with a further fine which may extend to Rs 50 for every day, after the first, during which such contravention continues.

The Companies (Declaration of Dividend out of Reserves) Rules, 1975

In exercise of the powers conferred by sub-section (3) of Section 205A of the Companies Act, the Central Government framed the Companies (Declaration of Dividend out of Reserves) Rules, 1975. These rules came into effect in July 1975. These rules provide as follows.

In the event of inadequacy or absence of profits in any year, dividend may be declared by a company for that year out of the accumulated profits earned by it in previous year and transferred by it to the reserves, subject to the conditions that--

(*a*) the rate of dividend declared shall not exceed the average of the rates at which dividend was declared by it in the five years immediately preceding that year or ten per cent of its paid up capital, whichever is less;

(*b*) the total amount to be drawn from the accumulated profits earned in previous years and transferred to the reserves shall not exceed an amount equal to one-tenth of the sum of its paid up capital and free reserves and the amount so drawn shall first be utilised to set off the losses incurred in the financial year before any dividend in respect of preference or equity shares is declared; and

(*c*) the balance of reserves after such withdrawal shall not fall below fifteen per cent of its paid up share capital. For the purpose of these rules, "profits earned by a company in previous years and transferred by it to the reserves" shall mean the total amount of net profits after tax transferred to reserves as at the beginning of the year for which the dividend is to be declared; and in computing the said amount, the appropriations out of the amounts transferred from the Development Rebate Reserve (at the expiry of the period specified under the Income-tax Act, 1961) shall be included and all items of Capital Reserves including reserves created by revaluation of assets shall be excluded.

Unpaid or Unclaimed Dividends

Transfer to Unpaid Divident Account. Section 205A has been amended by the Companies (Amendment) Act, 1988 with a view to providing that all dividends remaining unpaid or unclaimed within 42

days from the date of declaration, shall be deposited by the company in a special account to be called "Unpaid Dividend Account" in a scheduled bank. The company shall do it within 7 days of the expiry of the said period of 42 days. Prior to the amendment, unclaimed dividend was not to be deposited. [Sec. 205A(1)]

The expression "dividend which remains unpaid" means any dividend the warrant in respect thereof has not been encashed or which has otherwise not been paid or claimed. [Explanation to Sec. 205A(1)]

Transfer to Investor Education and Protection Fund

If money transferred to the Unpaid Dividend Account remains unpaid or unclaimed for a period of seven years, it will then be transferred by the company to the Fund called Investor Education and Protection Fund created under Section 205-C inserted by the Companies (Amendment) Act, 1999. [Sec. 205-A(5)]

Section 205-C empowers the Central to establish a fund called the Investor Education and Protection Fund. The Fund shall be utilised for promotion of investor awareness and protection of the interests of investors. The following amounts, if remaining unpaid or unclaimed for seven years or more, shall be credited to this Fund: (a)amounts in the unpaid dividend accounts of companies; (b) application moneys received by companies for allotment of securities and due for refund; (c) matured deposits with companies; (d) matured debentures with companies; (e) interest accruing on the above items; (f) grants and donations given to the Fund; and (g) the interest or other income received out of investments made from the Fund.

It is further clarified by explanation to section 205-C that no claim shall lie against the Fund or the company in respect of individual amounts which were unclaimed and unpaid for a period of seven years from the dates that they first became due for payment and that no payment shall be made in respect of any such claim.

Interim Dividend

The board may, from time to time, pay to the members such interim dividends as appear to it to be justified by the profits of the company. (Regulation 86 of Table A)

An interim dividend is that dividend which is declared between two annual general meeting.[12]

An interim dividend may be declared by the board of directors provided the articles authorise the board in this behalf. No meeting of the shareholders is essential such a dividend. Thus a resolution of the general meeting in this respect is not operative.[13]

[12] *Re Jowitt, Jowitt v. Keeling* (1922) 2 Ch. 442.

[13] *Scott v. Scott* (1943) 1 All E.R. 582.

An interim divided declared by the directors does not become a debt and therefore it can be rescinded by the directors any time before payment.[14]

Before declaring an interim dividend, the directors must satisfy themselves regarding the general conditions and prospects of the trade carried on by the company and the financial aspect of the matter.

BONUS SHARES

Section 205(3) provides that dividends shall be payable in cash but it does not prohibit the capitalisation of profits or reserves of a company for the purpose of issuing fully paid-up bonus shares or paying up any amount for the time being unpaid on any shares held by the members of the company. This means that instead of paying dividend in cash, the profits may be capitalised, if the articles permit.

In such a case the company declares a dividend or bonus out of the undistributed profits. At the same time the company issues a corresponding number of new shares. Instead of paying dividend in cash, it is utilised for payment of the amount due on shares. The company in this way capitalises its profits instead of paying them out in cash. Shareholders receive their dividends in the shape of fully paid-up shares which are called bonus shares.

It may be noted here that a capital redemption reserve account under Section 80(5), and the share premium account under Section 78(2), may be applied by the company in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

Regulation 96 of Table A of the Companies Act, 1956, which is usually incorporated in the articles of most companies, provides that on the recommendation of its board of directors, the company may, in general meeting, resolve that any amount standing to the credit of the company's reserves or profit and loss account, which is otherwise available for distribution, should be capitalised and that the amount so set free be divided amongst members entitled to dividend. The above sum shall not be paid in cash but shall be applied either in paying the amounts remaining unpaid on the shares of members concerned or in issuing to such members fully paid-up bonus shares.

Conditions for issue of bonus shares

For issuing bonus shares, the following conditions must be complied with: (*a*) articles of association must permit such issue of bonus shares;

[14]*Laguna Nitrate Co. v. Schroeder & Co.* (1901) 85 L.T. 22.

(*b*) sufficient undistributed profits must be present; (*c*) a resolution for capitalising the profits must have been passed by the board of directors; (*d*) the resolution of the board of directors must be approved by the shareholders in general meeting; (*e*) guidelines for the issue of bonus shares prescribed by the Securities and Exchange Board of India (SEBI) must be complied with; and (*f*) whenever a company with a share capital makes any allotment of bonus shares, the company shall file with the Registrar a return stating the number and nominal amount of bonus shares issued together with the names, addresses and occupations of the allottees and a copy of the resolution authorising the issue of such shares. This must be done within thirty days of the allotment of shares.

Guidelines on Issuing Bonus Shares

Earlier the proposals for the issue of bonus shares were examined and cleared by the Controller of Capital Issues on the basis of certain guidelines issued under the Capital Issues (Control) Act, 1947. But with the repeal of the Capital Issues (Control) Act, 1947 w.e.f. 29th May, 1992, the issue of bonus shares has been freed from the requirement of prior approval of the Controller of Capital Issues.

Now any proposal for issue of bonus shares should be in conformity with the guidelines for issue of bonus shares issued by the Securities and Exchange Board of India (SEBI) under clause (M) of its "Guidelines for Disclosure and Investor Protection." In suppression of its earlier guidelines for the issue of bonus shares, the Board of SEBI issued, on 13th April, 1994, revised guidelines for the issue of bonus shares, keeping in view the current pace of liberalisation and reforms in the primary market. It may be noted here that the revised guidelines have done away with certain requirements relating to the issue of bonus shares, namely, Profitability Test, Residual Reserve Test, etc.

It is believed that the Board of Directors of the companies wishing to make bonus issues will take into account the relevant financial factors while deciding bonus issues and observe the following guidelines issued by SEBI:

1. No bonus issue shall be made within 12 months of any public/ rights issue.

2. These guidelines are applicable to existing listed companies who shall forward to SEBI a certificate duly signed by the issuer company and duly countersigned by its statutory auditor or by a company secretary in practice to the effect that the terms and conditions for issue of bonus shares as laid down in these guidelines have been complied with.

3. Issue of bonus shares after any public/rights issue is subject to the condition that no bonus issue shall be made which will dilute the value or rights of the holders of debenture, convertible fully or partly.

4. The bonus issue is made out of free reserves built out of the genuine profits or share premium collected in cash only.

5. Reserves created by revaluation of fixed assets are not capitalised.

6. The declaration of bonus issue, in lieu of dividend, is not made.

7. The bonus issue is not made unless the partly-paid shares, if any existing, are made fully paid-up.

8. The company—
   - (*a*) has not defaulted in payment of interest or principal in respect of fixed deposits and interest on existing debentures or principal on redemption thereof, and
   - (*b*) has sufficient reason to believe that it has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity, bonus, etc.

9. A company which announces its bonus issue after the approval of the Board of Directors must implement the proposal within a period of six months from the date of such approval and shall not have the option of changing the decision.

10. There should be a provision in the Articles of Association of the company for capitalisation of reserves, etc., and if not, the company shall pass a Resolution at its General Body Meeting making provisions in the Articles of Association for capitalisation.

11. Consequent to the issue of bonus shares if the subscribed and paid-up capital exceed the authorised share capital, a Resolution shall be passed by the company at its General Body Meeting for increasing the authorised capital.

Payment of Interest out of Capital

Where any shares in the 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, the company may, (*a*) pay interest on so much of that share capital as is for the time being paid up; and (*b*) charge the sum so paid by way of interest to capital as part of the cost of construction of the work or building or the provision of a plant. [Sec. 208(1)]

No such payment shall be made unless it is authorised by the articles or by a special resolution. [Sec. 208(2)]

No such payment, whether authorised by the articles or by special resolution, shall be made without the previous sanction of the Central Government. (Sec. 208(3)]

The Central Government may hold an inquiry at the company's expense before granting the necessary sanction and may require security for the cost of the inquiry. (Sec. 208(4)]

Payment shall be made only for such period as the Central Government many determine. The period shall in no case extend beyond the close of the half year following the half year during which the work or building has been actually completed, or the plant provided. [Sec. 208(5)]

The rate of interest shall in no case exceed four per cent per annum or such other rate as the Central Government may, by notification in the Official Gazette, direct. [Sec. 208(6)]

The payment shall not operate as a reduction of the amount paid up on the shares in respect of which it is paid. [Sec. 208(7)]

This section does not affect any company to which the Railway Companies Act, 1895, or the Indian Tramways Act, 1902 applies.

QUESTIONS

1. Define dividend. State the provisions of the Companies Act, 1956, as to the declaration and payment of dividends.

2. "No dividend can be paid by a company except out of profits in the legal sense". Comment. *[Delhi, B.Com. (Hons.), 1975]*

3. Briefly explain the provisions relating to transfer of profit to reserves and declaration and payment of dividends out of profits and reserves. *[C.A. (Final), November 1976]*

4. Explain the meaning of dividend. What are the rules regarding payment of dividend? Can dividends be paid out of capital? *[Company Secretary (Final), December 1977]*

5. "A company can pay interest out of its capital". Comment. *[Delhi, B.Com. (Hons.). 1974]*

6. Define interim dividend. Under what circumstances is it declared? Can an interim dividend once declared be revoked?

7. Briefly explain the guidelines issued by the Government in regard to the issue of bonus shares. *[C.A. (Final), November 1976]*

PRACTICAL PROBLEMS

1. Examine the legality of the following:

The shareholders, in a duly convened annual meeting of a company, passed a resolution for payment of dividend at a higher rate than what was recommended by the Board of Directors. *[I.C.W.A., June 1974]*

2. Board of directors of a company proposed a dividend at Rs 5 per equity share. At the annual general meeting some shareholders suggested that the dividend should be declared at the rate of Rs 6 per equity share while some other shareholders suggested that the dividend should be declared at the rate of Rs 4 per equity share. Explain how the chairman of the meeting should deal with these suggestions. *[C.A. (Final), May 1977]*

3. Can an extraordinary general meeting of a company declare extra-dividend in addition to what has already been declared by the annual general meeting of the

company in relation to a particular year? Give reasons for your answer.

[*I.C.W.A, June 1975*]

4. Directors of a newly formed company puropose to pay interest out of capital. Advise the directors in respect of the above proposal in the light of the provisions of the Companies Act, 1956.

5. *A B* Limited owes an amount of Rs 5,000 to *R*, a shareholder, as unpaid dividend. *R* has not yet paid his calls on shares to the company to the extent of Rs 3,000 Can *A B* Limited set off the dividend amount towards the calls in arrears and pay the balance to *R*? [*C.A. (Final), May 1976*]

17

MAJORITY POWERS AND MINORITY PROTECTION

MAJORITY POWERS

SUPREMACY of the majority is the fundamental principle of company law. Generally, a majority of members of a company is entitled to exercise the powers of the company and generally to control its affairs. There is no doubt that directors enjoy wide powers in respect of controlling, directing and managing the affairs of a company but one must not forget the fact that directors are elected by majority shareholders. The Act lays down certain matters which can be decided by the shareholders at general meetings by simple majority, whereas certain more important matters can be decided by a special majority of three-fourth of the shareholders. It is, therefore, obvious that in the administration of the affairs of the company, it is the wish of the majority shareholders that prevails. Majority shareholders determine the fate of the company.

The Principle of Majority Rule

The principle of majority rule was recognised in *Foss v. Harbottle.*[1] In this case a suit was brought by two shareholders against the directors of the company. It was alleged by the shareholders that the directors were guilty of fraudulent and illegal acts which resulted in loss to the company. The shareholders filed the suit to recover damages from the directors for the loss caused on account of their acts. The company in general meeting had already resolved not to take any action against the directors. The suit was dismissed on ground that injury, if any, was injury to the corporation as a whole and not to the plaintiffs exclusively and therefore, action should have been brought by the corporation itself and not by the minority shareholders. Besides, the acts of the directors were such as could be confirmed by the majority shareholders.

The opinion of the court was: "The conduct with which the defendants

[1](1843) 2 Hare 461.

are charged is an injury not to the plaintiffs exclusively, it is an injury to the whole corporation. In such cases the rule is that the corporation should sue in its own name and in its corporate character. it is not a matter of course for any individual members of a corporation thus to assume to themselves the right of suing in the name of the corporation. In law the corporation and the aggregate of members of the corporation are not the same thing for purposes like this."

The principle laid down in *Foss. v. Harbottle* was stated by Mellish L.J. in *Macdougall v. Gardiner*[2] in these words: "If the thing complained is a thing which, in substances, the majority of the company are entitled to do, or something has been done irregularly which the majority of the company are entitled to do regularly or if something has been done illegally which a majority of the company are entitled to do legally, there can be no use in having litigation about it, the ultimate end of which is only that a meeting has to be called, and then ultimately the majority gets its wishes."

Similarly Lord Davery in *Burland v. Ealre*[3] observed as fallows: "It is an elementary principle of law relating to joint stock companies that the court will not interfere with the internal management of companies acting within their powers and has in fact no jurisdiction to do so. Again it is clear law that in order to redress a wrong done to the company or to recover moneys or damages due to the company, the action should *prima facie* be brought by the company itself."

Thus, where the managing agents were appointed by directors and their appointment was approved in the general meeting of shareholders, the court dismissed the suit filed against their appointment by minority shareholders who alleged that the managing agents company was a dummy and their appointment was not in the interest of the company. The court observed: "Ir is difficult to see how a few shareholders who represent a minority are entitled to maintain the suit and ask the court to interfere on the question as to who should be the managing agents of the company."[4]

In *Rajahmundry Electric Supply Corporation v. A. Nageshwar Rao,*[5] the same principle was repeated: "The courts will not, in general, intervene at the instance of the shareholders in matters of internal administration, and will not interfere with the management of a company by its directors so long as they are acting within the powers conferred on them under the

[2](1875) 1 Ch. D. 13.
[3](1920) A.C. 83 (P.C.)
[4]*Bhajekar v. Shinkar* A.I.R. 1934 Bomb. 243.
[5]A.I.R. (1956) S.C. 213.

articles of the company. Moreover, if the directors are supported by the majority shareholders in what they do, the minority shareholders can, in general, do nothing about it."

PROTECTION OF MINORITY SHAREHOLDERS

It becomes clear from the above discussion that it is the majority rule that prevails in company management. Such wide powers concentrated in their hands may be misused to exploit the minority shareholders and to serve their personal ends. The possibility of such domination will be even more in case of private companies where a majority of shares may be held by a few individuals. It is, therefore, rightly pointed out by Palmer that "a proper balance of the rights of majority and minority shareholders is essential for the smooth functioning of the company."[6]

In order to prevent the majority from misusing this privilege and at the same time to ensure justice to minority shareholders, certain exceptions to *Foss v. Harbottle* have been admitted, which are as follows:

(*i*) **Acts which are ultra vires or illegal.** It may be noted that the rule in *Foss v. Harbottle* will apply only when the act done by the majority is one which the company is authorised by its memorandum to do. Any act done by the majority beyond the object clause is *ultra vires* and it cannot be ratified even if every shareholder is willing to do so. In the case of *ultra vires* acts, even a single shareholder can restrain the company from committing those acts by filing a suit of injunction.

In *Bharat Insurance Company Ltd. v. Kanhya Lal,*[7] one of the objects of the company was to advance money at interest on security of land, houses, machinery and other property situtated in India. *K,* who was a shareholder of the company, complained that the company had made several investments without keeping in view the object clause of the company, that is, several investments were made without adequate security and contrary to the provisions of the memorandum. He prayed for an injunction to restrain the company from making such investments. Held, the suit was maintained.

Similarly the majority rule will not apply where the act in question is illegal.[8]

(*ii*) **Acts supported by insufficient majority.** For certain acts, the Act or the articles of the company require a special majority of three-fourths

[6]Palmer's *Company Law,* London, Stevens and Sons Ltd., 1959, (20th Ed.) p. 492.

[7]A.I.R. 1935 Lah. 792.

[8]*North West Transportation Co. v. Beatty* (1887) L.R. 12 App. Cas. 589.

of the shareholders. The rule in *Foss v. Harbottle* cannot be invoked to override these requirements by a resolution passed by a simple majority. If the requirements of a special majority are not fulfilled, any shareholder can restrain the company from acting on the resolution.[9]

(iii) **Where the act of majority constitutes a fraud on minority.** The rule in *Foss v. Harbottle* will not apply to such acts of majority which constitute a fraud on minority. Majority powers must be exercised *bona fide* for the benefit of the company as a whole. A resolution would constitute a fraud on minority if it is not *bona fide* for the benefit of the company as a whole. In such cases, the decision of the majority can be challenged by the minority.

Similarly, an action of the majority which discriminates between majority shareholders and minority shareholders would constitute a fraud of minority. "A special resolution would be liable to be impeached if the effect of it were to discriminate between the majority shareholders and minority shareholders, so as to give the former an advantage of which the latter were deprived."[10] The following cases would illustrate the concept of fraud on minority:

Menier v. Hooper's Telegraph Works Ltd.[11] In this case, companies A and B were in rivalry. The majority shareholders of company A were also the shareholders of company B. Company A had filed a suit against company B. Later, shareholders of company A passed a resolution to compromise the action against company B in such a manner that the terms of compromise were favourable to company B and unfavourable to company A. The minority shareholders questioned the power of the majority to make the said compromise and the court set aside the same. It observed: "It would be a shocking thing, if that could be done.... then the majority have put something in their pockets at the expense of the minority."

Cook v. Deeks.[12] In this case the directors of a railway construction company obtained a contract in their own names to construct a railway line. The contract was obtained under circumstances which amounted to breach of trust by the directors who then used their voting powers to pass a resolution of the company declaring that the company had no interest in the contract. It was held that the benefit of the contract belongs in equity to the company and that the directors could not benefit themselves at the expense of the minority. If it were not checked, this would be tantamount to allowing a majority to oppress the minority.

[9] *Nagappa Chettiar v. Madras Race Club* (1949) 1 M.L.J. 662.
[10] *Greenhalf v. Arden Cinemas Ltd.* (1951) 1 Ch. 286.
[11] (1874) 9 Ch. App. 350.
[12] 1916 A.C. 544.

Brown v British Abrasive Wheel Co.[13] The majority shareholders holding ninety-eight per cent of the shares were willing to subscribe further capital which the company badly needed, but only if they were able to acquire the shareholdings of the minority. They passed a special resolution to alter the articles to enable them to purchase the minority shares compulsorily on certain terms. The plaintiff refused to sell its shares and challenged the validity of the majority resolution. It was decided that the alteration was not for the benefit of the company but for the benefit of the majority and accordingly an injunction was granted against the company prohibiting it from carrying out the resolution.

But a resolution of the majority shall be valid and binding if it is *bona fide* for the benefit of the company as a whole even if it is detrimental to the interests of a single shareholder or minority shareholders. In *Sidebottom v. Kershaw, Leese & Co. Ltd,*[14] the alteration of the articles empowered the directors to require any member, who carried on a business competing with that of the company, to sell his shares at a fair price to persons nominated by the directors. The validity of the resolution was challenged on the ground that the alteration will not be for the benefit of the company as a whole. "If the company as a whole means the whole body of corporators and every individual corporator and if one of them has detriment occasioned to him by the alteration it cannot be for the benefit of the company as a whole."

The court held that it was in the interest of the company as a whole to be protected against competition, and upheld the resolution. The court was of the view that the company as a whole means the corporators as a general body. Individual interests might have to be sacrified. In this case it was very much in the interest of the company as a whole to get rid of such members who were carrying on a competing business, as they always had the chance to exploit the company's secrets for their personal benefit and at its cost.

(*iv*) **Where it is alleged that the personal membership rights of the plaintiff shareholder have been infringed.** Every shareholder has individual membership rights against the company, conferred either by the Companies Act or the articles of the company. Such individual membership rights include the right to attend meetings, the right to receive dividends, the right to insist on strict observance of the legal rules, statutory provisions in the memorandum and articles, etc. If such a right is in question, a single shareholder can, on principle, defy a majority consisting of all other shareholders. The rule in *Foss v. Harbottle*

[13] 1919 1 Ch. 290.
[14] (1920) 1 Ch. 154.

has no application so far as these individual membership rights are concerned. If any individual's membership right is infringed, he can sue in his own name, and this right of action is unaffected by any decision of the majority.

Thus, where the chairman of a meeting at the time of taking a poll ruled out certain votes which should have been included, a suit by the shareholder concerned was held to be validity filed.[15]

Again, where the candidature of a shareholder for directorship is rejected by the chairman, it is an individual wrong in respect of which a suit is maintainable.[16]

(*v*) **Wrongdoers in control.** The general rule is that for a wrong done to a company, the company itself must sue and must act through its majority shareholders. However, the shareholders can sue in their own names if (*a*) a majority of shares are controlled by those against whom relief is sought and will not allow a suit to be brought in the name of the company, (*b*) the act complained of is either (*i*) *ultra vires* the company, or (*ii*) where the majority in law cannot bind the minority or (*iii*) where the act complained of is a fraudulent one having the effect of depriving the company of property or affecting its financial resources. The idea is that if minority shareholders were denied this right, their grievance could never reach the court because the wrongdoers themselves, being in control, would not allow the company to sue.

(*vi*) **Oppression and mismanagement.** The majority rule will not apply when the provisions of Section 397 and 398 are applicable to protect the minority in the case of oppression and mismanagement. These provisions are discussed in the next chapter.

QUESTIONS

1. "Majority must prevail" is the principle of company management. Explain the exceptions to this rule. [*Delhi, B.Com. (Hons.), 1972*]

2. Explain the rule of supremacy of the majority of shareholders with all its exceptions. [*Delhi, B.Com. (Hons.), 1974*]

3. Explain the principle of "majority rule". Are there any exceptions? Discuss them. [*Delhi, B.Com. (Hons.), 1976*]

4. Elucidate the rule of supermacy of majority of the shareholders and exceptions to the rule. [*Company Secretary, (Inter) October, 1974*]

5. "It is a cardinal rule of corporation law that a majority of its members is entitled to exercise the powers of the corporation and generally to control its operation." What are the qualifications subject to which this statement must be received? [*C.A. (Final), May 1977*]

[15]*Pender v. Lushington* (1877) 6 Ch. D. 70.
[16]*Joseph v. Jos.*, (1964) 1 Comp. L.J. 105.

PRACTICAL PROBLEMS

1. The minority shareholders in a company took legal proceedings against the directors to compel them to make good the loss sustained by the company by reason of their fraudulent acts. Will they succeed?

2. The directors of a company decided to apppoint a company as managing agents and their appointment was approved in the general meeting of shareholders. The minority shareholders challenged the appointment on the ground that the managing agents company was a dummy company and their appointment was not in the interest of the company. Decide.

3. A company was in great need of further capital. The majority representing 98% of the shares were willing to provide the capital if they could buy up the 2% minority. The majority passed a resolution altering the articles and enabling them to purchase the minority shares. The minority shareholders refused to surrender their shares and challenged the validity of the majority resolution. Decide.

4. The majority of the shareholders of a company passed a special resolution to alter its articles of association and give the directors a power to require any shareholder who competed with the company's business to transfer his shares. The plaintiff who carried on a competing business challenged the validity of the alteration. Give your decision on this point. [*I.C.W.A., December, 1976*]

5. Directors of a railway construction company obtained a contract in their own names. The contract was obtained under circumstances which amounted to breach of trust by the directors. By their votes as holders of three-fourth of the shares, they induced the company to pass a resolution declaring that it has no interest in the contract. Can the minority shareholders hold the directors liable to account for the profit made on the contract?

6. It was proposed to elect some directors by separate elections at a meeting of a company. *J* was a candidate and he contested the election, but he was defeated. His name was proposed again to fill up the second vacancy. But the chairman rejected his name on account of his previous defeat. *J* challenges the proceedings of the meeting regarding election of directors. Decide.

18

PREVENTION OF OPPRESSION AND MISMANAGEMENT

WITH a view to providing an alternative remedy to winding up in case of mismanagement of the affairs of the company and oppression of the minority shareholders in course of the management of the company, Sections 397 to 409 of the Companies Act, 1956, lay down specific provisions. The aim of these provisions is to protect the interest of investors in joint stock companies and also to safeguard the public interest. In effect, these provisions place a limitation on the rule of supremacy of the majority and empower the Company Law Board and the Central Government to intervene in the internal management of the company for preventing oppression and mismanagement.

Application to the Company Law Board for Relief in Cases of Oppression

Section 397 lays down that when the affairs of the company are being conducted in a manner prejudicial to public interest or in manner oppressive to any member or members, an application may be made to the Company Law Board for appropriate relief.

If oppression of this kind is established, the Company Law Board may, with a view to bring to an end the matters complained of, make such an order as it thinks fit.

Requirements for relief in cases of Opression. For claiming relief under Section 397, the following conditions must be satisfied:

(1) **Meaning of Oppression.** Simply speaking, oppression refers to an act performed in a burdensome, harsh and wrongful manner. In other words, to prove oppression the complaining shareholder must be under a burden which is unjust or harsh or tyrannical. "A persistent and persisting course of unjust conduct must be shown."[1]

Lord Cooper observed in *Elder v. Elder and Watson Ltd.*,[2] as follows:

[1]*Re H.R. Harmer Ltd.* (1958) 3 All E.R. 689.
[2]1952 S.C. 49

"The essence of the matter seems to be that the conduct complained of should at the lowest involve a visible departure from the standards of fair dealing and a violation of the conditions of fair play on which every shareholder who entrusts his money to the company is entitled to rely."

"Oppression involves at least an element of lack of probity or fair dealing to member in the matter of his proprietory right as a shareholder. Persons concerned with the management of the company's affairs must in connection therewith be guilty of fraud, misfeasance or misconduct towards the members. It does not include mere domestic disputes between directors and members or lack of confidence between one section of members and another section in the matter of policy or administration. Much less it covers mere private animosity between members and directors.[3]

(2) **Oppression upon member as a member.** Oppression must be upon members in their capacity as members and not in any other capacity.[4]

(3) **Oppression must justify winding up.** Oppression must be of such a nature as would justify the making of a winding up order on the ground that it is just and equitable that the company should be wound up but that such winding up would unfairly prejudice such oppressed member or members. If this is proved, the court may, with a view to bring to an end the matters complained of, make such an order as it thinks fit.

(4) **Oppression must be of continuing nature.** Isolated acts of oppression will not normally be sufficient to justify relief under Section 397. The words "are being conducted" suggest that oppression must be a continuing process. There must be continuous acts on the part of the majority shareholders, continuing upto the date of petition, showing that the affairs of the company were being conducted in a manner oppressive to some part of the members.[5]

Acts held oppressive. Where the majority shareholders tried to force an unwilling minority to invest their money in new and more risky objects after nationalisation of life insurance business of the company, it was held that this amounted to oppression on the minority.[6] Oppression was also established where the majority shareholders of a company engaged in forward contract business, altered its articles and thereby deprived its non-trading members of the right to vote, to call meetings, to elect directors and receive dividends.[7]

[3]*Kalinga Tubes Ltd. v. Shanti Prasad Jain* (1964) 1 Comp. L.J. 117.
[4]*Elder v. Elder and Watson Ltd.*, (1952) S.C. 49.
[5]*Shanti Prasad Jain v. Kalinga Tubes Ltd.*, A.I.R. (1965) S.C. 1935.
[6]*Re Hindustan Co-operative Society Ltd.* (1961) A.I.R. Cal 443.
[7]*Mohan Lal Chandu Mal v. The Punjab Co. Ltd.* (1961) A.I.R. Punj. 485.

Unreasonable conduct of directors of a private company in refusing, due to their private disputes with the petitioners, to register transfer of some shares in the name of the shareholder's widow though they had transferred to their own names some of the shares as provided under the will, involves the violation of the conditions of fairplay and amounts to oppression.[8]

Where the company's interest is being seriously prejudiced by the activities of one or the other group of shareholders, two different registered offices have been set up at two different addresses, two rival boards holding meetings, the company's business, property and assets have passed to the hands of unauthorised persons who have taken wrongful possession and who claim to be the shareholders and directors, it was held to be oppression of the majority by a minority and an order was made by the court under this section.[9]

Acts held not oppressive. Mere inefficiency on the management does not establish oppression or mismanagement. Thus, where it was alleged that the managing director had been unwise, inefficient and careless and the controlling shareholders had failed to exercise their control to curtail his damaging activities, it was held by the court that oppression had not been established since the managing director had not acted unscrupulously, unfairly or with any lack of probity, and mere acts of the controlling shareholders were not designed to achieve some unfair advantage.[10]

Similarly, a petition under this section which was brought for the collateral purpose of forcing the repayment of loans of other companies in which the petitioner was interested and not with the genuine object of obtaining relief under the section, was dismissed on the ground that it was nothing but an abuse of the process of the court.[11]

Oppression must be upon members in their capacity as members and not in any other capacity. Thus, a petition filed by the shareholders where they complained that they had been wrongfully removed from office as a director and from their employment as a secretary and factory manager was not entertained under Section 397 of the Companies Act, 1956. The court held that no case of oppression suffered by petitioners as members was made out.[12]

In another case it was held that mere illegal or irregular acts would not

[8]*Gajarabai (Mrs.) v. Patni Transport (P) Ltd.* (1966) A.I.R. Andhra 226.

[9]*In re Sindhri Iron Foundry (P) Ltd.* (1963) 68 C.W.N. 118.

[10]*Re Five Minute Car Wash Service Ltd.* (1966) 1 W.L.R. 745.

[11]*Re Bellador Silk Ltd.* (1966) 1 All E.R. 677.

[12]*Elder v. Elder and Watson Ltd.*, (1953) S.C. 49.

amount to oppression unless they are proved oppressive or prejudicial to the interests of the company or public interest.[13] Again oppression not relating to the company's affairs but directed towards a third person will not be covered under this section.[14] Similarly, denial of the rights of inspection of the books of acount of the company to the shareholders and the declaration of dividends below the actual profits could not be held to be the acts of oppression.[15]

Application to the Company Law Board for Relief in Cases of Mismanagement

Section 398 lays down that the requisite number of members may apply to the Company Law Board for relief on the ground of mismanagement of the affairs of the company. The petitioner must establish (*a*) that the affairs of the company are being conducted in a manner prejudicial to the public interest or the interests of the company; or (*b*) that a material change has taken place in the management or control of the company and that by reason of such a change, it is likely that the affairs of the company will be conducted in a manner prejudicial to the public interest or to the interest of the company. Such change may take place due to alteration in the company's board of directors or in the ownership of its shares or in its membership.

After considering the application, the Company Law Board may make such order as it thinks fit to bring to an end or prevent the matters complained of or apprehended.

In *Rajahmundry Electric Supply Corporation v. A. Nageshwara Rao,*[16] a petition was filed against the company by certain shareholders on the ground of mismanagement by directors. The court made a through enquiry and found that considerable amounts had been drawn by the vice-chairman for his personal use, large sums were owing to the Government, machinery was lying in state of disrepair and, moreover, that shareholders outside the vice-chairman's group were not powerful enough to set things rights. All these facts clearly stated a position of mismanagement and the court appointed two administrators for a period of six months to manage the affairs of the company and vested in them all the powers of the board of directors.

Inefficient management may also amount to mismanagement so as to

[13]*Seth Mohanlal Ganpatram v. Shri Sayaji Jubllee Cotton and Jute Mills Co., Ltd.* (1964) 1 Comp. L.J. 326.

[14]*Kanika Mukherji v. Rameshwar Dayal Dubey* (1966) 1 Comp. L.J. 65.

[15]*Lalita Rajya Lakshmi v. Indian Motor Co. Ltd.* A.I.R., (1962) Cal. 27.

[16]A.I.R. (1956) S.C. 213.

come under Section 398.[17] Further, the mismanagement must have existed and continued at the time of the application. The charges of mismanagement in the past but not in existence at the time of petition cannot be a ground of petition under Section 398.[18]

The concept of public interest takes the company outside the conventional sphere of being a concern in which the shareholders alone are interested. It emphasises the idea of the company functioning for the public good or general welfare of the community.[19] Accordingly, the court refused to wind up a grossly mismanaged company and appointed special officers to manage its affairs because the company was engaged in industries vital for the country's development.[20]

Parties Entitled to Apply to the Company Law Board for Relief

The following persons may apply to the Company Law Board for relief in case of oppression or mismanagement under Sections 397 and 398:

(*i*) In the case of a company having a share capital, not less than one hundred members of the company or not less than one-tenth the total number of members, whichever is less, or any member or members holding not less than one-tenth the issued share capital of the company provided that the applicant or applicants have paid all calls and other sums due on their shares.

(*ii*) In the case of a company not having a share capital, not less than one-fifth the total number of its members. [Sec. 399(1)]

(*iii*) The Central Government may authorise any member or members of the company to apply to the Company Law Board for an order even though their number is less than the requisite number mentioned in clause (*i*) or (*ii*). The Central Government may do it if in its opinion the circumstances exist which make it just and equitable to do so. [Sec. 399(4)]

The applicants to be entitled to apply must have paid all calls or other money due on their shares. All joint holders of shares are to be counted as one member. Moreover the preference shareholders may also apply for the appropriate relief since there is nothing to limit the right to apply under Section 397 or 398 of members holding equity shares only. [Sec. 399(2)]

Where any members of a company are entitled to make an application,

[17]*Kanika Mukherji v. Rameswar Dayal Dubey* (1966) 1 Comp. L.J. 65.

[18]*R.S. Mathur v. H.S. Mathur* (1970) 1 Comp. L.J. 35.

[19]*N.R. Murty v. Industrial Development Corporation of Orissa* (1977) 47 Comp. Cas. 389.

[20]*Richardson and Curddas Ltd. v. Haridas Mundra* (1959) 29 Comp. Cas. 547.

anyone or more of them may make the application on behalf and for the benefit of all of them after obtaining the consent of the rest in writing. [Sec. 399(3)]

(*iv*) The Central Government may itself apply for an order or cause an application to be made by any person authorised by it in that behalf. (Sec. 401)

Prior consent. In this connection it is important to note that the consent must have been obtained prior to the presentation of the application. A consent given subsequent to the presentation of application is not valid.[21]

Withdrawal of consent. When some members, after giving their cconsent for an application for relief under Section 397 or 398, withdraw their consent, this will not affect the right of applicant to proceed with the application.[22]

Nature of relief sought. The petition should state in clear terms the nature of relief sought.[23] A composite petition may be presented by the minority shareholders seeking relief under both Sections 397 and 398 provided the rights claimed are not conflicting.[24]

It has also been held that the relief under Section 397 and 398 is an alternative to an order for winding-up. Therefore, a composite petition for an order for winding-up the company and in the alternative for a relief under Sections 397 and 398 is maintainable if winding-up is sought on the ground that it is just and equitable to wind up the company.[25]

Oppressed majority can also seek relief. In another case, it was held that it is not only the oppressed minority which can apply to the court for relief, rather an oppressed majority may also apply if it is rendered completely ineffective by the wrongful acts of the minority group.[26]

Notice to Central Government. Under Section 400, the Company Law Board shall give notice of every application made to it under Section 397 or 398 to the Central Government and shall take into consideration the representations, if any, made to it by that Government before passing a final order.

Powers of the Company Law Board

Powers of the Company Law Board under Sections 397 and 398 are

[21]*Makhan Lal Jain v. The Amrit Banaspati Co. Ltd.* A.I.R. (1953) All. 326.

[22]*Rajahmundry Electric Supply Corporation v. A. Nageshwara Rao,* A.I.R. (1956) S.C. 213.

[23]*Re Antigen Laboratories Ltd.,* (1951) 1 All E.R. 110.

[24]*Sarab Dinshaji Dastoor v. D.R. Carrad* (1962) 64 Bom. L.R. 765.

[25]*Navnital M. Shah v. Atul Drug House Ltd.,* (1977) 47 Comp Cas. 136.

[26]*In re Sindhri Iron Foundary (P) Ltd.* (1963) 69 C.W.N. 118.

very wide. Instead of destroying the corporate existence of a company, the Company Law Board has been enabled to continue its corporate existence by passing such order as it thinks fit to do justice in all the circumstances of the case. According to Section 402, the Company Law Board order may provide for:

(*i*) regulation of the conduct of the company's affairs in future;

(*ii*) the purchase of the shares or interests of any member of the company by other members or by the company;

(*iii*) in the case of a purchase of its shares by the company, the consequent reduction of its share capital;

(*iv*) the termination, setting aside or modification of any agreement between the company and the managing director, any other director and the manager upon such terms and conditions as it may think just and equitable;

(*v*) the termination, setting aside or modification of any agreement with any person [not referred in clause (*iv*)] provided due notice has been given to the party concerned and his consent obtained;

(*vi*) the setting aside of any fraudulent preference made by the company within three months before the date of application under Section 397 or 398;

(*vii*) any other matter for which, in the opinion of the court, it is just and equitable that provision should be made.

Interim order. Under Section 403, the Company Law Board has wide discretionary powers to make an interim order which it thinks fit for regulating the conduct of the company's affairs upon such terms and conditions as appear to it to be just and equitable.

Effect of alteration of memorandum or articles. Where the Company Law Board orders any alteration in the memorandum or articles of a company, in future the company shall have no power to make any alteration in the memorandum or articles that is inconsistent with the Company Law Board order except by the leave of the Company Law Board. (Sec. 404)

Consequences of removal of managerial personnel. Where an order of the Company Law Board terminates, sets aside or modifies any agreement between the company and managing director, or any other director or manager, it will not give rise to any claim for damages or compensation for loss of office or in any other respect. Further, no managing director or other director or manager whose agreement is so terminated or set aside shall be capable of being appointed as the managing director or other director or manager of the company for a period of five years without the leave of the Company Law Board. (Sec. 407)

Powers of the Central Government

In order to prevent the oppression or mismanagement, the Central Government may exercise the following powers:

Power to appoint directors. The Central Government has the power to appoint such number of directors on the board of directors of a company as the Company Law Board may direct, in order to safeguard the interest of the company, its members and public interest. Such directors shall be appointed for a period not exceeding three years at a time. The Company Law Board may pass the above order on a reference made to it by the Central Government or on the application of at least one hundred members of the company or members holding at least one-tenth of the total voting power therein. The Company Law Board shall make such inquiry as it deems fit in order to find out whether the appointment of directors by the Central Government is necessary to prevent affairs of the company being conducted either in a manner which is oppressive to any members of the company or in a manner which is prejudicial to the interests of the company or to public interest.

Alternatively, the Company Law Board may direct the company to amend its articles so as to adopt the system of proportional representation for the appointment of directors under Section 265 and make fresh appointments in pursuance of the amended articles within the specified time. [Section 408(1)]

Till the new directors are appointed as aforesaid, the Company Law Board may direct the Central Government to appoint such number of additional directors as may be specified by it to effectively safeguard the interest of the company, its members and public interest. [Sec. 408(2)]

For the purpose of reckoning two-thirds or any other proportion of the total number of directors of the company, any director or directors appointed by the Central Government under the above provisions shall be taken into account. [Sec. 408(3)]

Any directors appointed by the Central Government shall not be required to hold any qualification shares nor shall they be liable to retire by rotation. But any such director may be removed from office by the Central Government at any time and another person may be appointed by the Government in his place to hold office as a director. [Sec. 408(4)]

After the appointment of directors by the Central Government, no change in the board of directors shall have effect unless confirmed by the Company Law Board. [Sec. 408(5)]

Where the Central Government appoints a person to hold office as director, it is empowered to issue such directions to the company as it considers necessary or appropriate with regard to its affairs. Such directions may include directions to remove an auditor already appointed

and to appoint another auditor in his place or to alter the articles of the company. Such removal, appointment or alteration shall have effect as if the requirements of the Act have been complied with. [Sec. 408(6)]

The Central Government may also require the persons appointed as directors to report to the Central Government from time to time with regard to the affairs of the company. [Sec. 408(7)]

Power to prevent change in the board of directors. Section 409 empowers the Company Law Board to prevent any change in the board of directors which is likely to affect prejudicially the affairs of the company. The managing director or any other director or the manager of the company may complain to the Company Law Board that as a result of change which has taken place or is likely to take place in the ownership of any shares of the company, a change in the board of directors is likely to take place and such change would affect prejudicially the affairs of the company and pray for necessary relief. After making such enquiry as the Company Law Board thinks fit, it may direct that no change in the board of directors after the date of complaint shall have effect unless confirmed by it.

This section is not applicable in the case of an independent private company.

QUESTIONS

1. State briefly the law relating to the prevention of oppression and mismanagement in the Companies Act, 1956. [*Delhi, B.Com. (Hons.), 1971*]

2. How does the Companies Act provide for prevention of oppression and mismanagement? [*Delhi, B.Com. (Hons.), 1986*]

3. To what extent does the Companies Act, 1956, protect minority shareholders against oppression and mismanagement? [*Delhi, M.Com., 1978*]

4. 'Majority will have its way but the minority must be allowed to have its say.' Discuss it with reference to oppression and mismanagement in a Company. [*Delhi, M.Com., 1976*]

5. Critically examine the provisions of the Companies Act, 1956, regarding oppression and mismanagement. [*Delhi, M.Com., 1977*]

6. "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." Examine this statement with reference to the provisions of the Companies Act relating to the prevention of oppression and mismanagement by the Court. [*I.C.W.A., January 1970*]

7. Summarise the powers conferred by the Companies Act, 1956 on the court, to prevent oppression and mismanagement. [*Delhi, B.Com. (Hons.), 1984*]

PRACTICAL PROBLEMS

1. (*a*) *A*, a shareholder, filed a petition complaining that the affairs of *XY* Co. Ltd. were conducted in a manner oppressive to him and to other members, after having obtained the written consent of one-tenth of shareholders. Some of these shareholders later withdrew their consent and as a consequence, the number of members fell below one-tenth. Can *A* proceed with his petition in the Company Law Board? (*b*) Indicate also, whether it was necesary for *A* in this case to show circumstances justifying the winding up of the company for an order by the Court.

2. A director of a public company apprehends that as a result of change in the ownership of the shares held in the company, a change will occur in the Board of Directors which would affect prejudicially the company's affairs. Advise him.

[*C.A. (Final), November 1973*]

3. A petition is filed in the Company Law Board under Sec. 397 by the two shareholders of a company. They allege that they have been wrongfully removed by the majority from their employment as Secretary and Factory Manager. Decide.

4. A dispute arose between two groups of directors of a company, one of which controlled majority of shares. The majority group applied to the Company Law Board for relief under Sections 397 and 398. The petition alleged that the minority group had taken possession and control of the management of the company's factory and workshop. The minority group had also taken possession of books of account and statutory books and consequently the profit and loss account could not be prepared for last two years. The majority group alleged that it had been rendered absolutely powerless and ineffective by reason of the wrongful and *ultra vires* activities of the rival group of minority shareholders. Decide whether the Company Law Board can consider the petition presented by the majority group.

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INVESTIGATIONS

IT has always been the intention of company law to prevent the exploitation of innocent members or creditors by dishonest and unscrupulous directors. For this purpose the Companies Act, 1956 provides for investigating the affairs of companies, and wide powers have been given to the Central Government for it. Sections 235 to 250 lay down provisions in this respect.

The importance of investigations is beatifully stated in the following words:

"There is no doubt that few shareholders have the means or ability to act against the management. It would furthermore be difficult for the shareholders to find out the facts leading to the poor financial condition of a company. The Government thought it right to take power to step in where there was reason to suspect that the management may not have been acting in the interests of the shareholders... and to take steps for the protection of such interests."[1]

Appointment of Inspectors by Central Government

The Central Government may appoint one or more competent persons as inspectors to investigate the affairs of a company and report thereon in the following cases:

(1) On members' application. An application for conducting investigation into the affairs of the company may be made by the number of members specified below:

(*a*) in the case of a company having a share capital, at least two hundred members or members holding not less than one-tenth of the total voting power;

(*b*) in case of a company not having a share capital, at least one-fifth of the company's members.

Section 235, as amended by the Companies Amendment Act, 1988, provides that the members shall make the above application to the

[1]*Barium Chemicals Ltd. v. The Company Law Board* (1966) 2 Comp. L.J. 151 p. 161 (S.C.)

Company Law Board. The Company Law Board shall give the parties an opportunity of being heard before declaring that the affairs of the company ought to be investigated. On such a declaration being made by the Company Law Board, the Central Government shall appoint one or more competent inspectors to investigate the affairs of the company and to report thereon. (Sec. 235)

When members apply for investigation, they must support their application 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. The Central Government may also require the applicants to give security for such amount not exceeding one thousand rupees for payment of the costs of the investigation. (Sec. 236)

(2) On a report by Registrar. In the case of any company, on a report by the Registrar under Section 234. The Registrar will make such a report in the following circumstances:

(*a*) if the information or explanation required by the Registrar in relation to any document submitted to him is not furnished by the company within the specified time; or

(*b*) if he is of the opinion that the documents and papers produced or information and explanations supplied disclose an unsatisfactory state of affairs or they do not disclose a full and fair statement of the matter to which they purport to relate; or

(*c*) if any contributory or creditor or any other person interested in the company has represented to him that the business of the company is being carried on in fraud of its creditors or persons dealing with the company or otherwise for a fraudulent or unlawful purpose.

It is important to note that it is not obligatory for the Central Government to order an investigation in the above two cases. The power conferred on the Central Government is a discretionary power.

(3) On the company's own initiative. Where the company itself, by passing a special resolution, requires its affairs to be investigated: [Sec. 237(a)]

(4) On the court's order. Where the court by its order declares that the affairs of the company ought to be investigated: [Sec. 237(a)]

The power of the Central Government under Section 237(a) is obligatory and not a discretionary one.

(5) On the Company Law Board's own intiative. Whenever the Company Law Board is of the opinion that there are circumstances suggesting:

(*a*) that the business of the company is being conducted with the intent to defraud its creditors, members or any other persons or otherwise for a fraudulent or unlawful purpose or in a manner oppressive

to any of its members; or

(*b*) that the company was formed for any fraudulent or unlawful purpose; or

(*c*) that the persons concerned in the formation of the company or the management of its affaris have been guilty of fraud, misfeasance or misconduct towards the company or any of its members; or

(*d*) that the members of the company have not been given all the information with respect to its affairs which they were entitled to receive under various provisions of the Act. [Sec. 237(b)]

The power conferred on the Central Government under Section 237(b) is a discretionary power.

Before ordering an investigation, the Central Government must satisfy that the circumstances, as specified in Section 237(b) exist. The Central Government does not have a general discretion to go on a fishing expedition to find evidence. In the connection it is important to note the facts of the leading case of *Barium Chemicals Ltd. v The Company Law Board.*[2]

In this case the chairman of the Company Law Board ordered for the investigation of the affairs of the appellant company under Section 237(b) on the grounds that there was delay, bungling and faulty planning of the project entailing double expenditure, continuous losses resulting in one-third the share capital being wiped out, shares being quoted at half their face value and severance of their connection by some eminent persons.

It was held by a majority judgement of the Supreme Court that the said circumstances cannot by themselves suggest either an intent to defraud or fraudulent management, and that, therefore, the order for investigation must be quashed.

Similarly, where the management of a company acquired the shares of Rs 10 each of subsidiary at a premium of Rs 100 and gave them to its members in lieu of cash dividends and made a loan of huge sum to its subsidiary at two percent interest, it was held that through the above transactions may not be justified by commercial expediency but they were not suggestive of any fraud so as to justify any order of investigation.[3]

In a recent case, it was held that the purpose of investigation is to discover something which is not apparently visible to the naked eye. The purpose of Section 237 is not an investigation being made into the economic functioning of a company, unless there is a material to show that fall of profits is on account of illegal acts. Appointments of directors' relatives to high positions and high salaries cannot be a ground for

[2](1966) 2 Comp. L.J. 151 (S.C.)

[3]*Jiyajeerao Cotton Mills v. Company Law Board,* (1969) 2 Comp. L.J. 380.

ordering investigation.[4]

Inspectors

No firm, body corporate or other association shall be appointed as an inspector. Only an individual can be appointed as an inspector to investigate the affairs of a company. (Sec. 238)

Powers of Inspectors

Sections 239 and 240 define the powers of the inspectors appointed to investigate the affairs of the company.

(1) *To investigate the affairs of related companies.* An inspector appointed to investigate the affairs of a company has the power to investigate also the affairs of other connected companies such as its subsidiary and holding companies and companies under the same management or group. [Sec. 239(1)]

But in some cases the inspector has to obtain the prior approval of the Central Government for this purpose. Before according this approval to inpectors, the Central Government must give the body corporate a reasonable opportunity to show cause why such approval should not be accorded. [Sec. 239(2)]

(2) *To obtain records and assistance from company's officers.* It shall be the duty of all officers and other employees and agents of the company to preserve and to produce before the inspector all books and papers which are in their custody or power, and to give to the inspector all assistance in connection with the investigation which they are reasonably able to give. [Sec. 240(1)]

(3) *To obtain necessary information from anybody corporate.* The inspector may, with the previous approval of the Central Government, require any body corporate to furnish such information or to produce such books and papers which he may consider necessary and relevant for the purpose of his investigation. [Sec. 240(1A)]

(4) *To keep records in custody.* The inspector may keep in his custody any books and papers for six months. After the expirty of six months, he should return the books to the persons from whom they were taken. However, the inspector may call for the books and papers if they are needed again. [Sec. 240(IB)]

(5) *To examine company's officials on oath.* An inspector may examine on oath any of the officials and other employees and agents of the company whose affairs he is investigating, and, with the previous approval of the Central Government, he may examine on oath any other

[4]*In re Delhi Flour Mills Ltd.*, (1975) 45 Comp. Cas. 33.

person. For this purpose the inspector may require any of those persons to appear before him personally. [Sec. 240(2)]

Notes of any examination shall be taken down in writing. It shall be read over to the person examined and signed by him and may thereafter be used in evidence against him. [Sec. 240(5)]

(6) *To seize company's records.* Where the inspector has reasonable ground to believe that the relevant papers or books may be destroyed, mutilated, altered, falsified or secreted, the inspector may make an application to a Magistrate for an order for the seizure of such books and papers. The order may authorise him to enter the place where such books and papers are kept, to search the place and to seize the books and papers he considers necessary for the purpose of his investigation. At the conclusion of the investigation, the inspector must return the papers and books and inform the Magistrate of such return. (Sec. 240A)

Inspector's Report

The inspector shall make a final report to the Central Government on the conclusion of the investigation. The Central Government may also direct him to submit interim reports from time to time. Any such report shall be written or printed, as the Central Government may direct. A copy of the report must always be forwarded to the company at its registered office, and also to any body corporate, managing director or manager dealt with in the report.

In case the inspectors have been appointed at the request of members of the company, a copy of the report shall be supplied to them

Where the inspectors are appointed in pursuance of an order of the court or the Company Law Board, a copy of the report shall be forwarded to the court or the Company Law Board.

The Central Government may, if it thinks fit, furnish a copy of the report to any interested person on request and on payment of a prescribed fee.

The Central Government may also cause the report to be published. (Sec. 241)

However, as a matter of administrative practice, a copy of the report is always sent to the Registrar for filing with the company's file.

It is important to note that an inspector's report is not a judgement. It states the opinion of the inspectors in respect of the affairs of the company. However, the Central Government may utilise it for its own information. The report does not operate against the company of its own force.[5] Where the Central Government has fixed the time for submitting

[5]*New Central Jute Mills. v. Deputy Secretary* 70(C.W.N.) 280.

the report, failure to submit the report within the time so fixed will not automatically put an end to the investigation.[6]

Powers of the Government on the Basis of Inspectors' Reports

(1) *Prosecution.* If it appears to the Central Government that any person has been guilty of an offence for which he is criminally liable, it may presecute such person for the offence. It shall be the duty of all officers and other employees and agents of the company to give the Central Government all assistance in connection with the prosecution, that they are reasonably able to give. (Sec. 242)

(2) *Application for winding up a company or an order under Section 397 or 398.* The Central Government may, on the basis of a report, apply to the court for winding up the company or make an application for prevention of oppression and mismanagement under Sections 397 and 398, or may do both. (Sec. 243)

(3) *Proceedings for recovery of damages or property.* Where from any such report, it appears to the Central Government that proceedings ought to be brought by the company in public interest (*a*) for the recovery of damages in respect of fraud, misfeasance or other misconduct in connection with the promotion or formation or the mismanagement of the affairs of such a company; or (*b*) for recovery of any property misapplied or wrongfully retained, the Central Government may itself bring proceedings for that purpose in the name of such a company. (Sec. 244)

Expenses of Investigation

The expenses of investigation shall be defrayed in the first instance by the Central Government, but the following persons shall be liable to reimburse the Central Government in respect of such expenses:

(*i*) any person who is convicted on a prosecution or who is ordered to pay damages or restore the property in pursuance of the report;

(*ii*) any company or body corporate in whose name the proceedings are brought;

(*iii*) any company or body corporate or any other managerial personnel dealt with by the report; and

(*iv*) the applicants for the investigation, where an inspector was appointed on the application of members of the company.

Insofar as the expenses to be defrayed by the Central Government are not recovered, they shall be paid out of the moneys provided by Parliament. (Sec. 245)

[6]*Ashoka Marketing Ltd. v. Union of India* A.I.R. 1967 Cal. 159.

Investigation of Ownership of Company

Section 247 of the Companies Act provides that where there is good reason to do so, the Central Government 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 succes or failure of the company; or (*b*) who are or have been able to control or materially influence the policy of the company.

The Central Government is also bound to appoint inspectors at the instance of the Company Law Board when the Company Law Board, in the course of any proceedings before it, declares by an order that the affairs of the company should be investigated as regards the membership of the company for the purpose of determining the true persons who are financially interested in the company or who are controlling the policy of the company.

When appointing an inspector, the Central Government will define the scope of his investigation.

Powers of inspector. Subject to the terms of an inspector's appointment, his powers extend to the investigation of any circumstances suggesting the existence of any arrangement or understanding which, though not legally binding, is or was observed or is likely to be observed by the company in practice and which is relevant to the purpose of his investigation.

An inspector appointed for this purpose shall have the same power with regard to production and seizure of documents and evidence as are enjoyed by an inspector appointed under Section 235.

Report of the Central Government. The inspector shall submit the report to the Central Government on the conclusion of the investigation and the Central Government shall not be bound to furnish the report to the company or any other person if it is of the opinion that there are good reasons for not divulging the contents of the report. But it must keep with the Registrar, a copy of such parts of the report as it thinks are not confidential.

Expenses of investigation. The expenses of any investigation under this section shall be defrayed by the Central Government out of moneys provided by Parliament unless the Central Government directs that the expenses should be paid by the persons on whose application the investigation was ordered.

Investigation of Persons with an Interest in the Company

Investigation without appointment of inspector. Where it appears to the Central Government or the Company Law Board that there is good

reason to investigate the ownership of any shares or debentures of a company and that it is unnecessary to appoint an inspector for the purpose, the Central Government or the Company Law Board may itself require the following persons to give information:

(*i*) any person who is or was interested in those shares or debentures;

(*ii*) any person who acts or has acted as the legal adviser or agent of someone in relation to those shares or debentures.

Information as to the present or past interest in shares or debentures. The person so summoned may be required to give to the Central Government any information he has or can reasonably to expected to obtain as to the present or past interest in those shares or debentures and the names and addresses of the persons interested and of any persons who act or have acted on their behalf in relation to the shares or debentures.

Effect of non-compliance. Any person, who fails to give any information required of him or makes any false statement, shall be punishable with imprisonment for a term which may extend to six months or with a fine not exceeding five thousand rupees or with both. (Sec. 248)

Restrictions on Shares and Debentures

Nature of restrictions. If as a result of investigation of the ownership of a company under Section 247 or investigation of the interests of members of a company under Section 248 or otherwise, it appears to the Company Law Board that there is good reason to find out the relevant facts about any shares in a company, the Company Law Board may impose the following restrictions on the shares:

(*i*) any transfer of shares shall be void;

(*ii*) where those shares are to be issued, they shall not be issued;

(*iii*) no voting rights shall be exercisable in respect of those shares;

(*iv*) no further shares shall be issued in the right of those shares; and

(*v*) except in liquidation, no payment will be made of any sums due from the company on those shares by way of dividend, capital or otherwise.

These restrictions may be imposed for any period not exceeding three years.

Change in the composition of board of directors. Where a transfer of shares has taken place and, as a result, a change is likely to take place in the composition of the board of directors, and the Company Law Board is of the opinion that any such change would be prejudicial to the public interest, the Company Law Board may direct by order that voting rights in respect of those shares shall not be exercisable for such period not exeeding three years and no change in the composition of the board of directors shall take place unless confirmed by the Company Law Board.

QUESTIONS

1. Under what circumstances may the Central Government appoint inspectors to investigate the affairs of any company? Who can be appointed as inspector?
[*Company Secretary (Final), October 1974*]

2. State briefly the provisions of the Companies Act, 1956, regarding the investigation of the affairs of a company by the Central Government. Describe the powers of the shareholders and the Registrar in this behalf.
[*C.A. (Final), November 1976*]

3. Who can apply for investigation against a company? What are the powers of an inspector appointed under the Companies Act, 1956, and what are the steps the Central Government can take on the basis of the report of the inspector?
[*Company Secretary (Inter), April 1971*]

4. What are the ppowers, duties and functions of an inspector appointed by the Central Government to investigate into the affairs of a company under the Companies Act, 1956. [*I.C.W.A, January 1966*]

5. What are the provisions of the Companies Act, 1956, with regard to defraying the expenses of investigations.

PRACTICAL PROBLEMS

1. The chairman of the Company Law Board ordered for the investigation of the affairs of a company under Sec. 237(b) on the grounds that there was delay, bungling and faulty planning of the project entailing double expenditure, continuous losses resulting in one-third of the share capital being wiped out, shares being quoted at half their face value and severance of their connections by some eminent persons. The order is challenged. Decide.

2. The management of a company acquired the shares of its subsidiary of Rs. 10 each at a premium of Rs 100. These shares were offered to the members in lieu of cash dividends. It also made a loan of huge sum to its subsidiary at two per cent interest. Do these circumstances justify an order of investigation?

3. An order of investigation required the inspector to submit the report within a certain time. Does the failure on the part of the inspector to submit the report within such time bring the investigation to an end?

20

COMPROMISE, ARRANGEMENT, RECONSTRUCTION AND AMALGAMATION

COMPROMISES AND ARRANGEMENTS

THE term "compromise" means settlement of a dispute by mutual concessions. It is an agreement terminating a dispute between parties as to the power to enforce rights or as to what those rights are.[1] In a compromise, the parties intend to settle the dispute between themselves by a give-and-take arrangement. The term "arrangement" is a wider one and it includes a reorganisation of the share capital of the company by the consolidation of shares of different classes or by division of shares of different classes or by both these methods [Sec. 390(b)]. It includes all modes of reorganising the share capital even when involving an interference with preferential or special rights attached to the shares by the memorandum.[2]

Procedure

1. *Application to the court.* Where a compromise or arrangement is proposed between a company and its creditors or any class of them or between a company and its members or any class of them, an application should be made to the court. Such application may be made by the company or by any creditor or member of the company. If the company is being wound up, its liquidator may apply to the court. [Sec. 391(1)]

2. *Meeting of creditors or members.* The court may order a meeting of the creditors or members or any class of them to be called, held and conducted in such a manner as it may direct. [Sec. 391(1)]

3. *Approval of the scheme.* Any compromise or arrangement shall be

[1]*Sneath v. Valley Gold Ltd.* (1893) 1. Ch. 477.

[2]*Hindustan Commercial Bank Ltd. v. Hindustan General Electric Corporation* (1960) Cal. 637.

binding on all the creditors or members and also on the company, or in the case of a company which is being wound up, on the liquidators and contributories of the company if (*a*) the scheme is approved by a majority in number representing three-fourths in value of the creditors or members, as the case may be, and (*b*) the scheme is sanctioned by the court. [Sec. 391(2)]

4. *Sanction by the court.* The court shall not sanction any compromise or arrangement unless the applicant has disclosed to the court all material facts relating to the company, such as the latest financial position of the company, the latest auditor's report on the accounts of the company, the pendency of any investigation proceedings in relation to the company under Sections 235 to 251, and the like. [Sec. 391(2)]

It may also be noted that the court shall give notice of every application made to it for compromise or arrangement to the Central Government and shall take into consideration the representations made to it by the Government before approving any scheme. (Sec. 394A)

It was held that the court must satisfy itself with the following points before sanctioning a scheme of arrangement:

(*i*) the provisions of the statute must have been complied with;

(*ii*) the class must have been represented by those who attended the meeting;

(*iii*) the statutory majority are acting *bona fide* and are not coercing the minority in order to promote interests adverse to those of the class whom they purport to represent; and

(*iv*) the arrangement is such as a man of business would reasonably approve.[3]

5. *Copy of court's order to be field with the Registrar.* An order made by the court under the above provisions shall have no effect until a certified copy of the order has been filed with the Registrar. [Sec. 391(3)]

6. *Copy of court's order to be annexed to memorandum.* A copy of every such order shall be annexed to every copy of the memorandum of the company issued after the certified copy of the order of the court has been filed with the Registrar. [Sec. 391(4)]

If default is made in complying with the above requirement, every officer of the company shall be punishable with a fine which may extend to ten rupees for each copy in respect of which default is made. [Sec. 391(5)]

7. *Stay of suits or proceeding against the company.* After an application has been made to the court for sanction of a compromise or arrangement, the court may stay the commencement or continuation of any suit or

[3]*Re Anglo Continental Supply Co.* (1922) 2 Ch. 723, 733.

proceeding against the company on such terms as the court thinks fit, until the application is finally disposed of. [Sec. 391(6)]

Power of High Court to Enforce Compromises and Arrangements

Court's power of supervision. Where a High Court makes an order sanctioning a compromise or an arrangement in respect of a company, it shall have the power to supervise the carrying out of the compromise or arrangement. It may give such directions in regard to any matter or make such modifications in the compromise or arrangement as it may consider necessary for the proper working of the compromise or arrangement. [Sec. 392(1)]

Compulsory winding up in certain cases. If the court is satisfied that a compromise or arrangement cannot be worked satisfactorily, it may make an order for compulsory winding up of the company. The court may do so either on its own motion or on the application of any person interested in the affairs of the company. [Sec. 392(2)]

Information to Creditors and Members as to Compromises or Arrangements

Notice to contain directors' material interests in scheme. Where a meeting of creditors or members or any class of them is called for passing a scheme of compromise or arrangement, a statement setting forth the terms of the compromise or arrangement and explaining its effect has to be sent along with the notice calling the meeting. The statement must also state any material interests of the directors, managing director or manager of the company and of every trustee of debenture holders, and the effect of a compromise or arrangement on those interests insofar as that effect is different from the effect on like interests of other persons. In every notice calling the meeting which is given by advertisement, there shall be included either such a statement as aforesaid or a notification of the place at which and the manner in which creditors or members entitled to attend the meeting may obtain copies of such a statement. [Sec. 393(1)(2)]

Any creditor or member entitled to such a statement may obtain it from the company, free of charge, by making an application in the manner indicated by the notice. [Sec. 393(3)]

Penalty for non-compliance. Where default is made in complying with any of the requirements of the section, the company and every officer of the company who is in default, shall be punishable with a fine which may extend to five thousand rupees. [Sec. 393(4)]

Notice to company by directors and trustees. Exery director, managing director or manager of the company and every trustee of the company's

debenture holders, shall give notice to the company of such matters relating to himself as may be necessary for the purpose of the compromise or arrangement. If he fails to do so, he will be punishable with a fine may extend to five hundred rupees. [Sec. 393(5)]

RECONSTRUCTION AND AMALGAMATION

The term "reconstruction" is commonly used to describe a scheme under which a company goes into liquidation for the express purpose of selling its assets to a new company for partly paid shares carrying a further liability. Usually, the liquidating company has exhausted its working capital and, by means of such a scheme, the company is reconstructed and reconstituted so as to form a new company with precisely the same objects and composed of the same shareholders, as are called upon to provide additional capital.

The term "reconstruction" is also used in connection with schemes for reduction of capital and variations of the rights of investors. In this case it is known as "internal reconstruction" and the company does not go into liquidation.

The term "amalgamation" implies creation of a new company by a complete consolidation of combining units. Two or more companies may liquidate themselves under the law and sell their assets and transfer their liabilities to a new company which issues its own stock in exchange for the net worth of property received from the amalgamating companies. Under amalgamation, therefore, none of the existing companies retain its entity or existence. It also includes merger. A merger is another name for absorption of one business unit by another. The absorbing company retains its entity and enlarges its size through a merger. The company which is absorbed loses its entity in the absorbing company.

Modes of Reconstruction and Amalgamation

The Companies Act, 1956 provides for reconstruction and amalgamation of companies under Sections 394 to 396. The amalgamation may take place by:

1. Purchase of one undertaking by the other;
2. Transfer of shares of one undertaking to the other; and
3. An order of the Central Government in the national interest.

1. Reconstruction or Amalgamation through Transfer of the Undertaking

(*i*) *Court's sanction.* Where an application is made to the court for the sanctioning of a compromise or arrangement and it is shown to the court

that (*a*) the compromise or arrangement is in connection with a scheme for the reconstruction of a company or its amalgamation with another company; and (*b*) that under the scheme the whole or any part of the undertaking, property or liabilities of any company concerned in the scheme (referred to as transferor company) is to be transferred to another company (referred to as the transferee company), the court may make an order sanctioning the compromise or arrangement. Such an order may provide for all or any of the following matters:

(*a*) the transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of the transferor company;

(*b*) the allotment or appropriation by the transferee company of any shares, debentures, policies or other like interests as provided in the scheme;

(*c*) the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company;

(*d*) the dissolution, without winding up, of any transferor company;

(*e*) the provision to be made for any persons who dissent from the compromise or arrangement; and

(*f*) such incidental, consequential and supplemental matters as are necessary to secure that the reconstruction or amalgamation shall be fully and effectively carried out. [Sec. 394(1)]

(*ii*) *Amalgamation in case of a company in course of winding up.* A compromise or an arrangement in connection with the amalgamation of a company in winding up with any other company or companies shall not be sanctioned unless the court has received a report from the Company Law Board or the Registrar that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to the public interest.

It further provides that no order for the dissolution of any transferor company shall be made by the court unless the official liquidator has, on scrutiny of the books and papers of the company, made a report to the court that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to the public interest. [Sec. 394(1)]

(*iii*) *Notice to Central Government.* The court shall give to the Central Government notice of every application made to it under Section 391 or 394 for sanction of schemes of arrangement, compromise and amalgamation and shall take into account the representations made by the Government before passing an order. (Sec. 394A)

(*iv*) *Copy of court's order to be filed with the Registrar.* A certified copy of the order shall be filed by the company with the Registrar for registration within thirty days of the date of the court order. [Sec. 394(3)]

2. Reconstruction or Amalgamation by Transfer of Shares

(i) Scheme involving transfer of shares. When a scheme or contract involves the transfer of shares in a company (referred to as the transferor company) to another company (referred to as the transferee company), the transferee company may do so by making an offer to the transferor company. [Sec. 395(1)]

(ii) Approval of scheme. The offer of the transferee company shall be placed before the shareholders of the transferor company for approval. The offer may be approved within four months of making the offer in that behalf by the transferee company by holders of not less than nine-tenths in value of shares whose transfer is involved other than shares already held by the transferee company or by its nominees or by its subsidiary.

(iii) Notice to dissenting shareholders. The transferee company may give notice in the prescribed manner to any dissenting shareholders that it desires to acquire his shares within two months of the expiry of above four months. [Sec. 395(1)]

(iv) Dissenting shareholders' application to court. When the transferee company gives notice to the dissenting shareholders, they may make an application to the court within one month from the date of such notice. [Sec. 395(1)]

It may be noted here that when an application is made to the court by a shareholder that the terms are not fair, the onús is upon the applicant to establish his allegation. The court will attach considerable weight to the fact that a large body of shareholders have accepted the offer.[4]

Where, however, the offer is in reality being made by same majority shareholders who have accepted it, the burden of proof is reversed and it is up to the offeror to show that the scheme is fair.[5]

(v) Rejection of application by court. If no application is made to the court or if the Court refuses it, the transferre company shall become entitled to acquire the shares of all persons on whom notice is served. In fact the transferee company shall be entitled and bound to acquire those shares on the terms on which the shares of other shareholders are to be transferred. [Sec. 395(1)]

(iv) Registration of transferee company in transferor company. Whey the transferee company acquires the shares and pays for them, the transferor company shall (a) thereupon register the transferee company as the holder of those shares; and (b) within one month of the date of such registration, inform the dissenting shareholders of the fact of such registration and of the receipt of the amount or other consideration

[4]*Re Hoare & Co.* (1933) 150 L.T. 374; *Re Press Caps* (1949) Ch. 434 C.A.
[5]*Re Bugle Press Ltd.*, (1961) Ch. 270.

representing the price payable to them by the transferee company.

(vii) Separate bank account. Any sum received by the transferor company under this section shall be paid into a separate bank account. This amount or any other consideration so received shall be held by that company in trust for its shareholders. [Sec. 395(4)]

Provisions applicable to a scheme involving transfer of shares. The following provisions will apply in relation to every offer of a scheme or contract involving the transfer of shares in the transferor company to the transferee company, namely:

(a) every such offer or every circular containing such an offer or every recommendation to the members of the transferor company by its directors to accept such offer shall be accompained by such information as may be prescribed;

(b) every such offer shall contain a statement by or on behalf of the transferee company, disclosing the steps it has taken to ensure that neccessary cash will be available;

(c) every circular containing or recommending acceptance of such an offer shall be presented to the Registrar for registration and no such circular shall be issued until it is so registered;

(d) the Registrar may refuse to register any such circular which does not contain the prescribed information or which sets out such information in a manner likely to give a false impression;

(e) an appeal shall lie to the court against an order of the Registrar refusing to register any such cicular. [Sec. 395(4A)]

3. Amalgamation in National Interest

Amalgamation by order of Central Government. Where the Central Government is satisfied that it is essential in the public interest that two or more companies should amalgamate, it may provide for the amalgamation of those companies into a single company with such constitution, property, powers, rights, interests, authorities and privileges and with such liabilities, duties and obligations,, as may be specified in the order. The direction for amalgamation shall be notified in the Official Gazette.

Interests of members or creditors. Every member or creditor or debenture holder of each of the companies before amalgamation shall have nearly the same interest or rights in the company resulting from amalgamation as he had in the company of which he was originally a member or creditor. However, to the extent that his interest or rights are reduced,he will be compensated and compensation shall be assessed by such authority as may be prescribed by the Central Government.

Any person aggrieved by any assessment of compensation made by the prescribed authority may prefer an appeal to the Company Law Board

and thereupon the assessment of the compensation shall be made by the Company Law Board. The compensation shall be paid by the company resulting from the amalgamation.

Pre-conditions of making the order. No order shall be made under this section, unless (a) a copy of the proposed order has been sent in draft to each of the companies concerned; (b) the time for preferring an appeal to the Company Law Board has expired, or where any such appeal has been preferred, the appeal has been finally disposed of; and (c) the Central Government has considered and made such modifications in the draft order as may seem to it desirable in the light of any suggestions and objections which may be received by it from any such company within such period as the Central Government may fix in that behalf, being not less than two months from the date on which the aforesaid copy is received by that company or from any class of shareholders or from any creditors.

Copies of every order made under this section shall be laid before both Houses of Parliament at the earliest opportunity. (Sec. 396)

Preservation of Books and Papers

The books and papers of a company which has been amalgamated with or whose shares have been acquired by another company, shall not be disposed of without prior permission of the Central Government. Before granting such permission, the Central Government may appoint a person to examine the books and papers or any of them for the purpose of ascertaining whether they contain any evidence of the commission of an offence in connection with the promotion, formation or management of the affairs of the company or its amalgamation or the acquisition of its shares. [Sec. 396(A)]

QUESTIONS

1. What do you understand by the scheme of arrangement or compromise? State the provisions of the Companies Act regarding the procedure to be followed in this connection.

2. What is an arrangement in respect of a company? How may it be effected and by whom? How may it be enforced any by whom? *[I.C.W.A., July 1966]*

3. What is the procedure prescribed by the Companies Act for resolving disputes between (a) company and its members, and (b) company and its creditors without recourse to liquidation? What are the powers of dissident members in such schemes of arrangements? *[Company Secretary (Final), October 1962]*

4. Summarise the provisions of the Companies Act pertaining to reconstruction and amalgamation of companies. [C.A., November 1960]

5. Explain the meaning and different modes of amalgamation of companies and state the statutory provisions and procedure regarding amalgamation.

[Meerut, M.Com., 1975]

6. Write a short note on amalgamation of companies in national interest.

PRACTICAL PROBLEMS

1. *X* Co. Ltd. is prosperous company, while *Y* Co. Ltd. is a losing concern due to lack of finance. *X* Co. Ltd. feels that if *Y* Co. Ltd. can be merged with it or if the business of *Y* Co. Ltd. can be taken over by it, the said business can be run profitably. Describe the various formalities prescribed by the Companies Act, 1956, which must be fulfilled in the case of both companies for each of the alternative schemes. *[C.A. (Final), November 1973]*

2. *A* company has offered to buy all the shares in the *B* company and the holders of nine-tenths 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. Can the *A* company acquire all the shares in the company?

3. The assets of a company which is a going concern are meagre and its liabilities heavy. The directors who wish to avoid liquidation propose a scheme for the reconstruction of the company involving a fresh issue of shares. Meetings of the members and creditors are thereafter held under the direction of the Court, at which the consent of requisite three-fourths majority is obtained in favour of the scheme. Thereafter some of the minority creditors prove before the Court that the directors had failed to disclose material facts regarding the company's financial position. Can these creditors succeed on this ground?

[C.A., November 1967]