

Question 1

XYZ Co. Ltd. was in the process of incorporation. Promoters of the company signed an agreement for the purchase of certain furniture for the company and payment was to be made to the suppliers of furniture by the company after incorporation. The company was incorporated and the furniture was used by it. Shortly after incorporation, the company went into liquidation and the debt could not be paid by the company for the purchase of above furniture. As a result suppliers sued the promoters of the company for the recovery of money.

Examine whether promoters can be held liable for payment under the following situations:

- (i) When the company has already adopted the contract after incorporation?
 - (ii) When the company makes a fresh contract with the suppliers in terms of pre incorporation contract?
- (November 2001)

Answer

The promoters remain personally liable on a contract made on behalf of a company which is not yet in existence. Such a contract is deemed to have been entered into personally by the promoters and they are liable to pay damages for failure to perform the promises made in the company's name (*Scot v. Lord Ebury*), even though the contract expressly provided that only the company shall be answerable for performance.

In *Kelner v. Baxter* also it was held that the persons signing the contracts viz. Promoters were personally liable for the contract.

Further, a company cannot ratify a contract entered into by the promoters on its behalf before its incorporation. Therefore, it cannot by adoption or ratification obtain the benefit of the contract purported to have been made on its behalf before it came into existence as ratification by the company when formed is legally impossible. The doctrine of ratification applies only if an agent contracts for a principal who is in existence and who is competent to contract at the time of contract by the agent.

The company can, if it desires, enter into a new contract, after its incorporation with the other party. The contract may be on the same basis and terms as given in the pre-incorporation contract made by the promoters. The adoption of the pre-incorporation contract by the company will not create a contract between the company and the other parties even though the option of the contract is made as one of the objects of the company in its Memorandum of Association. It is, therefore, safer for the promoters acting on behalf of the company about to be formed to provide in the contract that: (a) if the company makes a fresh contract in terms of the pre-incorporation contract, the liability of the promoters shall come to an end; and (b) if the company does not make a fresh contract within a limited time, either of the parties may rescind the contract.

Thus applying the above principles, the answers to the questions as asked in the paper can be answered as under:

- (i) the promoters in the first case will be liable to the suppliers of furniture. There was no fresh contract entered into with the suppliers by the company. Therefore, promoters continue to be held liable in this case for the reasons given above.
- (ii) in the second case obviously the liability of promoters comes to an end provided the fresh contract was entered into on the same terms as that of pre-incorporation contract.

Question 2

M Company Limited issued 2,00,000 equity shares of Rs 10 each. You are allotted 100 shares. Explain any ten rights you have as a member of the company. (November, 2001)

Answer

Rights of the member in a company:

A member of a company has the following rights against the company:

1. Right to have the certificate of shares held or the certificate of stock issued to him within the prescribed time.
2. Right to have his name borne on the register of members.
3. Right to transfer shares subject to any restrictions imposed by the articles of the company.
4. Right to attend meeting of shareholders, received proper notice and to vote at the meetings.
5. Right to associate in the declaration of dividends and to apply to the Court for an injunction restraining the directors from paying dividends on an ultra virus declaration or out of capital.
6. Right to inspect the registers, indexes, returns and copies of a certificates etc. kept by the company and to obtain extracts or copy thereof.
7. Right to obtain copies of Memorandum and Articles on request and on payment of the prescribed fees.

8. Right to have the first option in case of issue of new shares or a further issue of shares (i.e. right to pre-emption) by the company.
9. Right to receive a copy of the Statutory Report.
10. Right to apply to the court to have any variation or abrogation to his rights set aside by the Court.
11. Right to have notice of any resolution requiring special notice.
12. Right to obtain on request minutes of proceedings at general meeting.
13. Right to remove directors by joining with others.
14. Right to obtain a copy of the profit and loss account and the balance sheet with the auditor's report.
15. Right to apply for the appointment of one or more competent inspectors by the Government to investigate into the affairs of the company as well as for reporting thereon.
16. Right to participate in the appointment of an auditor at the AGM.
17. Right to inspect the auditor's report-at the AGM of the company.
18. Right to receive a share in the capital of the company and in the surplus assets, if any, on the company's liquidation.
19. Right to participate in passing of the special resolution what the company may be wound up by the court or voluntarily.
20. Right to participate in the appointment and in fixation of remuneration of one or more liquidators in the case of a Member's voluntary Winding-up and to fill any vacancy in the office of a liquidators so appointed by him.

Question 3

A company refuses to register transfer of shares made by X to Y. The company does not even send a notice of refusal to X or Y within the prescribed period. Has the aggrieved party any right(s) against the company for such a refusal?.Advise. (May, 2002)

Answer

The problem as asked in the question is based upon Section 111 of the Companies Act dealing with the refusal to register transfer and appeal against refusal.

On refusal to register a transfer or transmission by operation of law, of the right to any shares in, or debentures thereof, the company has to send notice of refusal giving reasons to the transferee or the transferor or to the person giving intimation of such transmission, or on delivery of transfer deed to the company, as the case may be within a period of 2 months from the date of the intimation or delivery of the transfer deed to the company. In the given case the company has failed to give such notice of refusal to the aggrieved parties within the stipulated time of 2 months. Failure to give notice of refusal gives a right/remedies to the aggrieved parties.

Rights/remedies to aggrieved parties:

The aggrieved parties may apply to the Company Law Board (Tribunal) under sub-section (2) or (4) of Section 111 against refusal or for rectification of the register of members, if his name is entered in the register without sufficient cause, or for omission of his name from the register or default in making an entry of his name in the register. The time of filing such appeal is 4 months from the date of lodgement of transfer application. There is no limitation period provided for making an application for rectification of register of members, under subsection (4). The company is also punishable under sub-section (12) with a fine upto Rs.500 per day.

Question 4

'A' commits forgery and thereby obtains a certificate of transfer of shares from a company and transfers the shares to 'B' for value acting in good faith. Company refuses to transfer the shares to 'B'. Whether the company can refuse? Decide the liability of 'A' and of the company towards 'B' (Nov. 2002)

Answer

Problem relating to forged transfer:

A forged transfer is a nullity. It does not give the transferee concerned any title to the shares. Since the forgery is an illegality therefore it cannot be a source of a valid transfer of a title. Although the innocent purchaser acting in good faith could validly and reasonably assume that the person named in the certificate as the owner of the shares was really the owner of the shares represented by the certificate. Even then the illegality cannot be converted into legality. Therefore, in this case company is right to refuse to do the transfer of the shares in the name of the transferee B.

Here, as regards to the liability of A against 'B', A does not stand directly responsible according to provisions of company law as he has already committed forgery which is illegal but A is liable to compensate the company as he has lodged the forged transfer and the company has suffered the loss.

As regards to the liability of the company towards B, the company shall be liable to compensate to B in so far as the company had issued a certificate to transfer and was, therefore, stopped from denying the liability accruing from its own act. Further, as the company has refused to register him as a shareholder, company has to compensate B. However, in this case the interest of the original shareholder will be protected.

Question 5

After receiving 80% of the minimum subscription as stated in the prospectus, a company allotted 100 equity shares in favour of 'X'. The company deposited the said amount in the bank but withdrew 50% of the amount, before finalisation of the allotment, for the purchase of certain assets. X refuses to accept the allotment of shares on the ground that the allotment is violative of the provisions of the Companies Act, 1956. Comment. (May 2003)

Answer

Allotment of Shares

The company has received 80% of the minimum subscription as stated in the prospectus. Hence the allotment is in contravention of section 69(1) of the Companies Act and the allotment is irregular attracting the provisions of Section 71 of the Companies Act 1956.

The consequences of such irregular allotment are as follows:

The allotment is rendered voidable at the option of the applicant. The option must however be exercised -

- (i) Within 2 months after the holding of the statutory meeting of the Company; or
- (ii) Where the Company is not required to hold a statutory meeting or where the allotment is made after the holding of the statutory meeting, within 2 months after the date of allotment [Section 71(1)].

The irregular allotment is voidable even if the company goes into liquidation on the meantime [section 71(2)].

In view of the above, refusal by 'X' to accept the allotment of shares on the ground that the allotment is violative of the provisions of the Companies Act is valid provided he has exercised his option to avoid the allotment within the period mentioned in Section 71(1) of the Companies Act.

The Company has also violated the provisions of Section 69(4) of the Companies Act in withdrawing 50% of the amount deposited with the bank before receiving the entire amount payable on application for shares in respect of the minimum subscription.

Question 6

The Directors of a company registered and incorporated in the name "Mars Textile India Ltd." desire to change the name of the company entitled "National Textiles and Industries Ltd." Advise as to what procedure is required to be followed under the Companies Act, 1956? (May 2003)

Answer

Change In the Name of Company:

In the first instance, Mars Textile India Ltd., should ascertain from the Registrar of Companies whether the proposed name viz. National Textiles and Industries Ltd. is available or not. For this purpose, the company should file the prescribed Form No.1A with the Registrar along with the necessary fees. The Registrar after examination will inform whether the new name is available or not for registration.

In case the name is available, the company has to pass a special resolution approving the change of name to National Textiles and Industries Ltd.

Thereafter the approval of the Central Government should be obtained as provided in Section 21 of the Companies Act, 1956. The power of Central Government in this regard has been delegated to the Registrar of companies. Thus, the company has to file an application along with the prescribed filing fee for change of name. The change of name shall be complete and effective only on the issue of a fresh certificate of incorporation by the Registrar. The Registrar shall enter the new name in the Register in place of the former name. The change of name shall not affect any rights or obligations of the company and it shall not render defective any legal proceedings by or against it.

Question 7

The Board of Directors of a company decide to pay 5% of issue price as underwriting commission to the underwriters. On the other hand the Articles of Association of the company permit only 3% commission. The Board of Directors further decide to pay the commission out of the proceeds of the share capital. Are the decisions taken by the Board of Directors valid under the Companies Act, 1956? (May 2003)

Answer

Underwriting Commission

Considering the provisions of Section 76 of the Companies Act, 1956:

- (i) The payment of commission should be authorised by the articles.
- (ii) The amount of commission should not exceed, in the case of shares, 5% of the price at which the shares have been issued or the amount or rate authorised by the articles whichever is less, and in the case of debentures, it should not exceed 2-1/2%.

Answer to problem:

Thus taking into account the above provisions it is concluded that the Board of Director's decision to pay 5% is not valid, since the payment cannot exceed 3% as provided in the Articles of the company. Secondly, decision of the Board to pay the commission out of capital is valid since underwriting commission can be paid both out of capital as well as out of profits (*Madan Lal Fakir Chand v. Shree Changdeo Sugar Mills Ltd. MR (1962) s.c. 1543*).

Question 8

A who holds one share certificate of 1000 Equity shares in a company, wants to transfer 300 shares in favour of B. Explain the procedure to be followed for executing the partial transfer under the provisions of the Companies Act, 1956. (May 2003)

Answer

Certification of Transfer:

Where a shareholder wishes to transfer only part of his shareholding or wishes to sell to them to two or more persons, he is required to lodge the share certificate with the company. Where he has already lodged with the company the relevant share certificate, together with an instrument of transfer for part of the shares, he may request the company to certify on the instrument of the transfer that the share certificate for the shares covered by the instrument of transfer has been *lodged* with the company. This is known as certification.

An instrument of transfer shall be deemed to be certified if it bears the words 'certificate lodged' or the words to the like effect. [Section 112(3)(a)]. Certification is, therefore, the act of noting by the secretary etc. stating that the share certificate has been lodged with the company. When only a portion of shares is transferred, the company usually issued him a ticket for the balance of shares which have not been transferred. Such a ticket is called a 'balance ticket'.

The certification by a company of a transfer as above is to be taken as a representation by the company to any person acting on faith of certification that there has been produced to the company such documents as, on the face of them, show prima facie title to the shares in the transfer. It is, however, not a representation that the transferor has any title to the shares. (Section 112(1)).

The company will be responsible for the certification only if:

- (a) the person issuing the installment is authorised to issue such installment on the company's behalf;
- (b) the certificate is signed by any officer or servant of the company or any other person authorised to certify transfer on the company's behalf.

Thus X holding 1000 shares in AJD Co . Limited is advised to act for certification of transfer in accordance with the provisions for partial transfer of his holding.

Question 9

A Company was incorporated on 6th October, 2003. The certificate of incorporation of the company was issued by the Registrar on 15th October, 2003. The company on 10th October, 2003 entered into a contract, which created its contractual liability. The company denies from the said liability on the ground that company is not bound by the contract entered into prior to issuing of certificate of incorporation. Decide, under the provisions of the Companies Act, 1956, whether the company can be exempted from the said contractual liability.

(November 2003)

Answer

Certificate of Incorporation and the binding effect:

Upon the registration of the documents as required under the Companies Act, 1956 for incorporation of a company, and on payment of the necessary fees, the Registrar of Companies issues a Certificate that the company is incorporated (Section 34). Section 35 provides that a certificate of incorporation issued by the Registrar is conclusive as to all administrative acts relating to the incorporation and as to the date of incorporation. The facts as given in the problem are similar to those in case of *Jubilee Cotton Mills v. Lewis (1924) A.C. 1958* where it was held that an allotment of shares made on the date after incorporation could not be declared void on the ground that it was made before the company was incorporated when the certificate of incorporation was issued at a later date.

Applying the above principles the contention of the company in this case cannot be tenable. It is immaterial that the certificate of incorporation was issued at a later date. Since the company came into existence on the date of incorporation stated on the certificate, it is quite legal for the company to enter into contracts. To conclude the contracts entered into by the company before the issue of certificate of incorporation shall be binding upon the company. The date of issue of certificate is immaterial.

Question 10

Dinesh, a director in a company, gave in writing to the company that notice for any General Meeting and the Board of Directors' Meeting be sent to him at his address in India only by Registered Mail and for which he paid sufficient money. The company sent two notices to him, of such meetings, by ordinary mail, under certificate of posting. Dinesh did not receive the said notices and could not attend the meetings and the proceedings thereof on the ground of improper notice. Decide in the light of the provisions of the Companies Act, 1956:

- (i) *Whether the contention of Dinesh is valid?*
- (ii) *Would you answer be still the same in case Dinesh remained outside India for two months (when such notices were given and meetings held) (November 2003)*

Answer

Problem on notice and validity of proceedings of the meeting: The problem as asked in the question is based on the provisions of the Companies Act, 1956 as contained in Section 172 read with Section 53. Accordingly, the notice may be served personally or sent through post to the registered address of the members and, in the absence of any registered office in India, to the address, if there be any within India furnished by him to the company for the purpose of servicing notice to him. Service through post shall be deemed to have effected by correctly addressing, preparing and posting the notice. If, however, a member wants to notice to be served on him under a certificate or by registered post with or with acknowledgement due and has deposited money with the company to defray the incidental expenditure thereof, the notice must be served accordingly, otherwise service will not be deemed to have been effected.

Accordingly, the questions as asked may be answered as under:

- (i) The contention of Dinesh shall be tenable, for the reason that the notice was not properly served and meetings held by the company shall be invalid.
- (ii) In view of the provisions of the Companies Act, 1956, as contained in Section 172, the company is not bound to send notice to Dinesh at the address outside India. Therefore, answer in the second case shall differ from the first one.

Question 11

Explain the provisions of the Companies Act, 1956 relating to holding of Annual General Meeting of the Company with regard to the following:

- (i) *Period within which the first and the subsequent Annual General Meetings must be held.*
- (ii) *Business which may be transacted at an Annual General Meeting. (November 2003)*

Answer

Annual General Meeting provisions under the Companies Act, 1956:

- (i) *Period Within which first and the subsequent AGM must be held:*
 - (a) In accordance with the provisions of the Companies Act, 1956 as contained in incorporation, and so long as the company hold its first annual general meeting within that period, the company need not hold any general meeting in

the year of incorporation or in the following year (First proviso to Section 166(1)). Further, the date of the first AGM must be within 9 months from the date of the financial year for which profit and loss account has been made,

- (b) Any subsequent AGM must be held not later than 6 months from the close of the financial year of the company. The gap between the two consecutive AGMs must not be more than 15 months [Section 166(1)]. Further the second proviso to Section 166(1) states that the Registrar may, for any special reason, extend the time within which any AGM (not being the first AGM) shall be held by a period not exceeding 3 months.
- (ii) *Business to be Transacted at an Annual General Meeting:* The following two businesses may be transacted at an annual general meeting:
1. Ordinary Business; Viz.
 - (a) Consideration of Annual Accounts, Directors Report etc.
 - (b) Declaration of Dividend.
 - (c) Election of Directors.
 - (d) Appointment of auditors and fixation of their remuneration.
 2. Special Business: Any business other than above 4 shall be special business, which may be transacted at any AGM.

Question 12

What are the provisions of the Companies Act, 1956 relating to the appointment of 'Debenture Trustee' by a company? Whether the following can be appointed as 'Debenture Trustee':

- (i) A shareholder who has no beneficial interest.
- (ii) A creditor whom the company owes Rs. 499 only.
- (iii) A person who has given a guarantee for repayment of amount of debentures issued by the company. (November 2003)

Answer

Appointment of Debenture Trustee: Section 117 B as introduced by the Companies (Amendment) Act, 2000 deals with the appointment and duties of debenture trustees. It is now provided that before issue of prospectus or letter of offer for the debentures, the company should appoint one or more debenture trustees and disclose their names and also state that they have given their consent. It is also provided that (i) a shareholder who has beneficial interest in shares (ii) creditor or (iii) a person who has given guarantee for repayment of principal and interest in respect of the debentures cannot be appointed as a debenture trustee.

Thus based on the above provisions answers to the given questions are:

- (i) A shareholder who has no beneficial interest can be appointed as a debenture trustee.
- (ii) A creditor whom company owes Rs. 499 cannot be so appointed. The amount owed is immaterial.
- (iv) A person who has given guarantee for repayment of principal and interest thereon in respect of debentures also cannot be appointed as a debenture trustee.

Question 13

Some of the creditors of M/s Get Rich Quick Ltd. have complained that the company was formed by the promoters only to defraud the creditors and circumvent the compliance of legal provisions of the Companies Act, 1956. In this context they seek your advice as to the meaning of corporate veil and when the promoters can be made personally liable for the debts of the company. (November 2004)

Answer

Corporate Veil

After incorporation the company in the eyes of law is a different person altogether from the shareholders who have formed the company. The company has its own existence and as a result the shareholders cannot be held liable for the acts of the company even though the shareholders control the entire share capital of the company. This is popularly known as Corporate Veil and in certain circumstances the courts are empowered to lift or pierce the corporate veil by ignoring the company and directly examine the promoters and others who have managed the affairs of the company after its incorporation. Thus, when the corporate veil is lifted by the courts, (i.e., the courts have disregarded the company as an entity), the promoters can be made personally liable for the debts of the company. In the following circumstances, corporate veil can be lifted by the courts and promoters can be held personally liable for the debts of the company.

- (i) Trading with enemy country.

- (ii) Evasion of taxes.
- (iii) Forming a subsidiary company to act as its agent.
- (iv) The benefit of limited liability is destroyed by reducing the number of members below 7 in the case of public company and 2 in the case of private company for more than six months.
- (v) Under law relating to exchange control.
- (vi) Device of incorporation is adopted to defraud creditors or to avoid legal obligations.

Question 14

M/s ABC Ltd. a company registered in the State of West Bengal desires to shift its registered office to the State of Maharashtra. Explain briefly the steps to be taken to achieve the purpose.

Would it make a difference, if the Registered Office is transferred from the Jurisdiction of one Registrar of Companies to the jurisdiction of another Registrar of Companies within the same State? (November 2004)

Answer

Transfer of Registered Office of a Company

In order to shift the registered office from the State of West Bengal to the State of Maharashtra, M/s ABC Ltd has to take the following steps:

- (i) To pass a special resolution and thereafter file the same with the Registrar of Companies.
- (ii) To file a Petition before the Company Law Board (Central Government)* under Section 17, of the Companies Act, 1956.
- (iii) To give an advertisement in two newspapers one in English language and the other in local language indicating the change and any member/creditor having objection can write to the Company Law Board (Central Government)*.
- (iv) To give notice to the State Government of West Bengal.
- (v) To submit all the required documents along with the fee to Company Law Board (Central Government)*.

The Company Law Board (Central Government)* after hearing the petition passes an order confirming the alteration in the memorandum of association of the company regarding the shifting of the registered office. The Company Law Board's (Central Government)* order should be filed by ABC Ltd with both the Registrars of Companies West Bengal and Maharashtra. After registration of the said order the Registrar of Companies Maharashtra will issue a certificate which is the conclusive proof that all the formalities have been complied with.

Change of registered office from the jurisdiction of one Registrar to the other Registrar within the same State: The procedure and law pertaining to the change of registered office from the jurisdiction of one Registrar to the other Registrar within the same State is contained in Section 17A of the Companies Act, 1956 as amended upto date is as follows:

- (i) Company can do so only if the Regional Director permits to it.
- (ii) Application for permission has to be made on a prescribed form.
- (iii) The Regional Directors are required to confirm the Company's application and inform it accordingly within a period of four weeks.
- (iv) After getting the confirmation of the Regional Director, the company must file a copy of the same with the Registrar of Companies within two months from the date of the confirmation together with a copy of the altered memorandum.
- (v) The Registrar is required to register the same and inform the company within one month from the date of filing.
- (vi) The Registrar's certificate is a conclusive evidence of the fact of alteration and of compliance with the requirements (Section 17-A).

(*Note: Students may kindly note that, all Sections of the Companies (Second Amendment) Act, 2002 have not come into force. Till such time, jurisdiction of Company Law Board will continue to remain unchanged.)

Question 15

M/s Honest Cycles Ltd. has received an application for transfer of 1,000 equity shares of Rs. 10 each fully paid up in favour of Mr. Balak. On scrutiny of the application form it was found that the applicant is minor. Advise the company regarding the contractual liability of a minor and whether shares can be allotted to the Balak by way of transfer. (November 2004)

Answer

The Companies Act, 1956 does not prescribe any qualification for membership. Membership entails an agreement enforceable in a court of law. Therefore, the contractual capacity as envisaged by the Indian Contract Act, 1872 should be taken into consideration. It was held in the case of *Mohri Bibi Vs. Dharmadas Ghose (1930) 30 Cal. 531 (P.O.)* that since minor has no contractual capacity, the agreement with a minor is void. Therefore, a minor or a lunatic cannot enter into an agreement to become a member of the company. However, the Punjab High Court held in the case of *Diwan Singh vs. Minerva Films Ltd (AIR 1956 Punjab 106)* that there is no legal bar to a minor becoming a member of a company by acquiring shares by way of transfer provided the shares are fully paid up and no further obligation or liability is attached to these. The same view was upheld by the Company Law Board in the case of *S.L. Bagree Vs. Britannia Industries Ltd (1980)*.

In view of the above, M/s Honest Cycles Ltd can give membership to Balak through 1000 shares, received by way of transfer, in favour of Mr. Balak a minor because the shares are fully paid up and no further liability is attached to these.

Question 16

M/s Low Esteem Infotech Ltd. was incorporated on 1.4.2003. No General Meeting of the company has been held so far. Explain the provisions of the Companies Act, 1956 regarding the time limit for holding the first annual general meeting of the Company and the power of the Registrar to grant extension of time for the First Annual General Meeting. (November 2004)

Answer

According to Section 166 of the Companies Act, 1956, every company shall hold its first annual general meeting within a period of 18 months from the date of incorporation. Since M/s Low Esteem Infotech Ltd was incorporated on 1.4.2003, the first annual general meeting of the company should be held on or before 30th September, 2004. Even though the Registrar of Companies is empowered to grant extension of time for a period not exceeding 3 months for holding the annual general meeting, such a power is not available to the Registrar in the case of the first annual general meeting. Thus, the company and its directors will be liable for the default if the annual general meeting was held after 30th September, 2004.

Question 17

Annual General Meeting of a Public Company was scheduled to be held on 15.12.2003. Mr. A, a shareholder, issued two Proxies in respect of the shares held by him in favour of Mr. 'X' and Mr. T. The proxy in favour of 'Y' was lodged on 12.12.2003 and the one in favour of Mr. X was lodged on 15.12.2003. The company rejected the proxy in favour of Mr. X as the proxy in favour of Mr. Y was of dated 12.12.2003 and thus in favour of Mr. X was of dated 13.12.2003. Is the rejection by the company in order? (November 2004)

Answer

In case more than one proxies have been appointed by a member in respect of the same meeting, one which is later time shall prevail and the earlier one shall be deemed to have been revoked. Thus, in the normal course, the proxy in favour of Mr. X, being later in time, should be upheld as valid.

But, as per Section 176 of the Companies Act, 1956, a proxy should be deposited 48 hours before the time of the meeting. In the given case, the proxies should have, therefore, been deposited on or before 13.12.2003 (the date of the meeting being 15.12.2003). X deposited the proxy on 15.12.2003. Therefore, proxy in favour of Mr. X has become invalid. Thus, rejecting the proxy in favour of Mr. Y is unsustainable. Proxy in favour of Y is valid since it is deposited in time.

Question 18

The Board of Directors of M/s Reckless Investments Ltd. have allotted shares to the investors of the company without issuing a prospectus or filing a statement in lieu of prospectus with the Registrar of Companies, Mumbai. Explain the remedies available to the investors in this regard. (November 2003)

Answer

According to the provisions of Section 70 and 71 of the Companies Act, 1956, any allotment of shares by a company without filing a prospectus or statement in lieu of prospectus will become irregular allotment. The effect of it is that the allotment made by M/s Reckless Investment Ltd will become voidable at the instance of the allottee i.e., the applicant for the shares within a

period of two months from the date of allotment. The allotment is voidable at the option of the investor applicant even if the company is in the course of winding up. Further, the directors liable for the default are also liable to compensate the company and the allottee respectively for any loss to which the company may have sustained or incurred thereby. There is a time limit of two years for claiming damages for loss. etc., by the investors.

Question 19

What is meant by a Guarantee Company? State the similarities and dissimilarities between a Guarantee Company and a Company having Share Capital. (November 2004)

Answer

Meaning of Guarantee Company: Where it is proposed to register a company with limited liability, the choice is to limit liability by shares or by guarantee. Section 12(2)(b) of the Companies Act, 1956 defines it as a company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake by the memorandum to contribute to the assets of the company in the event of its being wound up. Thus, the liability of the member of a guarantee company is limited by a stipulated amount mentioned in the memorandum. The members cannot be called upon to contribute more than the stipulated amount for which they have guaranteed in the memorandum of association of that company. The articles of association of such company shall state the number of members with which the company is to be registered.

Similarities and dis-similarities between the Guarantee Company and the Company having share capital: The common features between a "guarantee company" and the "company having share capital" are legal personality and limited liability. In case of the later company, the members' liability is limited by the amount remaining unpaid on the shares, which each member holds. Both of them have to state this fact in their memorandum that the members' liability is limited.

However, the dissimilarities between a 'guarantee company' and 'company having share capital' is that in the former case the members may be called upon to discharge their liability only after commencement of the winding up and only subject to certain conditions; but in latter case, they may be called upon to do so at any time, either during the company's life or during its winding up.

Further to note, the Supreme Court in *Narendra Kumar Agarwal vs. Saroj Maloo (1995) 6 SC C 114* has laid down that the right of a guarantee company to refuse to accept the transfer by a member of his interest in the company is on a different footing than that of a company limited by shares. The membership of a guarantee company may carry privileges much different from those of ordinary shareholders.

It is also clear from the definition of the guarantee company that it does not raise its initial working funds from its members. Therefore, such a company may be useful only where no working funds are needed or where these funds can be had from other sources like endowment, fees, charges, donations etc.

Question 20

The Board of Directors of M/s Optimistic Company Ltd. propose to pay interim dividend of Rs.2 per equity share of Rs. 10 each. Advise the Board regarding:

- (i) *the time limit for payment of interim dividend to the shareholders, and*
- (ii) *steps to be taken in case any dividend amount remains unpaid in the books of the company. (November 2004)*

Answer

The Board of directors of M/s Optimistic Company Ltd should take the following steps for declaration and payment of interim dividend;

- (i) The Board should carefully assess the adequacy of profits since in the event of absence or inadequacy of profits, the distribution would amount to reduction of capital.
- (ii) The interim dividend amount should be deposited in a special bank account.
- (iii) Depreciation on assets should be provided for the full year.
- (iv) If there is a carry forward loss from past years, the same should be adjusted against the estimated profits.
- (v) The company should transfer to reserves the prescribed percentage of the estimated profits of the period arrived at after providing for current year's depreciation and arrears of depreciation/loss.

Time Limit:

Interim dividend should be paid within 30 days. If any amount of interim dividend remains unpaid or unclaimed, for more than 30 days, the same should be transferred to a special account in a Scheduled Bank called 'Unpaid Interim Dividend Account of M/s Optimistic Company Ltd. Any amount remaining in the said bank account for a period of seven years should be transferred to the Investor Education and Protection Fund established under Section 205C of the Companies Act, 1956.

Question 21

The management of Ambitious Properties Ltd., has decided to take up the business of food processing activity because of the downward trend in real estate business. There is no provision in the object clauses of the Memorandum of Association to enable the company to carry on such business. State with reasons whether its object clause can be amended. State briefly the procedure to be adopted for change in the object clause. (May 2005)

Answer

Section 17(1) of the Companies Act, 1956 permits a company to alter its objects for the under mentioned purposes:

- (1) to carry on business more economically;
- (2) to attain the main purpose of the company by new and improved means;
- (3) to carry on some business which the existing circumstances may conveniently or advantageously be combined with existing business;
- (4) to change and enlarge the local area of operations;
- (5) to restrict or abandon any of the existing objects;
- (6) to sell or dispose of the whole or any part of the undertaking;
- (7) to amalgamate with any other company or body of persons.

The case of the company is covered under point No. 3 above and therefore the company can amend its object clause to take up the business of Food Processing activity.

PROCEDURE

The company should amend the object clause by passing a special resolution in a general meeting.

File with the Registrar of companies, a copy of the special resolution within one month from the date of passing of such resolution together with a printed copy of the memorandum as altered and the Registrar shall register the same and certify the registration under his hand written one month from the date of filing of such documents. The certificate is a conclusive evidence that all the requirements with respect to the alteration have been complied with and the memorandum so altered shall be the Memorandum of Association of the company.

Question 22

Several small depositors of Overtrading Company Ltd., have made complaints about non-refund of the deposits after due date. Explain briefly (1) the meaning of small depositor and (2) the duty of the company after the default has taken place in the matter of repayment of the deposits. (May 2005)

Answer

Meaning of Small Depositor: According to Section 58AA of the Companies Act, 1956, a small depositor means a depositor who has deposited in a financial year a sum not exceeding Rs. 20,000/- in a company and includes his successors, nominees and legal representatives.

Duty of company in case of default in repayment of deposits: Every company accepting deposits from small depositors should intimate the Company Law Board/Tribunal within 60 days of the date of default the name and address of each small depositor to whom it had defaulted in repayment of deposit or interest thereon. Thereafter, the company should also give intimation to the Company Law Board/ Tribunal on a monthly basis.

Question 23

A company is required to pay dividend to its shareholders within 30 days of its declaration. State the circumstances when a company will not be deemed to have committed any offence even if it does not pay within 30 days.
(May 2005)

Answer

Section 207 of the Companies Act, 1956 provides for the following cases when failure to pay dividend within 30 days of its declaration is not deemed to be an offence:

- (i) Where dividend could not be paid due to operation of any law;
- (ii) Where a shareholder has given directions to the company regarding the payment of the dividend and those directions cannot be complied with;
- (iii) Where there is a dispute regarding the right to receive dividend;
- (iv) Where the dividend has been lawfully adjusted by the company against any sum due to it (company) from the shareholder; or
- (v) Where for any reason, the failure to pay the dividend or to post the dividend warrant within the period of 30 days from the date of declaration was not due to any default on the part of the company.

Question 24

XYZ Limited realised on 3rd November, 2005 that particulars of charge created on 11th September, 2005 in favour of a bank were not filed with the Registrar of Companies for registration. What procedure should the company follow to get the charge registered with the Registrar of Companies? Would the procedure be different if the charge was created on 11th August, 2005 instead of 11th September, 2005? Explain with reference to the relevant provisions of the Companies Act, 1956.
(November 2005)

Answer

Section 125(1) of the Companies Act, 1956 provides that the prescribed particulars of the charge together with the instrument of any, by which the charge is created or evidenced, or a copy thereof, shall be filed with the Registrar within 30 days after the date of the creation of charge. In the given case particulars of charge have not been filed within the prescribed period of 30 days of its creation.

However, the Registrar of Companies is empowered under the proviso to Section 125(1) to extend the period of 30 days by another 30 days on payment of such additional fee not exceeding 10 times the amount of fee specified in Schedule X as the registrar may determine. Taking advantage of this provision, XYZ Limited should immediately file the particulars of charge with the Registrar and satisfy the Registrar that it had sufficient cause for not filing the particulars of charge within 30 days of creation of charge.

If the charge was created on 11th August, 2005, then the company has to apply to the Company Law Board u/s 141 (now Tribunal) and seek extension of time for filing the particulars for registration. The company must satisfy the Company Law Board (now Tribunal).

- (a) that the omission was accidental or due to inadvertence or due to some other sufficient cause or was not of the nature of prejudice the position of creditors or shareholders of the company or.
- (b) that it is just and equitable to grant relief on other grounds. On such satisfaction, the Company Law Board (now Tribunal) may extend the time for registration of charge on such terms and conditions as it may think expedient. Once the time is extended and it is made out that the particulars have been filed within the extended time, the Registrar is bound to register the charge.

Question 25

“Every shareholder of a company is also known as a member, while every member may not be known as a shareholder.” Examine the validity of the statement and point out the distinction between a ‘member’ and a ‘shareholder’.
(November 2005)

Answer

‘Member’ or ‘Shareholders’ of a company are the persons who collectively constitute the company as a corporate. Entry, the terms ‘Member’ and ‘Shareholder’ and ‘holder of a share’ are used interchangeable. (*Balkrishan Gupta v. Swadeshi Polytex Ltd.*) They are synonymous in the case of a company limited by shares, a company limited by guarantee and having a share

capital and on unlimited company whose capital is held in definite shares. But in the case of an unlimited company or a company limited by guarantee, a Member may not be a shareholder, for such a company may not have a share capital.

A shareholder may be distinguished from a Member as follows:

- (1) A registered shareholder is a member but a registered member may not be a shareholder because the company may not have a share capital.
- (2) A person who owns a bearer share warrant is a shareholder but he is not a member as his name is struck off the register of members. [Section 115(i)]. This means that a person can be a holder of shares without being a member.
- (3) A legal Representative of a deceased Member is not a member until he applies for registration. He is, however, a shareholder even though his name does not appear on the register of members.
- (4) A person who subscribes to the Memorandum of Association immediately becomes the member, even though no shares are allotted to him. Till shares are allotted to the subscriber, he is a member but not a shareholder of the company.
- (5) A person who has transferred his shares ceases to be a holder of those shares from the date of the transfer, but he continues to be a member till such time the transfer is registered in the name of the transfers in the books of the company.

Question 26

M/s India Computers Ltd. was registered as a Public Company on 1st July, 2005 in the State of Maharashtra. Another company by name M/s All India Computers Ltd. was registered in Delhi on 15th July, 2005. The promoters of India Computers Ltd. have failed to persuade the management of All India Computers Ltd. to change the company's name, as it closely resembles with the name of the first registered company.

Advise the Management of India Computers Ltd. about the remedies available to them under the provisions of the Companies Act, 1956. (November 2005)

Answer

Since the name of M/s India Computer Ltd., was registered earlier, on 1st July, 2005, the promoters have a right to ask the management of M/s All India Computers Ltd to change its name suitably as the said name closely resembles with that of the first registered company. Since the management of M/s All India Computers Ltd has not agreed, the promoters of India computers Ltd can approach the Central Government under Section 22 of the Companies Act, 1956 for rectification of the name of the company registered subsequently. The Central Government can direct the second registered company for correction. This direction can be given within 12 months from the date of registration of the latter company and the said company has to comply with the direction within 3 months by changing its name suitably failing which penal provisions will become applicable. The power of the Central Government under Section 22 has been delegated to the Regional Director.

Question 27

"Moonstar Ltd" is authorised by its articles to accept the whole or any part of the amount of remaining unpaid calls from any member although no part of that amount has been called up. 'A', a shareholder of the Moonstar Ltd., deposits in advance the remaining amount due on his shares without any calls made by "Moonstar Ltd."

Referring to the provisions of the Companies Act, 1956, state the rights and liabilities of Mr. A, which will arise on the payment of calls made in advance. (November 2005)

Answer

Mr.. A, a shareholder of the 'Moon Star Ltd'., deposited in Advance the remaining amount due on his shares without any calls made by 'Moon Star Ltd'. 'Moon Star Ltd' was authorized to accept the unpaid calls by its articles. According to section 92(1) of the Companies Act, 1956, a company may, if so authorized by the articles, accept from any member the whole or a part of the amount remaining unpaid or any shares by him although no part of that amount has been called up. The amount so received or accepted is described as payment in advance of calls. When a company receives payment in advance of calls, the rights and liabilities of the shareholder will be as follows:

- (i) The shareholder is not entitled to voting rights in respect of the moneys so paid by him until the same would, but for such payment become presently payable. [Section 92(2)].
- (ii) The shareholder's liability to the company in respect of the call for which the amount is paid is distinguished.
- (iii) The shareholder is entitled to claim interest on the amount of the call to the extent payable according to the articles of association. If there are no profits, it must be paid out of capital, because shareholder becomes the creditor of the company in respect of this amount.

- (iv) The amount received in advance of calls is not refundable.
- (v) In the event of winding up the shareholder ranks after the creditors, but must be paid his amount with interest, if any before the other shareholders are paid off.
- (vi) The power to receive the payment in advance of calls must be exercised in the general interest and for the benefit of the company.

Question 28

C, a member of LS & Co. Ltd., holding some shares in his own name on which Final call money has not been paid, is denied by the company voting right at a general meeting on the ground that the articles of association do not permit a member to vote if he has not paid the calls on the shares held by him.

With reference to the provisions of the Companies Act, 1956, examine the validity of company's denial to C of his voting right.
(November 2005)

Answer

Section 181 of the Companies Act, 1956 lays down the grounds on which right of a shareholder to vote at the general meeting may be excluded. These are:

- (a) Non-payment of calls by a member;
- (b) Non-payment of other sums due against a member;
- (c) Where company has exercised the right of lien on his shares.

Since the stipulation in the Articles relates to one of the grounds permitted under Section 181, the same is valid C's protest is not valid.

Question 29

At a General meeting of a company, a matter was to be passed by a special resolution. Out of 40 members present, 20 voted in favour of the resolution, 5 voted against it and 5 votes were found invalid. The remaining 10 members abstained from voting. The Chairman of the meeting declared the resolution as passed.

With reference to the provisions of the Companies Act, 1956, examine the validity of the Chairman's declaration.
(November 2005)

Answer

Under Section 189(2) of the Companies Act, 1956, for a valid special resolution, the following conditions need to be satisfied:

- (i) The intention to propose the resolution, as a special resolution must have been specified in the notice calling the general meeting or other intimation given to the members;
- (ii) The notice required under the Companies Act must have been duly given of the general meeting;
- (iii) The votes cast in favour of the resolution (whether by show of hands or on poll) by members present in person or by proxy are not less than 3 times the number of votes, if any, cast against the resolution.

Thus, in terms of the requisite majority, votes cast in favour have to be compared with votes cast against the resolution. Abstentions or in valued, if any, are not to be taken into account. Accordingly, in the given problem, the votes cast in favour (20) being more than 3 times of the votes cast against (5), if other conditions of Section 189(2) are satisfied, the decision of the Chairman is in order.

Question 30

Mars India Ltd. owed to Sunil Rs. 1,000. On becoming this debt payable, the company offered Sunil 10 shares of Rs. 100 each in full settlement of the debt. The said shares were fully paid and were allotted to Sunil.

Examine the validity of these allotment in the light of the provisions of the Companies Act, 1956.
(November 2005)

Answer

Allotment of Shares: As per the Section 75 of the Companies Act, 1956 when shares are allowed to a person by a company, payment may be made – (i) in cash, or (ii) in kind (with the consent of the company).

'Cash' here does not necessarily mean the current coin of the country. It means "such transaction as would in an action at law for calls, support a plea of payment."

On the basis of the above provision and decision of the related case *Coregam Gold Mining Co. of India V. Roper, (1892), A.C. 125*, the allotment of fully paid up shares in full satisfaction of Sunil's debt is valid.

Question 31

The Directors of "Sunrise Computers Ltd." desire to change the Company's name to "Royal Computers Ltd." and seek your advice. Explain the procedure to be followed, for the said purpose, under the Companies Act, 1956.

(May 2006)

Answer

Change of name of the company: 'Sunrise Computers Ltd.' may change its name to 'Royal Computers Ltd.' as per section 21 of the Companies Act, 1956.

A company may by special resolution, and with the approval of the Central Government, signified in writing, change its name [Section 21]. Power under Section 21 has been delegated to the Registrar of Companies vide notification GSR 507(E) dated 24-6-85]. The application for change of name is required to pay a fee of Rs. 500/- to ascertain whether the proposed name is available and thereafter pass the required special resolution and thereafter submit the necessary documents to the Registrar. If the Registrar is satisfied that the relevant procedures have been complied with by the Company, in this regard, the Registrar shall issue fresh certificate with the change embodied therein. The change in name shall not affect any of the company's rights or obligations of the company or render any legal proceedings by / or against it. Any legal proceedings which might have been continued or commenced by or against the company by its former name may be continued by its new name [Section 23].

Question 32

The Registrar of Companies on examining the statutory report filed with him by M/s Jyothi Company Ltd., finds that the report has been certified as correct, by all the directors of the Company, except the Managing Director. The Registrar refuses to register the said document on the ground that it was not signed by the Managing Director of the Company.

Answer the following in the light of the Companies Act, 1956:

- (i) Whether the Registrar of Companies can hold the officers of the Company liable?*
- (ii) What provisions of the Companies Act have not been complied with by the company and its officers?*
- (iii) To what penalties are the Company and its officers liable? (May 2006)*

Answer

FILING REPORT WITHOUT SIGNATURE:

- (i) Yes, the Registrar can hold the officers of the company liable.*
- (ii) Section 165(4) of the Companies Act, 1956 requires the statutory report to be certified as correct by at least two directors of the company one of whom must be a managing director, where there is one. Thus, the aforesaid provision of Section 165(4) has not been complied with.*
- (iii) Sub –Section (9) of Section 165 provides for penalties for non-compliance of Sub-section (4). It makes every director or other officer of the Company who is in default punishable with fine upto Rs. 5,000/-.*

Question 33

To remove the Managing Director, 40% members of Global Ltd. submitted requisition for holding extra-ordinary general meeting. The company failed to call the said meeting and hence the requisitionists held the meeting. Since the Managing Director did not allow the holding of meeting at the registered office of the Company, the said meeting was held at some other place and a resolution for removal of the Managing Director was passed.

Examine the validity of the said meeting and resolution passed therein in the light of the companies Act, 1956.

(May 2006)

Answer

Extraordinary meeting: Every shareholder of a company has a right to requisition for an extraordinary general meeting. He is not bound to disclose the reasons for the resolution to be proposed at the meeting [Life Insurance Corporation of India vs. Escorts Ltd., (1986) 59 Comp. Cas. 548].

Section 169 of the companies Act contains provisions regarding holding of extraordinary general meetings. It provides that if directors fail to call a properly requisitioned meeting, the requisitionists or such of the requisitionists as represent not less than 1/10th of the total voting rights of all the members (or a majority of them) may call a meeting to be held on a date fixed within 3 months of the date of the requisition.

Where a meeting is called by the requisitionists and the registered office is not made available to them, it was decided in R. Chettiar v. M. Chettiar that the meeting may be held any where else.

Further, resolutions properly passed at such a meeting, are binding on the company.

Thus, in the given case, since all the above mentioned provisions are duly complied with. Hence the meeting with the resolution removing the managing director shall be valid.

Question 34

The principal business of XYZ Company Ltd. was the acquisition of vacant plots of land and to erect the houses. In the course of transacting the business, the Chairman of the Company acquired the knowledge of arranging finance for the development of land. The XYZ Company introduced a financier to another company ABC Ltd. and received an agreed fee of Rs. 2 lakhs for arranging the finance. The Memorandum of Association of the company authorises the company to carry on any other trade or business which can in the opinion of the board of directors, be advantageously carried on by the company in connection with the company's general business. Referring to the provisions of the Companies Act, 1956 examine the validity of the contract carried out by XYZ Company Ltd. with ABC L
(November 2006)

Answer

Under the provision of Companies Act, 1956 as contained in Section 17(1) a company is permitted to alter the objects to carry on some business which come under the existing circumstances may conveniently advantageously be combined with the existing law of the company.

In the light of the clause in the Memorandum of Association of the company which authorizes the company to carry on any other trade or business which can, in the opinion of the board of directors, be advantageously carried on by the company in connection with the general business. Since the directors honestly believes that the transaction could be advantageously carried on an ancillary to the company's main objects, therefore, it was not ultra vires. (Bell Houses Ltd. Vs. City Wall Properties Ltd.)

Question 35

XY Ltd. has its registered office at Mumbai in the State of Maharashtra. For better administrative conveniences the company wants to shift its registered office from Mumbai to Pune (State of Maharashtra). What formalities the company has to comply with under the provisions of the Companies Act, 1956 for shifting its registered office as stated above? Explain.
(November 2006)

Answer

According to Section 17A read with Section 146 of the Companies Act, 1956, the following procedure is to be followed by the company for shifting of the registered office of the company:

- (i) A special resolution is required to be passed at a general meeting of the share holders.
- (ii) Confirmation of Regional Director is to be obtained and for this company has to apply in the prescribed form.
- (iii) The Regional Director shall convey his confirmation within four weeks from the date of receipt of the application.
- (iv) Copy of the special resolution within 30 days and certified copy of the confirmation along with a printed copy of the altered memorandum of association must be filed with the Registrar of companies within 2 months from the date of confirmation.
- (v) *Within one month of the filing, the Registrar of companies shall certify registration, which shall be the conclusive evidence that all requirements with respect to alteration and confirmation have been complied with.*

Question 36

With a view to issue shares to the general public a prospectus containing some false information was issued by a company. Mr. X received copy of the prospectus from the company, but did not apply for allotment of any shares. The allotment of shares to the general public was completed by the company within the stipulated period. A few months later, Mr. X bought 2000 shares through the stock exchange at a higher price which later on fell sharply. X sold these shares at a heavy loss. Mr. X claims damages from the company for the loss suffered on the ground the prospectus issued by the company contained a false statement. Referring to the provisions of the Companies Act, 1956 examine whether X's claim for damages is justified.

Answer

According to Section 62 of the Companies Act, 1956, every director, promoter and every person who is responsible for the issue of the prospectus containing false or untrue information are liable to compensate all those persons who subscribe to the shares on the faith of prospectus. It was held in the case of Peek Vs. Gurney that the above-mentioned remedy by way of damage will not be available to a person if he has not purchased the shares on the basis of prospectus. Since X purchased shares through the stock exchange open market which cannot be said to have bought shares on the basis of prospectus. X cannot bring action for deceit against the directors. X will not succeed.

Question 37

X had applied for the allotment of 1,000 shares in a company. No allotment of shares was made to him by the company. Later on, without any further application from X, the company transferred 1,000 partly-paid shares to him and placed his name in the Register of Members. X, knowing that his name was placed in the Register of Members, took no steps to get his name removed from the Register of members. The company later on made final call. X refuses to pay for this call. Referring to the provisions of the Companies Act, 1956, examine whether his (X's) refusal to pay for the call is tenable and whether he can escape himself from the liability as a member of the company. (November 2006)

Answer

According to Section 164 of the Companies Act, 1956, the register of member is a prima facie evidence of the truth of its contents. The contents of the register of members are of decisive importance in determining as to who were the shareholders of the company at a crucial time. Accordingly, if a person's name, to his knowledge, is there in the register, he shall be deemed to be a member. In the given case X knows that his name is included in the register of shareholders and stands by and allows his name to remain, he is holding out to the public that he is shareholder and thereby he will be liable as shareholder.

Question 38

DJA Company Ltd. has only 50 preference shareholders. A meeting of the preference shareholders who called by the company for amending the terms of these shares. Mr. A, was the only preference shareholder who attended the meeting. He, however, held proxies from all other shareholders. He took the Chair, conducted the meeting and passed a resolution for amending the terms of the issue of these shares. Referring to the provisions of the Companies Act, 1956, examine the validity of the meeting and the resolution passed thereat. (November 2006)

Answer

This question was decided in Sharp Vs., Dawes case which provides that "The word meeting prima facie means coming together of more than one person." In this given case, only one shareholder present. This was not a meeting within the meaning of the Companies Act, 1956. According to Section 174 another requirement of valid meeting is the presence of a required quorum. Moreover, the section also says that "the members actually present shall be the quorum." The presence of one member may not be enough. This was not a valid meeting.

In East Vs. Bennet Brothers Ltd. (1911) it has been held that in case of a class meeting of all the shares of a particular class are held by one person, one person shall form the quorum. In the given case, since all the shares are not held by one person, no quorum is therefore present. The meeting and the resolution passed there shall not be valid.

Question 39

The object clause of the Memorandum of Association of LSR Private Ltd, Lucknow authorized it to do trading in fruits and vegetables. The company, however, entered into a Partnership with Mr. J and traded in steel and incurred liabilities to Mr. J. The Company, subsequently, refused to admit the liability to J on the ground that the deal was 'Ultra Vires' the company. Examine the validity of the company's refusal to admit the liability to J. Give reasons in support of your answer. (May 2007)

Answer

In terms of Companies Act, 1956, the powers of the company are limited to:

- (i) Powers expressly given by the Memorandum (which is popularly known as 'express' power or conferred by the Companies Act 1956, or other statute and
- (ii) powers reasonably incidental or necessary to the company's main purpose (termed as "Implied" powers). The Act further provides that the acts beyond the powers of a company are ultra vires and void and cannot be ratified even though every member of the company may give his consent [*Ashbury Railway Carriage Company Vs Richee*]

The object clause enable shareholders, creditors or others to know what its powers are and what is the range of its activities and enterprises. The objects clause therefore is of fundamental importance to the share holder, creditors and others.

M/s LSR Pvt. Ltd is authorised to trade directly on fruits and vegetables. It has no power to enter into a partnership for Iron and steel with Mr. J. Such act can never be treated as 'express' or 'implied' powers of the company. Mr J who entered into partnership is deemed to be aware of the lack of powers of M/s LSR (Pvt) Ltd. In the light of the above, Mr, J cannot enforce the agreement or liability against M/s LSR Pvt. Ltd. Mr. J should be advised accordingly. This conclusion is supported by the decision reported in the case of '*The Ganga Mata Refinery Company (Pvt) Ltd CIT*'.

Question 40

VRS Company Ltd. is holding 45% of total equity shares in SV Company Ltd. The Board of Directors of SV Company Ltd. (incorporated on January 1, 2004) decided to raise the share capital by issuing further Equity shares. The Board of Directors resolved not to offer any shares to VRS Company Ltd, on the ground that it was already holding a high percentage of the total number of shares already issued, in SV Company Ltd. The Articles of Association of SV Company Ltd. provide that the new shares be offered to the existing shareholders of the company. On March 1, 2007 new shares were offered to all the shareholders except VRS Company Ltd. Referring to the provisions of the Companies Act, 1956 examine the validity of the decision of the Board of Directors of SV Company Limited of not offering any further shares to VRS Company Limited. (May 2007)

Answer

The problem as asked in the question is based on the application of the provisions of the Companies Act, 1956 as contained in Section 81 and the ruling given in *Gas Meter Co. Ltd. Vs Diaphragm & General leather co. Ltd.*

According to Sec 81, if at any time after the expiry of two years from the formation of the company or after the expiry of one year from the first allotment of shares, whichever is earlier, it is proposed to raise subscribed capital by allotment of further shares, it should be offered to the existing equity share holders of the company in proportion to the capital paid upon those shares. Further in case of *Gas Meter Ltd. Vs Diaphragm, & General; leather Co. Ltd* where the facts of the case were similar to those given in the problems asked in the question, the articles of Diaphragm Co. provided that the new shares should first be offered to the existing share holders. The company offered new shares to all shareholders excepting Gas Co., which held its controlling shares. It was held that D company could be sustained from doing this.

In the given case applying the provisions and the ruling in the above case, SV Ltd.'s decision not to offer any further shares to VRS Co. Ltd on the ground that VRS Co. Ltd already held a high percentage of shareholding in SV Co. Ltd. is not valid for the reason that it is violative of the provisions of Section 81 and against the ruling in the above case.

Secondly, the offer for issue of the shares was made on 1st March 2007, i.e. after two years of the formation of the company. Therefore Board of Directors of SV Ltd cannot take a decision not to allot shares to VRS Company, unless the same is approved by the Co. in general meeting by means of special resolution as required under Section 81 (A).

Question 41

X, a registered shareholder of Y Limited left his share certificates with his broker. A forged the transfer deed in favour of Z, accompanied by these share certificates lodged the transfer deed alongwith the share certificates with the company for registration. The Company Secretary who had certain doubts, wrote to X informing him of the proposed transfer and in the absence of a reply from him (X) within the stipulated time, registered the transfer of shares in the name of Z. Subsequently, Z sold the shares to J and J's name was placed in the register of shareholders. Later on, X discovered that forgery has taken place.

Referring to the provisions of the Companies Act, 1956, state the remedy available to X and Z in the given case. Explain. (May 2007)

Answer

In the given case, there is a forged transfer of shares. The company in such a case should first inquire into the validity of the instrument of transfer. It should also send a notice to the transfer or of his address and inform him that such a transfer has been lodged and if no objection is made before this specified date, it would be registered.

Remedies available to X:

Since a forged transfer is a nullity, it does not pass any legal title to the transferee. The true owner can have his name restored on the register of member. A forged document can never have any legal effect.

(1) Can also claim any dividend, which may not have been paid to him during the intervening period. (*Barton V North Staffordshire*)

Remedy to Z:

(2) If by forgery a person obtains a certificate of transfer of shares from a company and transfers the shares to a purchaser for value acting in good faith i.e. without the knowledge of forgery, such purchaser does not get good title to the shares so transferred because a forged transfer is a nullity and cannot be a source of a valid transfer of title. But the company shall be liable to compensate the purchaser in so far as the company had issued a certificate to transfer and was therefore, estopped from denying the liability accruing from his own act. Therefore, if Z has suffered any loss, he can claim it from the company in this case.

Question 42

The paid-up Share Capital of AVS Private Limited is Rs. 1 crore, consisting of 8 lacs Equity Shares of Rs. 10 each, fully paid-up and 2 lacs Cumulative Preference Shares of Rs. 10 each, fully paid-up. XYZ Private Limited and BCL Private Limited are holding 3 lacs Equity Shares and 1,50,000 Equity Shares respectively in AVS Private Limited.

XYZ Private Limited and BCL Private Limited are the subsidiaries of TSR Private Limited.

With reference to the provisions of the Companies Act, 1956, examines whether AVS Private Limited is a subsidiary of TSR Private Limited ? Would your answer be different if TSR Private Limited has 8 out of total 10 directors on the Board of Directors of AVS Private Limited?
(May 2007)

Answer

Holding, subsidiary relationship: For the purpose of determining whether a company is subsidiary of another company, only equity shares issued by the first mentioned company are to be taken into account [Section 4 (1) (b) (ii), Companies Act, 1956]. Again, shares held by a subsidiary company shall be treated as held by its holding company [Section 4 (3) (b) (ii)] If a company by itself or along with its subsidiaries holds more than half in nominal value of the equity shares capital of another company, it will be considered as the holding company of the other company [Section 4(3) (b) (ii)]

In this case, the equity share capital of AVS Pvt. Ltd. is Rs. 80,00,000 consisting of 8,00,000 equity shares of Rs 10 each fully paid up XYZ and BCL Pvt. Ltd. are holding 4,50,000 (3,00,000+1,50,000) equity shares in AVS Pvt Ltd., TSR Pvt, Ltd will be treated as holding more than half in nominal value of the equity share capital of AVS Pvt Ltd.

If TSR Pvt. Ltd. controls the composition of the Board of Directors of AVS Pvt. Ltd; it will also be treated as holding company by virtue of Section 4 (1) (a). Hence the answer will not be different.

Question 43

ABC Limited served a notice of a general meeting upon its members. The notice stated that a resolution to increase the Share Capital of the company would be considered at the meeting. A member complains to the company that the amount of the proposed increase was not specified in the notice. In the light of the provisions of the Companies Act, 1956, examine the validity of the notice.
(May 2007)

Answer

Section 173 of the Companies Act, 1956 requires a company to annex an explanatory statement to every notice for a meeting of company, at which some 'special business' is to be transacted. This explanatory statement is to bring to the notice of members all material facts relating to each item of special business. Section 173 further specifies that all business in case of any meeting is regarded as special business. Thus, the objection of the shareholder is valid since the details on the item to be considered are lacking. The information about the amount is a material fact with reference to the proposed increase of share capital. The notice is, therefore, not a valid notice under Section 173.

Question 44

XYZ Limited held its Annual General Meeting on September 15, 2006. The meeting was presided over by Mr. V, the Chairman of the Company's Board of Directors. On September 17, 2006, Mr. V, the Chairman, without signing the minutes of the meeting, left India to look after his father who fell sick in London. Referring to the provisions of the Companies Act, 1956, state the manner in which the minutes of the above meeting are to be signed in the absence of Mr. V and by whom.
(May 2007)

Answer

By virtue of Section 193 (1A) (b) of the Companies Act, 1956, minutes of proceeding of general meeting can be signed and dated within a period of 30 days, by a director duly authorized by the board for the purpose. In the circumstances contemplated by the question, therefore, a Board meeting has to be convened and one of the directors present thereat be authorized to sign and date the minutes of the annual general meeting.

Question 45

A limited company is formed with its Articles stating that one Mr. X shall be the solicitor for the company, and that he shall not be removed except on the ground of misconduct. Can the company remove Mr. X from the position of solicitor even though he is not guilty of misconduct?
(November 2007)

Answer

The Articles of Association of a company are its bye-laws that govern the management of its internal affairs. As between outsiders and the company, Articles do not give any right to outsiders against the company even though their names might have been mentioned in the Articles. An outsider cannot take advantage of the Articles to found claim thereon against the company. Thus, in the given case, the company shall succeed in removing Mr. X as solicitor of the company (*Eley V Positive Government Security Life Assurance Co.*)

Question 46

For a special resolution in a Company's general meeting, 10 voted in favour, 2 against and 4 abstained. The chairman declared the resolution as passed. Is it a valid resolution as per the provisions of the Companies Act, 1956.
(November 2007)

Answer

Yes, it is a valid resolution. Section 189 (2) (c) of the Companies Act, 1956 provides that the votes cast in favor of resolution (whether on a show of hands, or on a poll as the case may be) by members who, being entitled so to do, vote in person or where proxies are allowed, by proxy, are not less than three times the number of votes, if any, cast against resolution by members so entitled and voting.

Question 47

While sanctioning working capital limit of a company, the rate of interest has been fixed at a specified percentage above the bank rate as notified by the Reserve Bank of India. There was a change in the interest rate due to RBI notification issued later. The bank insisted on filing a return of modification of charges. Is the stand of the bank correct? Discuss this in the light of the provisions of the Companies Act, 1956.
(November 2007)

Answer

Section 135 of the Companies Act, 1956 provides that whenever the terms or conditions or the extent or operation of any charge registered under this part are or is modified, it shall be the duty of the company to send to the Registrar the particulars of such modifications and the provisions of this part as to registration of a charge shall apply to modification of the charge. In the light of this provision the changes in the rate of interest constitute modification; therefore, the stand of bank is correct.

Question 48

X, a chemical manufacturing company distributed 20 lac (Rs. Twenty Lac) to scientific institutions for furtherance of scientific education and research. Referring to the provisions of the Companies Act, 1956 decide whether the said distribution of money was "Ultra vires" the company?
(November 2007)

Answer

Distribution of Rupees Twenty Lac by a company engaged in Chemical manufacturing is not 'Ultra Vires' the company since it was conducive to the continued growth of the company as chemical manufacturers (*Evans v. Brunnner, Mood & Co. Ltd. 1921*).

Question 49

Sunrise Limited submitted the documents for incorporation on 5th October, 2006. It was incorporated and certificate of incorporation of the company was issued by the Registrar on 20th October, 2006. The company on 14th October, 2006 entered into a contract which created its contractual liabilities. The company denies the said liability on the ground that company is not bound by the contract entered into prior to issuing of certificate of incorporation. Decide under the provisions of the Companies Act, 1956, whether the company can be exempted from the said contractual liability. (November 2007)

Answer

Sometimes contracts are made on behalf of a company even before it is incorporated. But no contracts can bind a company before it becomes capable of contracting by incorporation. Two consenting parties are necessary to a contract, whereas the company before incorporation is a non-entity [*Kelner v. Baxter 1866*].

Pre-incorporation contracts in general are void ab initio and hence not binding on the company. However, under section 19 (e) of the Specific Relief Act, 1963 the party to the contract can enforce the contracts against the company if the company had adopted the same after incorporation and the contract is warranted by the terms of incorporation. Thus unless the company adopts the contract, the other party cannot enforce the same against the company. However, promoters can be held personally liable. The problem is based on above case i.e. *Kelner v. Baxter*. After application of above provisions it is clear that the company can be exempted from the said contractual liability .

Question 50

P the secretary of a XYZ Limited issues a Share certificate in favour of A purporting to be signed by the directors and the secretary and the seal of the company affixed to it. In fact the secretary forged the signature of the directors and has affixed the seal without authority. Can A hold the company liable for the shares covered by the share certificate, under the provisions of the Companies Act, 1956? (November 2007)

Answer

Share certificate is a document under the common seal of the company specifying that a member is the holder of specified number of shares of the company. The company is estopped from denying the title of the shareholder on number of shares in the share certificate. Hence share certificate is a prima facie evidence of the title of member to such shares.

Facts given in the problem are based on the facts of *Rubben v. Great Fingall Consolidated Co. [1906]*. In this case it was held that the company is liable if an officer of the company, who has no authority to issue a certificate, issues a forged certificate. Hence A can hold the company liable for the shares covered by the forged share certificate issued by P, the secretary of XYZ Limited.

Question 51

ABC Pvt. Ltd., Company is a Private Company having five members only. All the members of the company were going by car to Mumbai in relation to some business. An accident took place and all of them died. Answer with reasons, under the Companies Act, 1956 whether existence of the company has also come to the end? (May 2008)

Answer

Death of all members of a Private Limited Company, The Companies Act, 1956

A joint stock company is a stable form of business organization. Its life does not depend upon the death, insolvency or retirement of any or all shareholder(s) or director(s). The provision for transferability or transmission of the shares helps to preserve the perpetual existence of a company. Law creates it and law alone can dissolve it. Members may come and go but the company can go on forever. So in such case, the ABC Pvt. Ltd. Co. does not cease to exist. By way of transmission of shares, shares are transmitted to their legal representatives. The company ceases to exist only on the winding up of the company. Therefore, even with the death of all members (i.e. 5), ABC (P) Ltd. does not cease to exist.

Question 52

Before the incorporation of the company, the promoters of the company entered into an agreement with Mr. Jainson to buy an immovable property on behalf of the company. After incorporation, the company refused to buy the said property. Advise Mr. Jainson whether he has any remedy under the provisions of the Companies Act, 1956? (May 2008)

Answer

Pre-Incorporation Contracts, The Companies Act, 1956

The present case is related to the pre-incorporation contract. The promoters of the company usually enter into contracts to acquire some property or right for the company which is yet to be incorporated. As such contracts are a nullity and the company cannot sue or be sued on such contract when company comes into existence. So in such case 'A' has remedy against the promoters only. They are liable personally for those contracts that are made on behalf of the company before it comes into existence. Even the company cannot ratify such contracts after its registration. Such contracts are deemed to have been entered into personally by the promoters.

Question 53

Under the Articles of Association of Sunshine Ltd. Company, directors had power to borrow up to Rs.10,000 without the consent of the general meeting. The Directors themselves lent Rs.35,000 to the company without such consent and took debentures of the Company. Decide under the provisions of the Companies Act, 1956, whether the company is liable? If so, what is the extent of liability of the company in this case? (May 2008)

Answer

Directors' Power to Borrow, The Companies Act, 1956

An outsider is presumed to know the constitution of company, but not what may or may not have taken place within the doors that are closed to him. However, where a person dealing with a company has actual or constructive notice of the irregularity as regards internal management, he cannot claim the benefit under the rule of indoor management.

In this case, the directors of a company could borrow any amount up to Rs. 10,000/- without the resolution of the company in a general meeting. But for any amount beyond Rs. 10,000/- they had to obtain the consent of the shareholders in a general meeting. The directors themselves lent Rs. 35,000/- to the company without such consent and took debentures. The directors had the notice of the internal irregularity and hence the company was liable to them only for Rs. 10,000/-

Question 54

Peek Ltd. Co. issued and published its prospectus to invite the investors to purchase its shares. The said prospectus contained false statement. Mr. X purchased some partly paid shares of the company in good faith on the Stock Exchange. Subsequently, the company was wound up and the name of Mr. X was in the list of contributors. Decide:

(i) Whether Mr. X is liable to pay the unpaid amount?

(ii) Can Mr. X sue the directors of the company to recover damages?

(May 2008)

Answer

False Statement in Prospectus, the Companies Act, 1956

(i) Yes, X is liable to pay the unpaid amount on the shares. As X has purchased partly paid shares, so he is liable for the remaining part of the shares. At the time of winding up he is liable to contribute a contributory. The related case law in this subject matter is *Peak vs. Gurney*.

(ii) No, X cannot sue the directors to recover damages for the misstatement. The shareholder must have relied on the statement in the prospectus in applying for shares. If a person purchases shares in open market, the prospectus ceases to be operative. In the present case, Mr. X purchased shares in good faith on the stock exchange. He had not relied on the statement in prospectus. So he cannot sue.

Question 55

The Articles Association of PQR Ltd. provided that documents upon the company may be served only through E-mail. Arvind sent a document to the company by registered post. The company did not accept the document on the ground that sending documents to the company by post was in violation of the Articles. As a result Arvind suffered loss. Decide the validity of argument of the company and claim of Arvind for damages in the light of provisions of the Companies Act, 1956. (May 2008)

Answer

Service of Documents, the Companies Act, 1956

Section 51 of the Companies Act, 1956 contains the law relating to service of documents on company. The Section provides that a document may be served on a company or an officer thereof by sending it to the company or officer at the registered office of the company by post under a certificate of posting or by registered post, or by leaving it at its registered office.

Since, as per Section 9 of the Companies Act, any provision in the Articles of Association contrary to the provisions of the Act shall be void, the requirement in the Articles that documents shall be served on the company only through E-mail is not valid. Accordingly, company's refusal to accept the document is not valid and company shall be held liable in damages to Arvind.

Question 56

The Directors of Mars India Ltd. desire to alter capital clause of Memorandum of Association of their company. Advise them, under the provisions of the Companies Act, 1956 about the ways in which the said clause may be altered and the procedure to be followed for the said alteration.
(May 2008)

Answer

Alteration of Capital (Section 94) the Companies Act, 1956

A limited company with a share capital can alter the capital clause of its memorandum of association in any of the following ways, provided authority to alter is given by the articles.

- (i) it may increase its capital by issuing new shares
- (ii) consolidated the whole or any part of its shares capital into shares of larger amount
- (iii) convert shares into stock or vice versa
- (iv) sub-divide the whole or any part of its share capital into shares of smaller amount
- (v) cancel those shares which have not been taken up and reduce its capital accordingly.

Provisions regarding confirmation, resolution and notices: Any of the above things can be done by the company by passing a resolution at general meeting, but do not require to be confirmed by the National Company Law Tribunal. Within thirty days of alteration notice must be given to the Registrar who will record the same and make necessary alteration in the company's memorandum and articles. Notice to the Registrar has similarly to be given when redeemable preference shares have been redeemed. Similar information is also required to be sent where the capital has been increased beyond the authorized limit, or where a company, being not limited by shares, has increased the number of its members.

Question 57

The Chairman of the meeting of a company received a Proxy 54 hours before the time fixed for the start of the meeting. He refused to accept the Proxy on the ground that the Articles of the company provided that a Proxy must be filed 60 hours before the start of the meeting. Decide, under the provisions of the Companies Act, 1956 whether the Proxy holder can compel the Chairman to admit the Proxy?
(May 2008)

Answer

Proxy, the Companies Act, 1956

Yes. The holder of proxy can compel. As per Section 176(3) of the Companies Act, 1956 proxy shall be deposited with the company within 48 hours before the meeting. Any provisions contained in the Articles of a company that requires a longer period than 48 hours before a meeting of the company for depositing a proxy, shall have effect as if a period of 48 hours had been required by such provision for such deposit.

Question 58

Ramesh, who is a resident of New Delhi, sent a transfer deed, for registration of transfer of shares to the company at the address of its Registered Office in Mumbai. He did not receive the shares certificates even after the expiry of four months from the date of dispatch of transfer deed. He lodged a criminal complaint in the Court at New Delhi. Decide, under the provisions of the Companies Act, 1956, whether the Court at New Delhi is competent to take action in the said matter? (May 2008)

Answer

Jurisdiction of Court, now Tribunal, the Companies Act, 1956

According to Section 113(1) of the Companies Act, 1956 every company, unless prohibited by any provision of law or of any order of court, Tribunal or other authority, shall within two months after the application for the registration of transfer of any such shares, deliver the certificates of all shares transferred. In the case of a listed company under the listing agreement this period has been reduced to 30 days.

The facts of the given case are similar to *H.V. Jaya Ram Vs. ICICI Ltd., 1998*. In this case the Special Court for Economic Offences in the State of Karnataka rejected the appellant's complaint against the respondent company on the ground that since the company had its registered office at Mumbai it is only the court which has territorial jurisdiction over the registered office of the company that can entertain the petition and not the court located in the State of Karnataka where the shareholder is residing. The High Court also upheld the order of the Special Court. On appeal Supreme Court held that cause of action for failure to deliver share certificate arises where the registered office of the company is situated and not in the jurisdiction of the Court located in the place where the complaint resides.

Accordingly in the present case also, the Court in New Delhi cannot entertain the complaint against a company having its registered office in Mumbai.

Question 59

A company was started with the object of building 'A mall with shops'. The building was destroyed by fire and the company wanted to alter the objects clause in the memorandum by substituting the words 'A mall with shops' with the words "Shops, Residential buildings and Warehouses for letting purposes." Will this alteration of the memorandum for the purpose be permissible? Decide referring to the provisions of the companies Act, 1956. (November 2008)

Answer

Alteration of objects

Section 17 (1) of the Companies Act, 1956, permits a company to alter its objects in the memorandum to carry on some business which under the existing circumstances may conveniently or advantageously be combined with the existing business. Thus, in the given problem the new object of "shops, residential buildings and warehouses for letting purposes" can be conveniently and advantageously combined with the existing object of building a "mall with shops" which is obviously for letting purposes. Accordingly, alteration is permissible.

Question 60

The Memorandum of Association of a company was presented to the Registrar of Companies for registration and the Registrar issued the certificate of incorporation. After complying with all the legal formalities a company started a business according to the object clause, which was clearly an illegal business. The company contends that the nature of the business cannot be gone into as the certificate of incorporation is conclusive. Answer the question whether company's contention is correct or not. (November 2008)

Answer

Object clause

The subscribers to the memorandum may choose any object or objects for the purpose of their company. However there are two restrictions on the selection of "object" for a company:

- (i) the object should not include anything which is illegal or contrary to law or public policy.
- (ii) the objects should not also contemplate doing anything which is prohibited by the Companies Act.

On applying the above provision in the present problem, the company's contention is wrong. Though a certificate of incorporation is a conclusive evidence of its registration, that is, it is conclusive evidence as to the fact that all requirements of the Companies Act for the incorporation of a company have been complied with, and that now company is a legal entity but, it does not mean that all its objects are legal. In *Bowman v. Secular Society Ltd.*, the court held that the statute does not provide that all or any of the objects specified in the memorandum, if otherwise illegal, would be rendered legal by the certificate. Therefore, the contention of the company that the nature of business cannot be gone into after the certificate of incorporation has been obtained is not tenable.

Question 61

M applies for share on the basis of a prospectus which contains mis-statement. The shares are allotted to him, who afterwards transfers them to N. Can N bring an action for a rescission on the ground of mis-statement? Decide under the provisions of the Companies Act, 1956.

(November 2008)

Answer

Mis-statement in prospectus

No, N cannot bring an action for rescission on the ground of mis-statement as N had not contracted with the company on the basis of prospectus containing mis-statement. The right to rescind the contract is available only to original allottees (*Peek vs Gurney*)

Question 62

A public limited company has only seven shareholders, all the shares being fully paid-up. All the shares of one such shareholder are sold by the court in an auction and purchased by another shareholder. The company continues to carry on business thereafter. Discuss the liabilities of the shareholders of the company under the Companies Act, 1956.

(November 2008)

Answer

Consequences of membership falling below legal minimum

The problem in the question relates to reduction of membership below the statutory minimum. Section 12 of the Companies Act, 1956 requires a public company to have a minimum of seven members. If at any time the membership of a public company falls below seven and it continues its business for more than six months, then according to Section 45 of the Act every such member who was aware of this fact would be personally and severally liable for all debts contracted by the company during the period and may be severally sued for all debts contracted after six months.

Accordingly, in the given problem, the remaining six members shall incur personal liability for the debts contracted by the company,

- (i) If they continued to carry on the business of the company with that reduced membership beyond the six month period.
- (ii) Only those members who knew of this fact of reduced membership shall be liable.
- (iii) The liability shall extend only to the debts contracted after six months from the date of auction of that member's shares.

Question 63

Apex Metals Limited wants to provide financial assistance to its employees, to enable them to subscribe for certain number of fully paid shares. Considering the provision of the Companies Act, 1956, what advice would you give to the company in this regard? (November 2008)

Answer

Financial assistance for purchase of own shares

Section 77 of the Companies Act, 1956 provides that no public company and no private company being a subsidiary of a public company, can give financial aid to any person, either directly or indirectly and whether by way of loan, guarantee or surety or otherwise, for or in connection with purchase or subscription made or to be made of any of its own shares or of its holding company.

There are, however, certain exceptions to this rule, namely-

- (a) a banking company may lend money for the purpose in the ordinary course of its business but not on the security of its own shares, or
- (b) The company in pursuance of a scheme for the purchase of or subscription for fully paid shares of the company (or those of its holding company) to be held by trustees for the benefit of the employees of the company, may advance loan for the purpose.
- (c) The company may advance a loan to a person bonafide in its employment (other than directors or managers) to enable them to purchase or subscribe for fully paid shares for an amount not exceeding their salary or wages for a period of six months. (section 77)

However, the exception to this rule allows making of loans by a company, to its bonafide employees for purchasing or subscribing to the fully paid shares of the company. Section 77(3) provided that such financial assistance should not exceed six months' wages or salary of the employee.