11
Meetings

Statutory meeting [S. 165]

The first meeting of the shareholders of a public company is known as the statutory meeting. It has to be called within six months from the date on which the company is entitled to commence business, but it cannot be held within one month from that date, as the requirement of Section 165 is that the meeting should be held "within a period not less than one month or more than six months from the date at which the company is entitled to commence business". In Palmer's COMPANY LAW the importance of statutory meeting is thus explained:[1]

> The obvious purpose of a statutory meeting with its preliminary report is to put the shareholders of the company in possession of all the important facts relating to the new company, what shares have been taken up, what money received, what contracts entered into, what sums spent on preliminary expenses, etc. Furnished with these particulars the shareholders are to have an opportunity of meeting and discussing the whole situation, the management, methods and prospects of the company.

Members are given the liberty to discuss any matter relating to the formation of the company or arising out of the statutory report.[2]

Statutory Report [S. 165(2)]

The shareholders cannot make the best use of this opportunity unless they have the fullest information on important matters. The directors are, therefore, required to prepare and to send to every shareholder a document known as the "statutory report".

This report must be sent to the members at least twenty-one days before the day on which the meeting is to be held.[3] The report should be certified as correct by at least two directors, one of whom should be managing director, if there is any, and must also be certified by the auditors.[4] The report must set out the following particulars:

1. The total number of shares allotted, giving details whether they are fully or partly paid-up and what consideration has been received.
2. The total amount of cash received in respect of all shares allotted.
3. An abstract of receipts, distinctly setting out the sources, and payments made out of that, balance remaining in hand, estimate of preliminary expenses, commission or discount paid or to be paid on issue of shares.
4. Names, addresses and occupations of the directors, manager and secretary and the changes, if any, that have occurred since the date of incorporation.

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1 455-456, 20th Edn.

2 S. 165(7).

3 *Ibid.* A proviso declares that if the report is not sent within the time so required, it may be condoned by all the members entitled to attend and vote.

4 S. 165(4).

5. Particulars of any contract to be submitted to the meeting for approval and modifications done or proposed, if any.
6. If the company has entered into underwriting contracts, the extent, if any, to which they have not been carried out and the reasons for the failure.
7. The arrears, if any, due on calls from every director and manager.
8. Particulars of any commission or brokerage paid or agreed to be paid in connection with the issue or sale of shares or debentures to any director or to the manager.

A copy of the above report should be sent to the Registrar also.[5] If any default is made in filing the statutory report or in holding the statutory meeting, those in default are liable to a fine.[6] The delay in sending the statutory report to the shareholders can, however, be condoned by a unanimous vote of the members present at the meeting. Another consequence of not holding the statutory meeting on time is that the court can under Section 433(*b*) order the compulsory winding up of the company.

Annual general meeting [S. 166]

Every company is required to call at least one meeting of its shareholders each year. This meeting is known as the annual general meeting. The first annual general meeting of a company must be held within eighteen months from the date of its incorporation, and then no meeting will be necessary for the year of incorporation and the following year.[7] Thereafter one annual general meeting must be held every year. The gap between one meeting and the next should not be of more than fifteen months. There is no provision in the Act for deferment of the first AGM.[8]

If a company fails to hold this meeting two consequences will follow. Firstly, any member can apply to the Central Government and the latter will order the calling of the meeting. An application can be made by any member under Section 167 of the Act.[9] The Central Government can give any ancillary or consequential directions which it thinks expedient in relation to the calling and conducting of the meeting. A meeting held in pursuance of this order will be deemed an annual general meeting of the company.[10] The Central Government

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5 S. 165(5).

6 S. 165(9). Every director or other officer of the company who is in default is punishable with fine extending upto Rs 5000.

7 An illustration will make this clear. Suppose that a company is incorporated in Jan 1960, its first annual general meeting should be held within eighteen months, that is, up to June 1961 and then no other meeting will be necessary either for 1960 or 1961.

8 *T. V. Mathew* v *Nadukara Agro Processing Co Ltd*, (2002) 108 Comp Cas 130 Ker. A failure in this respect would invite consequences under the Act.

9 "It is clear that a member and not the company is competent to invoke the provisions of S. 167. A company cannot seek directions against itself." *Cannanore Whole Body CT Scan & Research Centre (P) Ltd* v *Saibunnisa S .V.*, (1998) 93 Comp Cas 99. The Central Government substituted for the Company Law Board by the 2nd Amendment of 2002.

10 S. 167(2). See *Anuradha Mukherjee* v *Incab Industries Ltd*, [1996] 4 Comp LJ 482 (CLB), where a meeting was ordered to be held for each of the gap years. *Mukesh Sood* v *Incab Industries Ltd*, (1996) 23 Corpt LA 178 CLB, meeting ordered to be held with nominee of the

ordered a meeting to be called for carrying out non-controversial annual routine business and call an extraordinary general meeting, if necessary, for facing the controversial matters.[11]

This power has been vested exclusively in the Central Government. The court cannot exercise it even under its inherent powers.[12]

Secondly, the failure to call this meeting either generally or in pursuance of the order of the Central Government is an offence punishable with fine.[13] The penalty is imposed upon the company as well as every officer "who is in default". Thus, for example, in *Sree Meenakshi Mills Co Ltd* v *Asstt Registrar of Joint Stock Companies*:[14]

> A company was prosecuted for failure to call an annual general meeting. One general meeting was called in December, 1934. This was adjourned to March, 1935 and then held. Subsequent meeting was held in February, 1936. The prosecution was for not holding a meeting in 1935. It was contended on behalf of the company that a meeting was held in that year.

But the court held that the meeting of March, 1935, was the adjourned meeting of 1934. "There should be one meeting per year and as many meetings as there are years." The company was accordingly convicted.

Similarly, in another case,[15] for a failure to hold a meeting it was held to be no defence that on account of a criminal case against the secretary of the company some important books were exhibited in the court and as they had not been released in time, no accounts could be prepared, and no meeting could be held.[16] But in *Kastoor Mal Banthiya* v *State*:[17]

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financial institution to preside. *M. V. Paulose* v *City Hospital (P) Ltd*, (1998) 28 Corpt LA 46 CLB, the order of CLB for holding an AGM had to be kept in abeyance because a dispute about a substantial block of shares was pending before the High Court. The Company Law Board cannot review its own orders. *National Textile Corpn (UP) Ltd* v *Swadeshi Polytex Ltd*, (1998) 28 Corpt LA 238 CLB, default in holding AGM is a condition precedent, no incidental order issued about any person to preside after ordering a meeting.

11 *Taihan Electric Wire Co* v *TDP Copper Ltd*, (1998) 29 Corpt LA 126 CLB: (1999) 96 Comp Cas 415: [1998] 2 Comp LJ 351. The time for holding the meeting had expired. Without the order of the CLB meeting held out of time would not have been valid. The special business proposed in the notice related to a transaction which had become the subject matter of a litigation. The CLB, therefore, directed that that business should not be taken up at the meeting. *National Dairy Development Board* v *Indian Immunologicals Ltd*, (2002) 108 Comp Cas 909 (CLB), a meeting cannot be ordered just only to relieve defaulters from liability, Administrative difficulties were not accepted to be a ground for considering it to be impracticable to call a meeting.

12 *Nungambakkam D. S. Nidhi Ltd* v *ROC*, (1972) 42 Comp Cas 632 Mad; *A. K. Zacharia* v *Majestic Kuries and Loans (P) Ltd*, (1987) 62 Comp Cas 865 Ker, the court cannot appoint a commissioner for calling or holding a meeting.

13 *See* S. 168. The provision is applicable to private companies as well. *Registrar of Companies* v *F. S. Cabral*, (1988) 63 Comp Cas 126 Bom.

14 AIR 1938 Mad 640: [1938] 1 MLJ 856: 39 Cri LJ 907.

15 *Brahmanberia Loan Co Ltd, Re*, AIR 1934 Cal 624: 151 IC 693. *See* also *Ramchandra & Sons (P) Ltd* v *State*, [1967] 2 Comp LJ 92.

16 See *PSNSA Chettiar & Co* v *ROC*, [1966] 1 Comp LJ 17 Mad; *Nungambakkam D. S. Nidhi Ltd* v *ROC*, (1972) 42 Comp Cas 632 Mad. The meeting must be brought to completion within the statutory period notwithstanding adjournments. *Bejoy Kumar Karnani* v *Asstt ROC*, (1985) 58 Comp Cas 293. *Tapan Kumar Chowdhury* v *ROC*, (2003) 114 Comp Cas 631 Cal, the

The accused and his brother were the only two members and directors of a private company. During the period when a meeting should have been held his brother was lying seriously ill and the consequent failure to hold the meeting was not considered to be a wilful default.[18]

Where a managing director has been pressing his colleagues to call the annual meeting but in vain, he cannot, for the purposes of this section, be described to be an "officer in default".[19]

The Registrar has been given the power, for any special reason, to extend the time for holding an annual general meeting for a period of only three months. But the time for holding the first annual general meeting of a company is never extended.[20]

The meeting should be held during business hours, on a day which is not a public holiday and at the registered office of the company or at any place within the town where the registered office is situated.[21] The appointment of additional directors was held to be *prima facie* void where the meeting was held at a different place from the place specified in the notice. Individual notices were not given to members and the change of venue of the meeting was not notified.[22]

In the case of revival and rehabilitation of sick industrial companies this power is to be exercised by the National Company Law Tribunal.[23]

Importance of annual general meeting

Annual general meeting is an important institution for the protection of the shareholders of a company. The ultimate control and destiny of a company

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factory and offices of the company were the victims of industrial unrest and out of reach of the directors and that was held to be a good defence for the default.

17 AIR 1951 Ajm 39

18 It should be noted that the section requires the annual general meeting to be held "in addition to" any other meeting that may have been held in the year. Before the words "in addition to" were *inserted*, it was doubtful whether an extraordinary general meeting held in a year would exonerate the holding of the annual general meeting for the year. The Allahabad High Court had held in *Lachmi Narain* v *Emperor*, AIR 1920 All 357, that an extraordinary meeting would amount to annual general meeting for the year. But the Bombay High Court had differed in *Emperor* v *Nasurbhai Abdullabhai Lalji*, AIR 1923 Bom 194. *See* also *India Nutriments Ltd* v *Registrar of Companies*, [1964] 1 Comp LJ 56.

19 *S. S. Jhunjhunwala* v *State*, (1970) All WR 814.

20 Proviso to S. 166(1)(c). See *Dalmia Cement (Bharat) Ltd* v *Registrar of Joint Stock Companies*, AIR 1954 Mad 276. The power of extension cannot be exercised by the Central Government, *Nungambakkam D. S. Nidhi Ltd* v *ROC*, (1972) 42 Comp Cas 632 Mad. The Central Government also cannot examine aspects of validity; that is a matter for civil courts. *Ravinder Kumar Jain* v *Punjab Regd (Iron and Steel) Stock Holders Assn*, (1978) 48 Comp Cas 401 P&H.

21 S. 166(2). The Central Government may exempt a company from this sub-section. *See also* the proviso. According to S. 2(38) "public holiday" means a public holiday within the meaning of the Negotiable Instruments Act, 1881: *Provided* that no day declared by the Central Government to be a public holiday shall be deemed to be such a holiday, in relation to any meeting, unless the declaration was notified before the issue of the notice convening the meeting. *Dinkar Rai D. Desai* v *R. P. Bhasin*, (1986) 60 Comp Cas 14 Del: [1985] 1 Comp LJ 38, a direction that the meeting may be simultaneously held at three different places was held to be void. Postal limits can be considered as city limits for this purpose.

22 *Sikkim Bank Ltd* v *R. S. Chowdhury*, (2000) 102 Comp Cas 187 Cal.

23 This provision has been added by the Second Amendment of 2002, [Proviso to S. 167(3)].

should be in the hands of its shareholders. It is, therefore, desirable that the shareholders should come together once in a year to review the working of the company. This meeting affords that opportunity. It is at this meeting that some of the directors will retire and come up for re-election[24] and the shareholders will be able to exercise real control by "refusing to re-elect a director of whose action and policy they disapprove".[25] Again, auditors retire at this meeting enabling the shareholders to consider whether they should be re-appointed or replaced.[26] Dividends are declared at this meeting. Chairman delivers a speech listing the advances of the company during the year. Directors have to present annual accounts for the consideration of the shareholders. A failure to present the accounts is a punishable offence.[27] The shareholders can ask any questions relating to the accounts or affairs of the company.

The business to be transacted at the meeting is generally provided for in the articles of the company and that is known as the ordinary business of the meeting. The meeting may take up any other business also and that will be known as special business.

Extraordinary general meeting [S. 169]

Clause 47 of Table A provides that all general meetings other than annual general meetings shall be known as extraordinary general meetings. The board may, whenever it thinks fit, call an extraordinary general meeting. An extraordinary general meeting also becomes necessary on requisition, for Section 169 provides that on requisition of a given number of shareholders the directors must forthwith call a meeting.[28] The requisition must be signed by holders of at least one-tenth paid-up capital having the right to vote on the matter of requisition.[29] If the company has no share capital the requisition must be signed by as many members as have one-tenth of the total voting power.

The requisition must set out the matters for the consideration of which the meeting is to be called.[30] No other business can be done. For example, where certain shareholders requisitioned a meeting for the appointment of three new directors, and subsequently the chairman wanted to add to the agenda the removal

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24 S. 255.

25 GREER LJ in *Shaw & Sons* v *Shaw*, [1935] 2 KB 113, 134.

26 S. 224.

27 Ss. 219 and 220. Failure to lay accounts before the meeting does not invalidate the meeting. *Sunil Dev* v *Delhi and District Cricket Assn*, (1994) 80 Comp Cas 174 Delhi.

28 S. 169(1). Where the directors did not call a meeting because of irregularity in requisition notice and did not do so even after a rectified notice was given because of the pending contempt proceedings, the CLB ordered that they should call meeting on the dismissal of the contempt proceedings. *Shoe Specialities Ltd* v *Standard Distilleries & Breweries Ltd*, (1997) 90 Comp Cas 1 Mad.

29 S. 169(4)(*a*). Where a meeting was requisitioned by shareholders holding partly paid shares, the meeting and the appointment of directors made thereat were held be invalid. *Kuldip Singh Dhillon* v *Paragaon Utility Financiers (P) Ltd*, (1986) 60 Comp Cas 1075 P&H. Signatures by the requisite number on a draft requisition prepared by one of them is good enough. *B. G. Somayaji* v *Karnataka Bank Ltd*, (1995) 83 Comp Cas 649 Kant.

30 S. 169(2). *Malvika Apparels* v *UOI*, (2002) 112 Comp Cas 335 Delhi, the notice which the company served on the members in response to the requisition did not include all the items specified by the requisitionists. They went in for a writ. The court told them that they had an alternative remedy under S. 186.

of a director also, the meeting was restrained from considering the matter.[31] Only such matters can be taken up at the meeting in respect of which the requisitionists possess the same voting strength as is required to requisition a meeting.

When a requisition is deposited at the registered office of the company the directors should, within twenty-one days, move to call a meeting and the meeting should actually be held within forty-five days from the date of the requisition.[32] If the directors fail to do so, the requisitionists may themselves proceed to call the meeting[33] and claim the necessary expenses from the company. The company can indemnify itself out of the remuneration due to the directors in default.[34] The directors cannot refuse to call a meeting only on the ground that the resolution that the requisitionists propose to put would be contrary to the Act. That is a matter which can be considered by the court subsequently. The requisitionists wanted to add a clause to the articles that if a person had occupied the position of a director for six years, he should not seek re-election for three years. The court pointed out that such clause would be invalid under Section 274(3) as prescribing additional disqualifications, but even so directors should not refuse to respond to the requisition.[35] Where a meeting is requisitioned for the purpose of removing a bunch of directors, it has been held by the Supreme Court that it is not necessary for the requisitionists to state the reasons for removal.[36] A special notice of the resolution to remove a director has to be given. Where this was not done, it was held that though the meeting was valid, the resolution was not.[37] A meeting cannot be requisitioned for a declaration that the directors appointed at the preceding meeting were not validly elected and that the requisitionists should be appointed as directors in their place.[38]

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31 *Ball* v *Metal Industries Ltd*, 1957 SLT 124 Scotland.

32 S. 169(6).

33 *See*, for example, *M.R.S. Rathnaveluvami* v *M.R.S. Manickavelu Chettiar*, AIR 1951 Mad 542: [1951] 1 MLJ 5: 64 LW 172: (1951) 21 Comp Cas 93; also see *Topandas Mohanlal Advani* v *Yeotmal Electric Supply Co*, AIR 1940 Sind 87. The Board has been held to be justified in refusing to call a meeting when there is a stay order. *A. D. Chaudhary* v *Mysore Mills*, (1976) 46 Comp Cas 548 Kar.

34 S. 169(9).

35 *Cricket Club of India* v *Madhav L. Apte*, (1975) 45 Comp Cas 574 Bom.

36 *LIC* v *Escorts Ltd*, (1986) 1 SCC 264: (1986) 59 Comp Cas 548: [1986] 1 Comp LJ 91 SC, *reversing* Bom HC in [1984] 3 Comp LJ 387 where the High Court had held that if reasons are not stated the directors' right of making a representation against their removal would be defeated because there cannot be a worthwhile representation without knowledge of the reasons. The right of requisitioning a meeting or exercising normal voting rights is not affected by the fact that a receiver in respect of a member's shares has been appointed or the management of the company is with the Government under the Industries (D&R) Act, 1951. *Balkrishna Gupta* v *Swadeshi Polytex Ltd*, (1985) 2 SCC 167: (1985) 58 Comp Cas 563 SC. Followed in *Vijay M. Porwal* v *Pentokey Organy (India) Ltd*. (1996) 87 Comp Cas 331 CLB, neither the requisitionists nor the company is required to give a statement of reasons. To the same effect, *Karedla Suryanarayana* v *Shri Ramdas Motor Transport Ltd*, (1998) 28 Corpt LA 233 CLB: (1999) 98 Comp Cas 518 CLB, the company has not to comply with the requirement of explanatory statement.

37 *Queens Kuries and Loans (P) Ltd* v *Sheena Jose*, (1993) 76 Comp Cas 821 Ker. Followed in *Bhankerpur Simbhaoli Beverages (P) Ltd* v *Sarabhjit Singh*, (1996) 86 Comp Cas 842 P&H, notice not given to the concerned director and the proceedings became invalidated.

38 *B. Sivaraman* v *Egmore Benefit Society Ltd*, (1992) 75 Comp Cas 198 Mad. Where there was no proof of a requisitioned meeting being held at all, appointment of directors at the alleged

It is not necessary that an extraordinary general meeting should be held at the registered office of the company. A resolution passed at a meeting held at any other place than the registered office would be equally void.[39]

The Karnataka High Court held that refusal on the part of the directors to call a meeting on requisition does not amount to any offence either under Section 169 or under Sections 628, 629 or 629-A. The requisitionists have their own alternative of calling a meeting by themselves under Section 169(6).[40] The requisitionists cannot approach the Company Law Board under Section 186 for an order calling an extraordinary general meeting without first trying to call a meeting themselves.[41]

Power of National Company Law Tribunal to call meeting [S. 186]

Where the holding of a meeting, other than an annual general meeting, has for any reason become impracticable, the proper course for the company to follow is to apply to the Tribunal. In such cases the Tribunal can on its own motion or on the application of a director or a member order a meeting to be called and held in accordance with its directions. The word "impracticable" as construed in a reasonable way must naturally mean that it is not possible to hold a peaceful or useful meeting. "Impracticable" means impracticable from a reasonable point of view.[42] The Tribunal takes a common sense view of the matter and orders a meeting if it would appear to a prudent man of business that the holding of a useful meeting has become impracticable. In *Indian Spinning Mills Ltd* v *His Excellency*:[43]

> A person who was not holding the qualification shares of a director was appointed chairman and some directors had transferred shares to him to enable him to fulfil the requirement. This was alleged, by a group of shareholders, to be invalid and was the subject-matter of a suit. It was held that it was impracticable to hold a meeting in these circumstances and the court could intervene.

Similarly, in *Lothian Jute Mills Ltd, Re*,:[44]

> There was a dispute between the shareholders of a company as to who were the lawful directors of the company entitled to call a meeting. It was

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meeting was held to be not good. *V.G. Balasundaram* v *New Theatre Carnatic Talkies (P) Ltd*, (1993) 77 Comp Cas 324 Mad.

39 *Metal Box India Ltd, In Re*, (2001) 105 Comp Cas 939 CLB.

40 *Anantha R. Hegde* v *Captain (Er.) T.S. Gopala Krishna*, [1996] 3 Comp LJ 333 (Kant): (1996) 23 Corpt LA 142. The requisition in this case was short of the mandatory requirement. *Anantha R. Hegde* v *Captain T. S. Gopala Krishna*, (1996) 3 Comp LJ 333 (Kant): (1996) 23 Corpt LA 142: (1998) 91 Comp Cas 312, directors' default, no offence. The requisitionists' reasonable expenses are to be reimbursed by the company which in its turn can recover indemnity from the defaulting directors.

41 *B. Mohandas* v *A.K.M.N. Cylinders P Ltd*, (1998) 93 Comp Cas 532 CLB.

42 *Commissioner, Lucknow Division* v *Dy Commr, Pratapgarh*, (1937) 41 CWN 1072: AIR 1937 PC 240. Adopted by BANERJEE J in, *Malhati Tea Syndicate Ltd, Re*, 55 Cal WN 653. *See* also *Cricket Club of India Ltd* v *Madhav L. Apte*, (1975) 45 Comp Cas 574 Bom.

43 AIR 1953 Cal 355: 56 CWN 398.

44 55 CWN 646. For other cases see, *Malhati Tea Syndicate Ltd, Re*, 55 Cal WN 653; *Bal Krishna Maheshwari* v *Uma Shanker Mehrotra*, AIR 1947 All 361.

held to be proper that the court should step in and call a meeting "the validity of which is beyond question".

The power of the CLB (now Tribunal) was invoked to call a meeting where the company had no duly constituted board of directors. A meeting was necessary for putting the company on rails by removing impediments which had arisen in the way of proper functioning.[45]

In a decision on the power of the court, (now Tribunal) the Calcutta High Court[46] observed that the power "should be used sparingly with caution so that the court does not become either the shareholder or a director of the company trying to participate in the internecine squabbles of the company". The Board should interfere when it is fully satisfied that the application has been made *bona fide* in the larger interests of the company for removing a deadlock otherwise irremovable and that there is *prima facie* proof of the fact that a meeting called in the manner in which meetings are ordinarily called under the Act or articles would be invalid. The facts of the Calcutta case were:

> The directors of a company had divided themselves into two groups each claiming that the others were not lawfully directors. But neither made an effort to requisition a meeting. An application was made to the court to order a meeting. But the court advised them that they should first requisition a meeting themselves to see what the other group would do. Until that is known the court cannot intervene.

In a two-member-director company, there was a petition for prevention of unfairly prejudicial conduct (oppression). For that reason, one director would not sit with the other at a meeting. Additional directors could not be appointed for carrying on the management: A meeting for appointment of additional directors was ordered to be held.[47]

Before the amendment of 1974 this power was exercised by the court. Subsequently it was vested in the Company Law Board. Now it has been vested in the Tribunal.[48] The power being of judicial nature, the Tribunal is likely to follow the above-stated principles.[49]

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45 *Amrit Kaur Puri* v *Kapurthala Flour, Oil and General Mills Co (P) Ltd*, [1997] 1 Comp LJ 147 (CLB-PB).

46 *Ruttonjee & Co Ltd. Re*, [1968] 2 Comp LJ 155, 172 Cal: (1970) 40 Comp Cas 491, where MITRA J reviewed all the leading Indian and English authorities on the subject and stated the fundamental principles in terms of eight propositions; (1970) 40 Comp Cas 491. The Company Law Board may also fix the agenda of the meeting. *Baptist Church Trust Assn* v *CLB*, [1986] 1 Comp LJ 187 Cal.

47 *Sticky Fingers Restaurant Ltd, Re*, [1992] BCLC 84 Ch D. A meeting was ordered in parallel circumstances in *Pucci Dante* v *Rafeeque Ad*, (1999) 95 Comp Cas 566. *Oriental Benefit & Deposit Society Ltd* v *Bharat Kumar K. Shah*, (2001) 103 Comp Cas 947 Mad, where the holding of an AGM was restrained by an injunction, it was a question of fact whether the meeting itself was restrained or only the consideration of a particular transaction.

48 By the Companies (Second Amendment) Act, 2002.

49 There is no power to appoint an independent chairman where the meeting is not called at the orders of CLB. *Kishore Y. Patel* v *Patel Engg Co Ltd*, (1994) 79 Comp Cas 53 Bom.

PROCEDURE AND REQUISITES OF VALID MEETING

Meeting should be called by proper authority

The first essential requisite of a valid meeting is that it should be called by a proper authority. Obviously the only proper authority is the board of directors,[50] except when the meeting has, in the event of default by the directors, been called by the requisitionists or by the Company Law Board. Suppose, for example, that the meeting of the board at which it is resolved to call a general meeting is not properly convened or constituted, will it render the general meeting also invalid? It was held in *Browne* v *La Trinidad*[51] that by reason of irregularity of the board meeting the general meeting was not incapacitated from acting. But in the case of *Harben* v *Phillip*:[52]

> Certain directors held a meeting of the board but they prevented some lawfully constituted directors from attending the meeting. A quorum was, however, present. It was held that as the meeting of the board was unlawful, the notice convening the general meeting also became invalid. Directors have to exercise their discretion and have to fix the time and place or whether the meeting should be held at all.[53]

Notice [Ss. 171-172]

The second requirement of a valid meeting is that a proper notice of the meeting should be given to the members. Notice should be given to every member of the company.[54] Deliberate omission to give notice to a single member may invalidate the meeting,[55] although an accidental omission to give notice to, or non-receipt of it by, a member will not be fatal.[56] This is based upon the theory that the acts of a corporation are those of the major part of the corporators, corporately assembled. By "corporately assembled" it is meant that the meeting shall be one held upon notice which gives every corporator the opportunity of being present.[57] Secondly, notice should be in writing and must

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50 The natural corollary is that the board of directors can also postpone a meeting, *John Y. Chandy* v *Catholic Syrian Bank Ltd*, (1995) 1 Ker LJ 612.

51 (1887) 37 Ch D 1: 158 LT 137 CA. The court does not have the power to give directions for the conduct of a meeting already called by the directors. *R. Rangachari* v *S. Suppiah*, [1975] 2 SCC 605: (1975) 45 Comp Cas 641.

52 (1883) 23 Ch D 14: 48 LT 334: 31 WR 173.

53 *See* also *N.V.R. Nagappa Chettiar* v *Madras Race Club*, [1949] 1 MLJ 662, where all such cases were discussed and a meeting was held invalid, because the board which resolved to call it was not properly present. Compare, *Boschoek Proprietary Co Ltd* v *Fuke*, [1906] 1 Ch 148: 94 LT 398.

54 S. 172(2).

55 *Smyth* v *Darley*, (1849) 2 HL Cas 789: *Musselwhite* v *C.H. Musselwhite & Son*, [1962] Ch 964: [1962] 1 All ER 201. *Gajanan Narayan Patil* v *Dattatraya Waman Patil*, (1990) 3 SCC 634: (1990) 69 Comp Cas 1 SC, failure to give notice to nominees of public financial institutions who were co-opted directors, invalidated the meeting of the board of directors of a cooperative society. *R. R. Rajendra Menon* v *Cochin Stock Exchange Ltd*, (1990) 69 Comp Cas 231 Ker, a dispute as to 'notice' is a matter for the jurisdiction of civil courts and not that of company courts. Another *sub. nom* case on the same point, (1990) 69 Comp Cas 256 Ker.

56 S. 172(3).

57 *Mayor, etc. of the Staple of England* v *Governor and Company of Bank of England*, (1887) 21 QBD 160: 57 LJQB 418 CA.

be given twenty-one days before the date of the meeting. "Twenty-one days" are to be computed from the date of receipt of the notice by members and the notice shall be deemed to have been received at the expiration of forty-eight hours from the time of posting.[58] *N. V. R. Nagappa Chettiar* v *Madras Race Club*[59] is an illustration in point:

> Notices were posted on October 16, for a meeting to be held on November 7. The notice was held to be short by one day as in computing the interval of twenty-one days the date of posting and date of meeting should be excluded.[60]

Where notices were posted during a period of postal strike and decidely would not have been served upon members, the court said that the strike was in itself an evidence of the fact that there would not be effective service and, therefore, the presumption of deemed service was ruled out.[61]

The gap should be of twenty-one clear and whole days.[62] It has been held by the Madras High Court *Self-Help Private Industrial Estates (P) Ltd, Re*,[63] following Section 171, that all the members can, in the case of an annual meeting, voluntarily consent to a shorter notice either before or after the meeting. In the case of any other meeting the consent of the holders of 95% of the paid-up share capital, or the consent of 95% of the total strength of members, would be necessary. Where a special resolution to shift the registered office was passed at a meeting of which shorter notice was given, the court ignored this fact as there was sufficient evidence of ratification by the requisite number.[64] The fact that one of the members is not traceable does not make the consent less unanimous.[65] Similarly, it has been held in *Bailey, Hay & Co Ltd, Re*,[66] that a notice of a resolution for voluntary winding up had become valid through acquiescence of the company's members, all of whom attended the meeting despite the fact that it was defective, being short by a day.[67] The Bombay High Court has been of the view that the requirement as to

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58 S. 53(2)(*b*). See *Balwant Singh Sethi* v *Zoarwar Singh*, (1988) 63 Comp Cas 310 Bom, where notices were posted on August 31 and September 1 for a meeting to be held on September 21, and they were held to be not valid. *Somalingappa Shiva Putrappa Mugabasow* v *Shree Renuka Sugars Ltd*, (2002) 110 Comp Cas 371 Kant, notice served through courier and also received by members well before time, an application for stay order just 3 days before meeting, not allowed.

59 (1949) 1 MLJ 662.

60 Where a member does not have any registered address in India or has not supplied to the company any address for the giving of notices to him, the company may advertise the notice in a newspaper circulating in the neighbourhood of the company's registered office and it will be deemed to have been served on the member on the date of advertisement. (S. 53).

61 *Bradman* v *Trinity Estate Ltd*, 1989 BCLC 753 Ch D.

62 *Pioneer Motors (P) Ltd* v *Municipal Council, Nagercoil*, AIR 1967 SC 684; *Bharat Kumar Dilwali* v *Bharat Carbon & Ribbon Mfg Co Ltd*, (1973) 43 Comp Cas 197 Del.

63 (1972) 42 Comp Cas 605 Mad.

64 *Parikh Engineering & Body Building Co, Re*, (1975) 45 Comp Cas 157 Pat.

65 If the heirs of a deceased member do not supply their addresses, the service at the deceased member's address is sufficient. *Canara Bank Ltd* v *Thampi*, (1972) 42 Comp Cas 473 Ker.

66 [1971] 1 WLR 1357; [1971] 3 All ER 693.

67 Where only one member received notice late, though posted in time, meeting valid. *Calcutta Chemical Co Ltd* v *Dhiresh Chandra Roy*, (1985) 58 Comp Cas 275 Cal.

length of notice is merely directory and not mandatory. Where no prejudice whatsoever was caused to the member who complained of the notice being short by one day, the court refused to invalidate the meeting and its proceedings.[68] The shareholder who participated in the meeting, accepted dividend as well as directorship, was not allowed to question the validity of the meeting on account of short notice.[69]

A notice of a meeting despatched under certificate of posting creates a presumption that it was served at the expiration of 48 hours.[70]

A private company's articles may contain its own special provisions as to duration of notice.[71]

Contents of notice [Ss. 172 and 173]

Notice should specify the place and day and hour of the meeting and the meeting to be valid must be held at the place and time specified,[72] except, perhaps, in a situation that arose in *M. R. S. Rathnavelusami* v *M. R. S. Manickavelu Chettiar*:[73]

> On the failure of the directors of a company to call a meeting on a requisition, the requisitionists themselves sent a notice to all the members for a meeting to be held at the registered office of the company. But the managing director locked the premises of the registered office. It was held that a meeting held at some other place and the resolutions passed thereat were valid.

Again, the notice must contain a statement of the business to be transacted at the meeting. Section 173 puts businesses into two categories, namely:

1. ***General business***.—At the annual meeting the business of considering accounts and directors' report, the declaration of dividends, the appointment of directors and auditors and fixing their remuneration are regarded as general business.[74]
2. ***Special business***.—Any other business at an annual meeting and all business at extraordinary general meetings are regarded as special business.[75]

Explanatory statement

If any special business is to be transacted at an annual meeting, a statement to that effect must be annexed to the notice calling the meeting. The statement

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68 *Shailesh Harilal Shah* v *Matushree Textiles Ltd*, AIR 1994 Bom 20.

69 *V. Shanmugasundaram* v *Emerald Automobiles Ltd*, (2001) 103 Comp Cas 1108 CLB.

70 *Challa Rajendra Prasad* v *Asian Coffee Ltd*, (1999) 20 SCL 414 AP.

71 Section 170 and see *Sreerama Vilas Press and Publications (P) Ltd, Re*, (1992) 73 Comp Cas 275 Ker.

72 S. 172(1).

73 AIR 1951 Mad 542: [1951] 1 MLJ 5: 64 LW 172: (1951) 21 Comp Cas 93.

74 *Ramji Lal Baisiwala* v *Baiton Cables Ltd*, ILR 1964 Raj 135, 157.

75 *Martin Castelino* v *Alpha Omega Shipment P Ltd*, (2001) 104 Comp Cas 687 CLB, the agenda sent with the notice of the meeting did not contain the item of increase of share capital, the notice was held to be not proper.

must set out all the material facts concerning each item of the special business and should also disclose the interest of any director or other managerial personnel in the matter.[76] "Notice must give a sufficiently full and frank disclosure to the shareholders of the facts upon which they are asked to vote." The purpose of the explanatory statement is that the members should be informed of the nature of the business to be transacted at the meeting.[77] To take, for instance, *Narayanlal Bansilal* v *Maneckji Petit Mfg Co Ltd*:[78]

> A company had managing agents. It wanted to adopt a new set of articles changing the terms of their appointment. The notice convening a meeting of the shareholders for the purpose set out the proposed special resolutions, but did not give particulars of the important changes to be effected. Accordingly, the resolutions passed on the basis of this notice were held invalid.

Similarly in *Bimal Singh Kothari* v *Muir Mills Co Ltd*:[79]

> It was held that where there is a large body of shareholders residing at great distances from the registered office of the company, it would not be fair to leave the proposed articles at the registered office and give the shareholders notice of that fact. Printed copies of the new articles should be sent with the notice. Where this is not done, the notice is not sufficient.

Where a notice calling a meeting stated that the object of the meeting was to adopt an agreement for the sale of one company's undertaking to another, but did not disclose that a substantial sum was payable to the directors of the selling company as compensation for loss of office, the court held that the notice did not fairly disclose the purpose for which the meeting was convened.[80] Where the shareholders' resolution became necessary for selling a unit of the company, the court said that material facts could comprise of the reasons for sale, whether sale would affect the interests of the company, to whom the sale was being effected, the consideration for it, how and by whom the consideration was assessed, whether directors had any interest in the transaction, whether all statutory clearances were obtained. Such material facts would help the shareholders to make a decision on the proposal.[81] The Supreme Court order restraining the company from the sale of its assets has been held to be a material fact. Non-

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76 S. 173(2) *see also* the proviso. Where the notice of a meeting is given by newspaper advertisement, the statement of material facts need not be annexed to it, but it should be mentioned that the same has been forwarded to the members. [S. 172(2) Proviso]. Apart from this exception the requirements of the section are mandatory. *V. G. Balasundaram* v *New Theatre Carnatic Talkies P Ltd*, (1993) 77 Comp Cas 324 Mad.

77 *Rajiv Nag* v *Quality Assurance Institute (India) Ltd*, [2000] 4 Comp LJ 385 CLB. The statement is a part of the notice. It cannot be read de hors of it.

78 (1931) 33 Bom LR 556. See also *M. R. Goyal* v *Usha International Ltd*, (1997) 27 Corpt LA 187 (Delhi), explanatory statement not found to be tricky, complainant minimal shareholder, no harm to his small holding.

79 AIR 1952 Cal 645: ILR (1954) 1 Cal 185: 56 CWN 361.

80 *Kaye* v *Croydon Tramways Co*, [1898] 1 Ch 358: 78 LT 237: 67 LJ Ch 222.

81 *Mendonica (BA)* v *Philips India Ltd*, [2000] 3 Comp LJ 129 CLB.

disclosure of such material fact in the notice calling the meeting vitiated the resolution passed at the meeting. An agreement of sale entered into on the basis of such resolution was not enforceable. No action lay for compensation for breach of the contract.[82]

It was pointed out by their Lordships of the Judicial Committee in *Parsuram* v *Tata Industrial Bank Ltd,*[83] that a shareholder who by his conduct shows that he knew the real effect of the work to be transacted at a meeting cannot complain of the notice on the ground of insufficiency.[84]

Private companies

Section 170 enables private companies to adopt their own regulations over matters covered by Sections 171 to 186. The provisions of these sections would apply to private companies only to the extent to which they are not excluded by private company's own articles.[85]

Quorum [S. 174]

Another requirement of a valid meeting is the presence of a quorum. Quorum means the minimum number of members that must be present at the meeting. It is generally for the articles to provide what number of members will constitute a quorum. But Section 174 provides that unless the articles provide for a large number, five members personally present in the case of a public

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82 *Sunil Mills Ltd* v *Official Liquidator of Shri Ambica Mills Ltd,* [1999] 1 Comp LJ 423 Guj; *Y. S. Spinners Ltd* v *OL, Shri Ambica Mills,* [1999] 1 Comp LJ 442: (2000) 100 Comp Cas 547 Guj.

83 AIR 1928 PC 180. *See also* MISRA, J of the Orissa High Court in *Kalinga Tubes Ltd* v *Shanti Prasad Jain,* [1964] 1 Comp LJ 117, 138; *Shalagram Jhajharia* v *National Co,* [1965] 1 Comp LJ 112 Cal. The Rajasthan High Court held in *Seth Sobhag Mal Lodha* v *Edward Mills Co,* (1972) 42 Comp Cas 1: 1971 Tax LR 178 Raj, that where a notice proposed one person for managing directorship and the shareholders appointed another, it was good notice. The validity of a notice on account of inadequacy of time not allowed to be questioned by a transferee of shares when his transferor's right to question had become time-barred. *Joseph Michael* v *Travancore Rubber & Tea Co Ltd,* (1986) 59 Comp Cas 898 Ker. A person whose interest in the company was 0.006% was not permitted to question validity. *Gopaldas Gujrati* v *Titagarh Papers Mills Co Ltd,* (1986) 60 Comp Cas 920 Cal.

84 *See* also *European Home Products plc, Re.* 1988 BCLC 690, where the notice for reduction of share premium account carried an inaccuracy and the same was ignored by the court because no shareholder was apparently influenced by it. *Abnash Kaur* v *Lord Krishna Sugar Mills Ltd,* (1974) 44 Comp Cas 390, the business of a meeting can be transacted even without a formal agenda. The same view was endorsed in *Suresh Chandra Marwaha* v *Lauls (P) Ltd,* (1978) 48 Comp Cas 110 P&H, every agenda has a residuary clause which permits consideration of any other matter with the permission of the chairman. *Joginder Singh Palta* v *Time Travels (P) Ltd,* (1984) 56 Comp Cas 103 Cal, even if there are certain irregularities committed, it would not be a proper exercise of discretion in an application under S. 39 Rules 1 and 2 of CPC to restrain a company from acting on a resolution passed at a meeting irregularly convened or conducted. The company can rectify such matters. *Bentley-Stevens* v *Jones,* (1974) 2 All ER 653. Where the complaining shareholder was already aware of the facts, the meeting was not invalidated though the requisite particulars were not set out in the notice, *C. R. Priyachandra Kumar* v *Purasawalkam Permanent Fund Ltd,* (1995) 83 Comp Cas 150 Mad.

85 *Sreerama Vilas Press and Publications (P) Ltd, Re,* (1992) 73 Comp Cas 275 Ker; *K. Meenakshi Amma* v *Sree Rama Vilas Press and Publications Ltd,* (1992) 73 Comp Cas 275 Ker, the private company's articles carried special provisions on the subject and therefore the requirement of explanatory statement was not applicable.

company and two in the case of a private company shall be the quorum for a meeting. If within half an hour from the time of a meeting a quorum is not present the meeting will stand dissolved if it was called upon requisition. But in other cases the meeting is automatically adjourned to re-assemble on the same day in the next week.[86] And if at the re-assembled meeting also a quorum is not present within half an hour, as many members as are actually present shall constitute the quorum. The crucial problem in such a case is that if only one member turns up, will the meeting be valid, or, in other words, whether a meeting attended by only one member can be called a meeting at all. This was the question in *Sharp* v *Dawes*:[87]

> There were several shareholders in a company. A meeting was called for the purpose of making a call. Only one shareholder attended the meeting. He, however, held the proxies of other shareholders. He took the chair and passed a resolution for making a call and then proposed and passed a vote of thanks. In giving judgment in the Court of Appeal, Lord COLERIDGE said: "The word 'meeting' *prima facie* means a coming together of more than one person.... This was not a meeting within the meaning of the Act."

On the analogy of this case it may be said that even in the case of a meeting adjourned for want of a quorum, the attendance of one member only at the re-assembled meeting may not be enough. Moreover, the section also says that "*the members* actually present shall be a quorum". But exceptions will have to be admitted, particularly in a case like *East* v *Bennet Bros Ltd.*[88]

> Where all the preference shares in a company were held by one shareholder only, it was held that a meeting of preference shareholders attended by him only was proper.

Secondly, when the Central Government or the Tribunal calls a meeting under Section 167 or 186 respectively it may be directed that one member of the company present in person or by proxy shall be deemed to constitute a meeting.[89] This course was adopted in *L. Opera Photographic Ltd, Re.*[90] In a company consisting of two members with 51:49 holding, the majority shareholder was not able to remove the other from directorship because under the articles a meeting without the other attending was not possible. So the

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86 S. 174(4). Joint shareholders count for one member even if all of them are present.

87 (1876) 2 QBD 26: 46 LJQB 104: 36 LT 188. An extraordinary general meeting called by the requisitionists was presided over by a person who was not a member and the minimum of two members were not present with him, it was not a valid meeting, *Bhankerpur Simbhaoli Beverages (P) Ltd* v *P. R. Pandya*, (1995) 17 Corpt LR 170 P&H: (1996) 86 Comp Cas 842. *D.K. Chatterji* v *Rapti Supertonics P Ltd*, (2003) 114 Comp Cas 265 CLB, a resolution passed without the requisite quorum is void *ipso facto*.

88 [1911] 1 Ch 163: 80 LJ Ch 123: 103 LT 826.

89 S. 167(1) Explanation: S. 186(1) Explanation. *Shankar Sundaram* v *Amalgamations P Ltd*, (2002) 108 Comp Cas 885 (CLB), such directions can be given only when CLB has itself ordered the holding of a meeting and not when a meeting is convened by the company itself. *See also* an opinion expressed by Ashwin L. Shah in [1968] 1 Comp LJ 27 and the editor's reply. An order of this kind was made in *El Sombrero Ltd, Re*, [1958] Ch D 900: [1958] 3 WLR 349: [1958] 3 All ER 1.

90 1989 BCLC 763 Ch D.

majority applied for a court (here it would be CLB) order that a meeting should be called at which the attendance of one would be the quorum. Since the majority shareholder had a statutory right to remove the other from directorship his right could not be vetoed by quorum requirements and, therefore, the court passed necessary orders. Further, it was held in *Hartley Baird Ltd, Re*:[91]

> Where a clause in the articles of a company provided that "no business shall be transacted at any general meeting, unless a quorum is present when the meeting proceeds to business..." that the condition is sufficiently complied with if there is quorum present at the beginning of the meeting when it proceeds to business, and the subsequent departure of a member reducing the meeting below the number required for a quorum does not invalidate the proceedings at the meeting after his departure.

The authority of this statement has been to a certain extent undermined by *London Flats Ltd, Re*:[92]

> A meeting was attended by two members. The chairman was the majority shareholder. The other member proposed a name for appointment as liquidator. The chairman moved an amendment and proposed himself. Thereupon the other member left. The chairman by his majority votes confirmed his appointment.

The Court refused to uphold the appointment on the ground that any further proceedings, after the other member had left, were a nullity. The decision is good inasmuch as it provided to the company an independent liquidator, but the reason advanced may lead to wrong results. "Should it be the law that minority shareholders, realising that they cannot defeat a resolution by the constitutional process of voting against it, should be able to frustrate the wishes of the majority by walking out of the meeting?"[93]

Where the meeting commenced about 1½ hours late because there was no quorum within half hour of the scheduled time, it was held that S. 174 refers only to the presence of the quorum within half an hour and does not talk of the time at which the meeting should be called to order, a delay in the commencement of the meeting did not invalidate it.[94]

Chairman [S. 175]

For the proper conduct of business at a meeting a chairman is necessary. His appointment is usually regulated by the articles of association. But if there is nothing in the articles "the members personally present at the meeting shall elect one of themselves to be the chairman". The position and powers of a chairman

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91 [1955] Ch 143: [1954] 3 WLR 964: [1954] 3 All ER 695.

92 [1969] 2 All ER 744: [1970] 1 Comp LJ 28.

93 Editor's note on the case in 1969 JBL 2301, *see* also *El Sombrero Ltd, Re*, [1958] Ch D 900: [1958] 3 WLR 349: [1958] 3 All ER 1 where the court upheld the removal of a director by a meeting attended by one member.

94 *Janaki Printing P Ltd* v *Nadar Press Ltd*, (2001) 103 Comp Cas 546 CLB D.

were explained by the Madras High Court in *Narayana Chettiar* v *Kaleeswara Mills*:[1]

> If the chairman unjustly and without the consent of shareholders stops the meeting, it is perfectly within the powers of the meeting to elect another chairman and conduct the remaining unfinished business.[2]

A chairman by himself cannot postpone a meeting. The proper course to adopt is to hold the meeting and then adjourn it to a more convenient date. An adjournment will be within his competence in the case of a disorder but only for no longer than he considers absolutely necessary and his decision should be communicated to the meeting at least to the extent to which it is possible for him to do so. If the chairman adopts any other course, the members who can constitute a quorum may continue with the meeting and lawfully transact the announced business.[3] Where the chairman was a candidate for being appointed as managing director and, on finding that he wouldn't get majority support, dissolved the meeting and left the hall with his supporters, the appointment by the remaining members, being in quorum, of another person, as a managing director was held to be valid.[4]

Contrary opinions have also been expressed. The Calcutta High Court in its decision in *United Bank of India* v *United India Credit and Development Co Ltd*[5] recognised a chairman's right to make a *bona fide* adjournment but immediately added remarks from the authorities to the effect that if the intention and effect were to interrupt and procrastinate the business, such an adjournment would be illegal; if, on the contrary the intention and effects were to forward or facilitate it, and no injurious effects were produced, such an adjournment would be generally supported.[6]

Fresh light has been thrown on this question by the decision of the Court of Appeal in *Bying* v *Rondan Life Assn Ltd.*[7] A meeting was called for changing the company's memorandum for facilitating an amalgamation. A fairly large number of members wanted to oppose the move. The meeting became

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1 AIR 1952 Mad 515: ILR 1952 Mad 218: [1952] 1 MLJ 18. Other powers and privileges of the chairman will become apparent from the discussion on the procedure of voting. For further discussion on the chairman's power to adjourn meetings see *John* v *Rees*, [1969] 2 WLR 1294: [1969] 2 All ER 274, noted 1969 JBL 232; *Seth Sobhag Mal Lodha* v *Edward Mills Co*, (1972) 42 Comp Cas 1: 1971 Tax LR 178 Raj.

2 *PIK Securities Management P Ltd* v *United Western Bank Ltd*, (2002) 109 Comp Cas 500 CLB, power and duty only to assure good conduct of meeting, no power to withdraw a resolution, the chairman dissolving meeting before business finished, members could proceed after electing new chairman.

3 These principles were laid down by the Supreme Court in *Chandrakant Khare* v *Shantaram Kale*, (1989) 65 Comp Cas 121 SC, in connection with the meeting of a municipal corporation.

4 *Seth Sobhag Mal Lodha* v *Edward Mills Co*, (1972) 42 Comp Cas 1: 1971 Tax LR 178 Raj.

5 (1977) 47 Comp Cas 689 Cal. Frank Shackleton, LAW AND PRACTICE OF MEETINGS, 69 (3rd Edn); *Catesby* v *Burnett*, [1916] 2 Ch 325; *Deodutt Sharma* v *Zahoor Ad*, 1960 RLW 486: AIR 1960 Raj 25; *Nation Dwelling Society* v *Sykes*, [1894] 3 Ch 325; *United Bank of India* v *United India Credit and Development Co Ltd*, (1977) 47 Comp Cas 689 Cal; *Jackson* v *Hamlyn* [1953]1 All ER 887 applied.

6 Citing *John* v *Rees*, [1969] 2 WLR 1294: [1969] 2 All ER 274.

7 1989 BCLC 400: [1989]1 All ER 560: [1989] 1 WLR 738 CA.

overcrowded. The venue proved too small. The members were seated in the adjoining rooms and a sound system was installed to enable them to hear and to participate. That system failed. Then there was a bewildering confusion and in that state of things the chairman arranged for an alternative venue and resolved to adjourn the meeting to meet again in the afternoon at the new venue. There was opposition to this move. The meeting in the evening at the new venue was held to be invalid and the chairman's adjournment of the morning meeting without taking a sense of the meeting was held to be not lawful. The court recognised that it is not necessary that all the members should be present in one room, but that if the members are seated in different rooms there should be an audio-visual link between all the rooms. In this case the system having failed, the gathering could not be constituted into a valid meeting except for the rudimentary purpose of adjourning itself.[8] Under the articles of the company the chairman could adjourn a meeting only with the consent of the meeting. But even so the court was of the view that a residuary power of adjournment would survive because circumstances may develop, as they did in this case, where it is impossible to ascertain the view of the majority. Finally, the court came to the conclusion that the chairman's power of adjournment was not fairly exercised. He failed to take into account the relevant factors, such as, member, attempts at *sine die* adjournment, their objections to the temporary adjournment and that there was no such urgency, the final date of merger being still off. The court said that for testing the reasonableness of the conduct of a chairman, the same test is applicable which is generally applied in all cases of judicial review, namely, whether the chairman reached a conclusion which no reasonable chairman could have reached having regarded to the purpose of his power to adjourn.[9]

Further, it has been held in *Ram Narain* v *Ram Kishen*[10] that:

> A chairman who presides over a meeting of a company is neither wholly a ministerial officer nor wholly a judicial officer; his duties are of a mixed nature, and he is not liable to be mulcted in damages, if, acting *bona fide* according to the best of his judgment and without malice, he erroneously excludes a shareholder from voting and declares him to be ineligible as a director of the company. A shareholder who has been wrongfully refused the right of voting or of election as a director, cannot maintain an action of damages against the chairman of the company.

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8 Even in this respect the court had to face authorities like *Harben* v *Phillip*, (1883) 23 Ch D 14: 48 LT 334: 31 WR 173, where a meeting was invalid by reason of omission to give notice to all members and the same was held to be not even capable of adjourning itself; *Portuguese Consolidated Copper Mines Ltd, Re*, (1889) 42 Ch D 160 CA, a board meeting called on inadequate notice was held to be not capable of adjourning itself; the court also found in its support the New Zealand case of *Hetcher* v *New Zealand Glue Co Ltd*, (1911) 31 NZ LR 129 SC where an inchoate meeting was held to be valid for approving the annual return and adjournment.

9 The following cases were cited as propounding the test of judicial review: *Associated Provincial Picture Houses Ltd* v *Wednesbury Corp*, [1947] 2 All ER 680: [1948] 1 KB 223. *See* further *Second Consolidated Trust Ltd* v *Ceylon Amalgamated Tea & Rubber Estates Ltd*, [1943] 2 All ER 567: 169 LT 324, where too the chairman had failed to take into account the relevant factors.

10 (1911) 10 IC 515.

In the case of a tie of votes, the chairman can exercise a casting vote. This right can be exercised by the person who is occupying the chair. It is not necessary that he should be a regularly elected chairman.[11]

Appointment by court

The court also has the power to appoint an independent chairman to preside over a meeting of a company. Such a chairman is particularly necessary where there are factions among the shareholders and a peaceful meeting under the chairmanship of a person appointed by either faction is improbable.[12]

Voting

The business of a meeting is done in the form of resolutions passed at the meeting. Shareholders have the right to discuss every proposed resolution and to move amendments. If an amendment is reasonably germane to a proposed resolution and is not in substance a negative of it, it must be admitted and put to the meeting. Accordingly, in *T. H. Vakil* v *Bombay Presidency Radio Club*:[13]

> Where at a meeting of a company the chairman wrongfully ruled an amendment out of order, it was held that the subsequent proceedings relating to that particular motion were invalidated.

After a resolution has been discussed it is put to vote. Every holder of equity shares has the right to vote.[14] For, Section 182 now clearly provides that a company cannot prohibit any member from exercising his voting right on the ground that he has not held his shares for any specified period before the meeting or on any other ground.[15] The only ground on which the right to vote may be excluded is non-payment of calls by a member or other sums due against a member or where the company has exercised the right of lien on his shares.[16] Persons who are members on the last date for holding the meeting alone would be entitled to vote. Those who became members thereafter by virtue of a Government order were held to be not entitled to vote even at the postponed meeting.[17]

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11 *T.V. Prasadachandran Nair* v *Anandamandarim Hotels P Ltd*, (2002) 110 Comp Cas 394 CLB.

12 *See*, for example, *Ananthalakshmi* v *Tiffin's Barytes Asbestos & Paints Ltd*, AIR 1952 Mad 60; *Selvaraj* v *Mylapore H. P. Fund*, [1968] 1 Comp LJ 93 Mad. Apart from such extraordinary circumstances the courts do not interfere in the conduct of meetings by appointing a chairman. See *Kishore Y. Patel* v *Patel Engg Co Ltd*, (1994) 79 Comp Cas 53 Bom. Courts also do not interfere with adjournments agreed to by shareholders, *Swadee Chemicals Ltd* v *Kothari Industrial Corpn Ltd*, (1995) 18 Corpt LA 23 Mad.

13 AIR 1945 Bom 475. *See* also *Henderson* v *Bank of Australasia*, (1890) 45 Ch D 330: [1886-90] All ER Rep Ext 1190.

14 S. 87(1).

15 *See*, for example, the case of *Ananthalakshmi* v *H. I. & F. Trust*, AIR 1951 Mad 927 where a provision in the articles of a company that only those shareholders would be entitled to vote whose names have been there on the register for two months before the date of the meeting was held to be in contravention of the Act. Section 182 however does not apply to a private company which is not a subsidiary of a public company. Disproportionate voting rights have been terminated. S. 89.

16 S. 181.

17 *C.M. Varkey Chan* v *T.V. Mathew*, (2002) 108 Comp Cas 159 Ker.

A provision in the articles of a company introduced by an amendment to the effect that there would be full voting rights in respect of partly paid up shares also was held to be not permissible. It was in violation of the provisions of the Act.[18]

Before the Amendment of 2000 shares with differential voting rights were not permitted to be issued. Such voting rights existed up to the enactment of the 1956 Act. Now they have been brought back by the amendment. Section 2(46-A) provides that shares with differential voting rights means shares which are issued with differential rights in accordance with the provisions Section 86.

The voting rights of preference shareholders are restricted by Section 87(2). A preference shareholder has the right to vote only on resolutions which directly affect the rights attached to his preference shares.

Informal Agreements

A formal resolution is, however, not the only way for a company to act through the general meeting of its shareholders. An agreement unanimously adopted by all the members is sufficient to express the corporate will. Where a meeting was attended by all the five shareholders of a company and two of them having half the voting power supported a resolution for voluntary winding up and the rest holding the other half abstained altogether from voting, the resolution was held to be the unanimous will of all the members.[19] BRIGHTMAN J said: "It is established law that a company is bound in a matter, *intra vires* the company, by the unanimous agreement of all its corporators."[20] He then quoted ASTBURY J as saying: "Where a transaction is *intra vires* the company and honest, the sanction of all the members of the company, however expressed, is sufficient to validate it." Explaining how the agreement was deemed to be unanimous when three out of five members did not vote, the court said: "Admittedly three of the five corporators did not vote in favour of the resolution, but they undoubtedly suffered it to be passed with knowledge of their power to stop it.... If corporators attend a meeting without protest, stand by without protest while their fellows purport to pass a resolution and permit all persons concerned to act for years on the basis that the resolution was duly passed and rule their conduct on the basis that the resolution is an established fact, it is idle for them to contend that they did not assent to the purported resolution."

Some more decisions have been delivered on the validity of informal agreements having the effect of resolutions. The statutory procedural requirements of a shareholders' resolution at a general meeting for the award of a long term contract was taken by the court to be waived where the sole shareholder consented to the agreement. The correct approach is to consider the purpose and underlying rationale of the formality in question. The sole shareholder had given the genuine consent to something which was within the

18 *Ajit Singh* v *DSS Engg. P Ltd*, (2002) 109 Comp Cas 597 CLB.

19 *Bailey, Hay & Co Ltd, Re*, [1971] 1 WLR 1357: [1971] 3 All ER 693.

20 The learned judge cited *Express Engg Works Ltd, Re*, [1920] 1 Ch 466: [1920] All ER Rep Ext 850 and *Parker & Cooper Ltd* v *Reading*, [1926] Ch 975.

company's powers. The prescribed procedure was intended to ensure that there was a proper opportunity for shareholders to consider the agreement.[21] Where, however, certain additional requirements are prescribed, e.g., special notice of a resolution for removal of a director, it is doubtful whether such procedure can also be waived. Where a charge was created in favour of debenture holders but the receiver appointed by them could neither find the requisite shareholders' resolution for the creation of the charge, nor there was any evidence of the way in which the concerned group of shareholders had given its consent, the court said that the debenture could not be validated. But the company was not allowed to avoid the transaction because the debenture trustees had acted in good faith.[22]

***By show of hands* [S. 177]**

In the first instance, voting on a resolution takes place by show of hands. On a show of hands, one member has one vote. A declaration by the chairman on a show of hands that a resolution has or has not been carried is conclusive,[23] except when a poll is demanded or when as held by the Calcutta High Court in *Dhakeswari Cotton Mills* v *Nil Kumar Chakravorty*:[24]

> A declaration by the chairman would be conclusive only if he does not find by his declaration the figures for or against the resolution. But where the chairman finds the figures and erroneously in point of law holds that a resolution has been duly passed, the resolution cannot be said to have been passed according to law.

***Poll* [S. 179]**

If there is a dissatisfaction about the result of voting by show of hands a poll can be demanded.[25] Taking a poll means recording the number of votes cast for or against a resolution. The "voting right of a member on a poll shall be in proportion to his share of the paid-up equity capital of the company."[26] Shares with disproportionate voting rights were not allowed to be issued.[27] Section 88 which

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21 *Wright* v *Atlas Wright (Europe) Ltd*, [1999] 2 BCLC 301 CA.

22 *Torvale Group Ltd Re*, (1999) 2 BCLC 605 Ch D. Section 35 of the English 1985 Act validates transactions where the other party did not know of the directors' procedural lapses. The court considered the decisions in *Demite Ltd* v *Pratec Health Ltd*, (1998) BCC 638.

23 S. 178. *See*, for example, *E. D. Sassoon United Mills, Re*, AIR 1929 Bom 38. Section 177 (voting by show of hands) does not apply to a company which does not carry on business for profit or prohibits payment of dividends to members. Such a company may have any provision in the articles on the point. [S. 263-A].

24 AIR 1937 Cal 645: 41 CWN 1137.

25 S. 179. A poll may be demanded even before the declaration of the result on a show of hands. A member who participated in voting by show of hands and did not object to the result or demand a poll, was not allowed to question the validity of the resolution. *Jetu Jacques Taru Lalvani* v *JBA Printing Inks Ltd*, (1997) 88 Comp Cas 759 Bom.

26 S. 87(1)(*b*).

27 S. 88. Under S. 99 disproportionate voting rights in existing companies have also been terminated. But sub-section (4) empowers the Central Government to exempt any company from the operation of the section in public interest. An exemption of this kind was quashed by the Delhi High Court in *Mahant Vaishna Das* v *Fakir Chand*, [1967] 2 Comp LJ 171 because it was granted under the mistaken belief that the company was a trust. The court also pointed out that the Government must give a hearing to those shareholders whose rights are affected by the

so provided has been omitted by the Amendment of 2000. Section 86, as replaced by the same amendment, permits shares with differential rights to be issued. But so long as a company does not have such shares, the regime of equality of voting rights would prevail. So is true of quoted companies in England.[28] But private companies are exempted from the operation of this rule.[29] Thus a clause in the articles of a private company which gave three votes for each equity share to a director when a resolution was proposed for his removal has been held valid.[30] A poll may be ordered by the chairman of his own motion and he will be bound to order a poll when it is demanded—

1. in the case of a public company having a share capital, by any member or members present in person or by proxy and holding shares in the company (*i*) which confer a power to vote on the resolution not being less than one-tenth of the total voting power in respect of the resolution of, or (*ii*) on which an aggregate sum of not less than Rs 50,000 has been paid;
2. in the case of a private company having a share capital, by one member if not more than seven members are present at the meeting and by at least two members when more than seven members are present at the meeting;
3. in the case of any other company, by the holders of one-tenth of the total voting power in respect of the resolution.[31]

When a poll is taken a member is free to split his votes for as well as against the same resolution. He has the right to distribute his votes in any manner he chooses.[32]

The manner of taking a poll is to be decided by the chairman.[33] He appoints two scrutineers (one of whom must be a member if available and willing) to scrutinise the votes given on the poll.[34] A declaration of the chairman that a

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exemption. One could not go on enjoying disproportionate voting rights by paying penalty. *Namita Gupta* v *Cachar Native Joint Stock Co Ltd*, (1999) 98 Comp Cas.

28 *See* Clive M Schmitthoff, *The Issue of Securities in Great Britain*, 1969 JBL 1.

29 S. 90.

30 *Bushell* v *Faith*, [1969] 2 WLR 1067: [1969] 1 All ER 1002.

31 *Jetu Jacques Taru Lalvani* v *JBA Printing Inks Ltd*, (1997) 88 Comp Cas 759 Bom, the chairman is not bound to hold a poll in every case.

32 Now expressly provided in S. 183. *See also* the observations of the Calcutta High Court in *Mahaliram* v *Fort Gloster Jute Manufacturing Co*, AIR 1955 Cal 132. Section 180 says that a poll demanded on a question of adjournment shall be taken forthwith and a poll demanded on any other question (not being a question relating to the election of a chairman (which is provided for in S. 175) shall be taken at such time not being later than 48 hours from the time when the demand was made, as the chairman may direct. The meeting is deemed to continue upto that time. *Holmes* v *Keys*, [1958] 2 All ER 129 Ch D; *Shaw* v *Tati Concessions Ltd*, [1913] 1 Ch 292; *Jackson* v *Hamlyn*, [1953] 1 All ER 887. A person who was not then present may nevertheless vote on a poll. *Campbell* v *Maund*, [1835-42] All ER Rep 648; a breakdown of poll arrangement would require another effort. *M. K. Srinivasan* v *W. S. Subramania Iyer*, (1932) 32 Comp Cas 147: AIR 1932 Mad 100.

33 S. 185. *Mela Singh (Maj)* v *Jullundur Club Ltd*, [1969] 1 Comp LJ 273 where the chairman ordered open, not secret ballot.

34 S. 184(1), (2) and (3).

resolution has or has not been carried is *prima facie* evidence of the resolution.[35] The reason for this rule was explained in the case of *Mahaliram* v *Fort Gloster Jute Mfg Co*:[36]

> The validity of a resolution declared passed by the chairman at a poll was questioned on the ground that certain proxies were improperly rejected. The articles of association of the company provided that in such cases "the determination of the chairman made in good faith shall be final". The court observed: "The chairman by virtue of his position and the nature of his duties has to decide on the spot all emergent questions that arise at the meeting and it is not desirable to reduce the *prima facie* authority of his verdict.... Hence the burden of proof lies on the other party to show that the decision of the chairman was wrong."

Where a poll was demanded on a valid basis but was not allowed by the chairman, the Company Law Board held that the business on the agenda for which poll was demanded and which was carried through by show of hands became invalid.[37]

***Voting by proxy* [S. 176]**

A member may vote either in person or by proxy. Articles may allow voting by proxy even on show of hands.[38] But unless the articles otherwise provide, a proxy shall not be allowed to vote except on a poll. The system of voting by proxy has become very popular because of the unwillingness and inability of shareholders to be personally present at meetings:

> It is commonplace to observe that the modern shareholder is a kind of investor and does not think of himself as or like an owner. He hires his capital out to the managers, and they must run it for him; how they do it is their business, not his; and he always votes 'yes' on the proxy.

"A proxy is a person representative of a shareholder at a meeting of the company, who may be described as his agent to carry out a course which the shareholder has himself decided upon."[39] A proxy is not entitled to act contrary to the instructions of the shareholder in the matter. It is the relationship of principal and agent.

A proxy does not have the right to speak.[40]

The instrument appointing a proxy must be in writing and signed by the shareholder,[41] and should be deposited with the company forty-eight hours

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35 S. 195.

36 AIR 1955 Cal 132: 58 CWN 715.

37 *Namita Gupta* v *Cachar Native Joint Stock Co Ltd*, (1999) 98 Comp Cas 655 CLB.

38 S. 176(1)(c). The English cases bearing on the subject of right to vote by proxy are: *Horbury Bridge Coal, Iron & Waggon Co, Re*, (1879) 11 Ch D 109: 40 LT 353; *Bidwell Bros, Re*, [1893] 1 Ch 603: 68 LT 342; *Ernest* v *Loma Gold Mines Ltd*, [1897] 1 Ch D 1: 75 LT 317.

39 Lord HANWORTH MR in *Cousins* v *International Brick Co*, [1913] 2 Ch 90: 1913 All ER Rep 229; cited with approval in *Narayana Chettiar* v *Kaleeswara Mills*, AIR 1952 Mad 515: ILR 1952 Mad 218: [1952] 1 MLJ 18.

40 S. 176(1).

before the meeting.[42] The Act requires proxy forms to be supplied to members along with the notice for the meeting. The forms should be in blank and should not carry any suggested names. It would be a misuse of privilege to influence voting that way.[43]

"A proxy is always revocable. Even where by its terms it is made irrevocable, the law allows the stockholder to revoke it."[44] Revocation is, of course, subject to the provisions of the articles. Generally it is provided that revocation must be received at the office of the company before the commencement of the meeting. Accordingly, where a revocation was communicated before the poll, but not before the meeting, it was held to be ineffective and the proxy's vote stood.[45] Where, however, there is no provision in the articles, the power of revocation would be unfettered. And so in *Narayana Chettiar* v *Kaleeswara Mills*:[46]

> A proxy had exercised his votes in the first poll of a meeting but the proxy was revoked before the final poll was held. In the absence of any provision in the articles, the revocation was held to be effective and the rejection of the revocation by the chairman, was, therefore, untenable.

Proxy forms can be inspected by any member who has a right to vote at the meeting or on any resolution to be proposed at the meeting.[47]

Resolution by postal ballot [S. 192-A]

The Amendment of 2000 has introduced this new section so as to provide for passing of resolutions by postal ballot. This facility has been extended to listed

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41 S. 176(5). If the appointer is a body corporate, the instrument of proxy should be under its seal or be signed by an officer or attorney duly authorised by it. The relevent form is prescribed by Sch IX and it has been held that the members can use this form even if the company had adopted a form of its own. *General Commerce* v *Apparel Export Promotion Council*, [1990] 1 Comp LJ 297 Del.

42 S. 176(3). This sub-section declares that if the articles of a company require a longer period than forty-eight hours that will be inoperative and the shareholders will have the right to deposit proxies forty-eight hours before the meeting. There is no provision of law requiring holidays to be excluded in computing 48 hours and, therefore, forms filed on a Sunday would be valid *K. P. Chackochan* v *Federal Bank*, [1989] 2 Comp LJ 269: (1989) 66 Comp Cas 953 Ker. Proxy forms with uncancelled stamps have been held to be valid. *M. G. Mohanraj* v *Myalapore Hindu Permanent Fund Ltd*, [1990] 1 Comp LJ 87 (Mad). On the question whether a proxy form can be filed through fax, a beginning has been made with a creditors' meetings (S. 500). It has been held that a creditor can attend a meeting through a proxy by sending the proxy nomination by fax. *A Debtor (No 2021 of 1995), ex parte, Re.* (1996) 1 BCLC 538 Ch D; *IRC* v *Debtor*, (1996) 1 BCLC 538 Ch D.

43 *Peel* v *London & North Western Rly Co*, [1907] 1 Ch 5: [1904-07] All ER Rep Ext 1201; *Second Consolidated Trust Ltd* v *Ceylon Amalgamated Tea & Rubber Estates Ltd*, [1943] 2 All ER 567: 169 LT 324.

44 Cook on STOCK HOLDERS, S. 610, cited by Jessee W. Lilienthal, *Corporate Voting & Public Policy*, 10 Harv LR 428.

45 *Spiller* v *Mayo Development Co*, [1926] WN 78; *K. P. Chackochan* v *Federal Bank*, [1989] 2 Comp LJ 269: (1989) 66 Comp Cas 953 Ker.

46 AIR 1952 Mad 515: ILR 1952 Mad 218: [1952] 1 MLJ 18. For further details *see* M. S. Srinivasan, *Proxies*, [1965] 1 Comp LJ 64.

47 S. 176 proviso. The High Court of Delhi has held in *Swadeshi Polytex* v *V. K. Goel*, (1988) 63 Comp Cas 688 at 697 that where a member filed two different proxy forms in favour of two different persons, the Registrar's order for production of the certified copies of the rival forms was valid.

public companies and that too only in respect of a business which the Central Government declares by notification that it shall be conducted only by postal ballot. In such cases the company would have to pass the resolution by postal ballot instead of transacting the business in the general meeting of the company.

The company has to send a notice to all the shareholders alongwith the draft resolution and carrying an explanation of the reasons which necessitated the resolution. The notice should request the shareholders to send their assent or dissent in writing on the postal ballot within the period of thirty days from the date of the posting of the letter.

The notice has to be sent under acknowledgment due registered post or by any other prescribed method (to be prescribed by the Central Government). It has to carry a postage pre-paid envelope. If the resolution is assented to by the requisite majority, (depending upon the nature of the resolution) it shall be deemed to have been passed at a general meeting.

If anybody fraudulently defaces or destroys either the ballot paper as sent in by the shareholders or his identity, such person has been made punishable with imprisonment extending up to six months or with fine or with both.

Electronic Mode.—Postal ballot would include voting by electronic mode.[48]

Representation of companies and Government [Ss. 187 and 187-A]

Where a company or a corporation is a member of another company, it may attend the meetings of the other company through a representative. The representative must be appointed by a resolution of the board of directors or the other governing body. Where the Central Government or a State Government is a member, the President or the Governor of the State, as the case may be, has the power to appoint representatives to attend meetings of the company. The person nominated holds the position of a proxy.[49]

Resolution

Kinds of Resolution **[S. 189]**.—Resolutions are of two kinds, namely:

1. Ordinary resolution, and
2. Special resolution.

A resolution is said to be ordinary when the votes cast in favour of it at a general meeting of a company exceed the votes, if any, cast against the resolution. In other words, it means a resolution passed by a simple majority of shareholders.

A special resolution, on the other hand, requires the support of three-fourth majority of shareholders present and entitled to vote at a meeting. The votes cast in favour of the resolution should not be less than three times the number of votes, if any, cast against the resolution. It is also necessary that the intention to propose the resolution as a special resolution should have been specified in the notice calling the general meeting and the notice itself should have been given in

48 S. 192-A, *Explanation*.

49 Sections 187(2) and 187-A(2). A trust has been created for disposal of old lot shares. *See* Govt Circular of Oct 8, 1993.

accordance with the provisions of the Act.[50] Questions have arisen whether it is necessary for the validity of a special resolution that it should be passed as notified to the members or whether it can be passed with amendments at the meeting. In a case of this kind:[51]

> A notice was circulated of the intention to propose at an extraordinary general meeting a special resolution to cancel the company's share premium account on the ground that the amount credited to the account had been lost. It was subsequently realised that the figure standing to the credit of the account also included a small amount arising from a recent issue which was definitely not lost. At the meeting the form of the resolution had to be altered so as to provide not that the account had been cancelled, but that it had been reduced to a certain amount.

The court did not confirm the resolution as it was not validly passed. The court laid stress upon the requirement of the section, "intention to propose the resolution as a special resolution", which has been taken to mean that the resolution passed at the meeting must be the same as that specified in the notice.[52] In principle, however, the court agreed that a need for amendment may genuinely arise and the same should be allowed within reasonable limits. Correction of grammatical or clerical errors is allowed. Where the need for an amendment of substantive nature is feared, the notice itself should carry a warning that the resolution shall be passed subject to such amendments as may be determined at the meeting. Thus an amendment of even a slight substance would invalidate the resolution.[53]

A typed or printed copy of every special resolution must be registered with the registrar within thirty days of its date.[54]

For a decision relating to almost every important matter affecting the constitution, administration and affairs of a company, the Act has prescribed the formality of a special resolution. The support of a three-fourth majority of shareholders being requisite for passing a special resolution, the requirement is able to take care and protect the interests of a substantial group of shareholders.[55]

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50 The requirements of the section are mandatory. Non-fulfilment would make the resolution ineffective. *Self-Help Private Industrial Estates P Ltd. Re*, (1972) 42 Comp Cas 605 Mad; followed in *V.B. Balasundaram* v *New Theatres Carnatic Societies*, (1993) 77 Comp Cas 605 Mad.

51 *Moorgate Mercantile Holdings Ltd, Re*, [1980] 1 All ER 40, noted 1980 JBL 190.

52 In Palmer's COMPANY LAW it is categorically stated that such resolutions cannot be amended. Vol. 1, para 54-03 and in Gower, PRINCIPLES OF MODERN COMPANY LAW that the position should be the same as that of an ordinary resolution, namely, "would the amendment so alter the nature of the business as to cause any member who had stayed away reasonably to wish he had not." (545-46, 4th Edn). *See* also *Torbock* v *Lord Westbury*, [1902] 2 Ch 871.

53 See *Pearce Duff & Ltd, Re*, [1960] 1 WLR 1014; *Duomatic Ltd, Re*, [1969] 1 All ER 161: [1969] 2 WLR 114: [1969] 2 Ch 365.

54 S. 192(1).

55 A special resolution is required: to alter the memorandum [S. 17], articles [S. 31]; to issue further shares without pre-emptive rights [S. 81]; to convert uncalled capital into reserve capital [S. 99]; to reduce share capital [S. 100]; to shift registered office from one State to another [S. 146]; to authorise payment of interest out of capital [S. 208]; to request the Govern-

Where special notice of a resolution is required by the Act or the articles of a company, the intention to propose such a resolution must be notified to the company at least fourteen days before the meeting.[56] Such a resolution is called an ordinary resolution requiring special notice. This is necessary to enable the company to comply with its statutory obligation of informing the members of the resolution. This information has to be served on the members at least seven days before the meeting. Notice of the resolution may be given in the same manner in which notice for a meeting is given. Where that is not practicable, it may be given by advertisement in a newspaper having an appropriate circulation or in any other mode allowed by the articles.[57] Such notice is necessary, for example, for removing a director or an auditor or for proposing the appointment of a new director. Every member has a right to give a special notice of this kind relating to a proposed resolution, but he does not have the right to have the resolution included in the agenda of the meeting unless he is supported by as many members as can requisition a meeting[58] or can ask for circulation[59] of a member's resolution.[60]

Circulation of members' resolutions [S. 188]

Where certain members of a company desire to propose a resolution at the company's next annual general meeting a requisition may be served on the company requiring it to give the members notice of the resolution. The minimum number of members who must sign the requisition is the holders of one-twentieth of the total voting power of all the members having a right to vote on the resolution or one hundred members holding shares on which at least a sum of one lakh rupees has been paid.[61] The requisitionists have to deposit at the registered office of the company a copy of the requisition. Where the requisition requires notice of a resolution to be given to the members, it must be deposited six weeks before the meeting, in any other case, two weeks before. They have also to deposit with the requisition a sum reasonably sufficient to meet the expenses of the requisition. When these requirements are complied with, the company becomes bound to notify the members of the intended resolution. The requisition may require the circulation of any statement of not more than one thousand words with respect to the matter referred to in any proposed resolution of any business to be dealt with at the meeting. However, in certain cases, a company is not bound to give effect to any such requisition. In the first place, if,

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ment to appoint inspectors for investigation [S. 237]; to sanction the appointment of management's relatives [S. 261]; to authorise a director to hold a place of profit [S. 314]; to make the liability of any managerial personnel unlimited [S. 332]; to make loans or provide guarantees or security to other companies beyond a certain limit [S. 372-A]; to apply to the court for winding up [S. 433]; to wind up the company voluntarily [S. 484], etc.

56 S. 190.

57 S. 190(2).

58 S. 169.

59 S. 188.

60 *Pedley* v *Inland Waterways Assn Ltd*, [1977] 1 All ER 209: 1976 JBL 349.

61 Where the consenting shareholders did not sign as requisitionists and instead gave power to a single shareholder to represent them at the meeting, this was held to be not a sufficient compliance with S. 188. *Naresh Kumar Jain* v *UOI*, (1997) 90 Comp Cas 445 Del.

on the application of the company or any other aggrieved person, the Central Government is satisfied that the right is being abused to secure needless publicity for defamatory matter, the court may relieve the company of the burden of this obligation.[62] Secondly, a banking company shall not be bound to circulate any such statement, if in the opinion of its board of directors, the circulation will injure the interests of the company.[63]

Registration of resolutions and agreements [S. 192]

Following resolutions and agreements have to be registered with the Registrar of Companies:[64]

1. special resolutions;
2. resolutions which have been agreed to by all the members of a company, but which, in the absence of such an agreement would have to be passed as special resolutions;
3. any resolution of the board of directors of a company or an agreement executed by a company relating to the appointment of a managing director or variation of its terms;
4. any transaction of the above kind relating to managing agents or secretaries and treasurers;
5. resolutions or agreements which have been approved by all the members of a class of shareholders, but which would have otherwise required to be passed by a particular majority and resolutions or agreements which bind all the members of a class of shareholders though not agreed to by all those members;
6. resolutions passed by a company conferring power under Section 293 upon its directors to sell or dispose of the whole or any part of the company's undertaking; or to borrow money beyond the limit of the paid-up capital and free reserves of the company; or to contribute to charities beyond fifty thousand rupees or five per cent of the average net profits;
7. any resolution approving the appointment of sole selling agents under Section 294;
8. resolutions requiring the company to be wound up voluntarily.

Such resolutions or agreements must be filed with the Registrar within thirty days. The copy to be filed must be certified under the signature of an officer of the company.[65]

Minutes [Ss. 193-195]

Every company has to keep a record of the proceedings of its general meetings and the meetings of its board of directors. Such records have to be kept of all the proceedings of every general meeting and of all the proceedings of

62 S. 188(5).
63 S. 188(6).
64 S. 192(4).
65 S. 192(1). *See also* sub-sections (5) and (6) which provide penalty for default.

every meeting of the board of directors or of every committee of the board. Within thirty days of every such meeting, entries of the proceedings must be made in the books kept for the purpose and their pages must be consecutively numbered. Pasting of loose-leaf papers or maintaining minutes in loose-leafs is not allowed.[66] Proceedings have to be recorded in bound books and, therefore, they have to be handwritten. Typed sheets cannot be pasted.[67] These records are known as minutes. Each page of a minutes book which records proceedings of a board meeting must be signed by the chairman of the same meeting or the next succeeding meeting,[68] adding the date on the last page of the record. In the case of a general meeting this is the responsibility of the chairman of the same or of the next succeeding meeting.

The minutes of each meeting must contain a fair and correct summary of the proceedings of the meeting.[69] All appointments of officers made at any such meeting must be included in the minutes.[70] In the case of a meeting of the board of directors or of a committee of the board the minutes must state the names of the directors present at the meeting and the names of directors dissenting from or not concurring in a resolution passed at the meeting.[71] The chairman may exclude from the minutes, matters which are defamatory, irrelevant or immaterial or which are detrimental to the interests of the company. The discretion of the chairman in respect to the inclusion or exclusion of any such matter is absolute:[72]

> Minutes of the board meeting are kept in order that shareholders of the company may know exactly what their directors have been doing, why it was done, and when it was done. If any alteration or addition is called for it should be done by resolution, not by clerical correction.[73]

Minutes kept in accordance with the above provisions are evidence of proceedings recorded in them. Any such meeting of the proceedings[74] of which

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66 S. 193(1-B).

67 *Anil Kumar Mukherjee* v *Clarion Advertisement Services Ltd*, (1982) 52 Comp Cas 315. The High Court of Delhi accepted evidence of loose-leaf forms, *Edward Keventer Successors (P) Ltd* v *K. K. Sud*, (1968) 38 Comp Cas 507, but the Calcutta High Court did not accept pasted sheets as evidence, *Gluco Series (P) Ltd, Re*, (1987) 61 Comp Cas 227. The Deptt of Co Affairs (DCA) has advised companies maintaining loose-leafs to observe appropriate safeguards against interpolation of leaves, serially numbering them, authentication and safe-custody and to bind them up periodically say in six months. Field officers have been advised not to take action against loose-leaf practice of keeping minutes.

68 S. 193(1-A). It is not necessary that the chairman who signs the minutes at the next meeting should have been present at the preceding meeting. *Karnataka Bank Ltd* v *A.B. Datar*, (1994) 79 Comp Cas 417 at 436: (1993) 2 Kar LJ 230, citing Shackleton on THE LAW AND PRACTICE OF MEETINGS, 83, (7th Edn).

69 S. 193(2). Any error in the minutes of an earlier meeting may be rectified by the board of directors. *Gorden Woodroffe Ltd* v *Trident Investment*, (1994) 79 Comp Cas 764 CLB: [1994] 1 Comp LJ 313. The court also noted that minutes constitute good evidence.

70 S. 193(3).

71 S. 193(4).

72 S. 193(5).

73 *See* Lord ESHER MR in *Cawley & Co, Re*, (1889) 42 Ch D 209, 226: 61 LT 601.

74 S. 194. Thus in *Edward Keventer Successors (P) Ltd* v *K.K. Sud*, (1968) 38 Comp Cas 507, a resolution recorded in the minutes book authorising the general manager to file a suit was held to be good evidence of his authority.

proper minutes have been maintained is presumed to have been duly called and held. The proceedings at the meeting and the appointments of directors or of liquidators are deemed to be valid.[75] The presumption is rebuttable. Where a controversy is raised, evidence of conclusive nature to establish the points stated in the minute would become necessary. At the interlocutory stage, however, the trial court was held to be not justified in expressing doubts upon the genuineness of the minutes. He could not discard them at that stage.[76]

The minutes books are to be maintained at the registered office of the company. They are open to the inspection of members during business hours and without charge.[77] Restrictions may be imposed but a minimum of two hours each day must be granted for inspection. Members are also entitled to obtain copies of minutes.[78] Any denial of this right of members is punishable and the Central Government may compel an immediate inspection or supply of copies.[79]

Publication of reports of proceedings [S. 197]

The section requires that no document purporting to be a report of the proceedings of a general meeting shall be circulated or advertised at the cost of the company. Circulation of any such matter can be made if it is such that it is required to be included in the minutes of the proceedings.[80]

Service of documents on members [S. 53]

The mode prescribed by Section 53 for service of documents by a company on its members is that a document may be served either personally or by sending it to him by post. The letter should be sent to his registered address. If he has no registered address, any address, given by him to the company for the purpose of

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75 S. 195. See *Kerr* v *John Mottram Ltd*, [1940] 2 All ER 629: [1940] Ch 657. No such presumption about an appointment was drawn where the minute book was not produced. *V.G. Balasundaram* v *New Theatre Carnatic Talkies (P) Ltd*, (1993) 77 Comp Cas 324 Mad. Burden of proof would lie on those who allege that a particular record was not factually true. *B. Sivaraman* v *Egmore Benefit Society Ltd*, (1992) 75 Comp Cas 199 Mad. The only way to prove that a particular resolution was passed is to produce the minutes book of the company which carries the record of the resolution in question, *Escorts Ltd* v *Sai Autos*, (1991) 72 Comp Cas 485 Del. Anybody challenging the validity of appointment of a director would have to dislodge the presumption of validity arising from recorded minutes, *C. R. Priyachandra Kumar* v *Purasawalkam Permanent Fund Ltd*, (1995) 83 Comp Cas 150 Mad. Where a Chairman was appointed by the court to preside over a meeting because of a conflict between members, it was held that the minutes prepared and approved by him were to be accepted as authentic and not the minutes prepared by the secretary of the company. *Nazir Hoosein* v *Darayas Bhattena*, (2000) 5 SCC 601: AIR 2000 SC 2427: (2000) 37 CLA 414 SC.

76 *BDA Breweries* v *Cruickshank & Co*, (1996) 85 Comp Cas 325, 374 (Bom): (1997) 25 Corpt LA 275. This presumption is not applicable to a meeting held on requisition. Where the records of such a meeting showed that two members were present, but evidence showed that only one was present, evidence prevailed over the presumption, *Bhankerpur Beverages (P) Ltd* v *Sarbhjit Singh*, (1996) 86 Comp Cas 842 P&H.

77 S. 196(1). Rupee 1 has been prescribed as fee for inspection. Rule 21-A of Companies (Central Government's) General Rules and Forms, 1956.

78 S. 196(2).

79 S. 196(3) and (4).

80 S. 197(1), sub-s. (2) provides that defaulting officers shall be punishable with a fine up to Rs 5000.

communications may be used. Where post is used as the medium of communication, service shall be deemed to have been effected when a properly addressed and stamped letter of notice is posted.[81] Where a member wants service by registered post or under certificate of posting and he has paid to the company sufficient amount for the purpose, he must be served in the manner prescribed by him. In either case, the service shall be deemed to have been effected, in the case of notice of a meeting, at the expiration of forty-eight hours from the date of posting, and, in any other case, when such letter is likely to be delivered in the ordinary course of post. Such a presumed service was not deemed to have taken place when the company was not able to produce any record of posting and the addressee denied service.[82]

In the case of a member who has no registered address in India, nor has supplied any address for communication purposes, service shall be taken to have been effected if an advertisement is inserted in a newspaper circulating in the neighbourhood of the registered office of the company.

In case of joint-holders, a document may be served on the first named holder. In the case of death or insolvency of a member, the same rules apply for service of documents upon his representatives.

Where certain documents were sent by the company to the shareholders by registered post but the post was not delivered to the addressee, the court said that the company was not absolved from its responsibility of delivering the documents to the shareholders.[83]

Service of documents on Registrar [S. 52]

A document may be served on a Registrar by sending it to him at his office by post under a certificate of posting or by registered post, or by delivering it to, or leaving it for him at his office.

Service of documents on company [S. 51]

Documents can be served on a company or its officers by sending them to the registered office of the company by post under certificate of posting or by registered post or by leaving them at the registered office of the company. Where the securities are held in a depository, the records of the beneficial ownership may be served by such depository on the company by means of electronic mode or by delivery of floppies or discs.[84]

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81 Service of notice by post under postal certificate which was directed by the court was held to be a good service, *National Breweries Ltd, Re*, (1991) 1 Gau LR (NOC) 44.

82 *Bhankerpur Simbhaoli Beverages (P) Ltd* v *P. R. Pandya*, (1995) 17 Corpt LA 170 P&H: (1996) 86 Comp Cas 842. The presumption of service is rebuttable. The burden of proof is on the addressee to show that he did not receive the service. A director who attended both the Board meeting and the general meeting was not heard to say that he did not receive the notice and was only orally informed by others, *R. Khemka* v *Deccan Enterprises (P) Ltd*, [1998] 5 Comp LJ 258 AP.

83 *Inter Sales* v *Reliance Industries Ltd*, (1999) 35 CLA 370 Cal.

84 S. 51 (proviso).

The service of a High Court writ by posting it on the company's registered office address was held to be a good service.[85]

The service of notice on a company, for the purpose of filing a suit, by giving it to the office assistant of the company was held to be not a good service.[86]

85 *Addis Ltd* v *Berkerly Supplies Ltd*, [1964] 2 All ER 753; *T. O. Supplies (London) Ltd* v *Jerry Creighton Ltd*, [1952] 1 KB 402; *Indian Air Gases Ltd* v *Tarwan Sood*, (1999) 33 CLA 157 Delhi, concurrent finding of good service by post, not interfered with in a writ petition.

86 *Nicco Corpn Ltd* v *Cethar Vessels Ltd*, (1998) 92 Comp Cas 748 Mad.

12

Dividends, Accounts and Audit

DIVIDENDS

Dividend means the share of profit that falls to the share of each individual member of a company. It is that portion of the corporate profits which has been set aside and "declared by the company as liable to be distributed among the shareholders".[1] Almost all commercial corporate enterprises are undertaken with the view of making profits for their members. The profits of a company when distributed among its members are called "dividends". No special authority either in the memorandum or in the articles is necessary to enable a company to pay dividends. The power is implied.

The payment of dividends is bound by two fundamental principles. The first is that dividends must never be paid out of capital.[2] It is supplemented by the second that dividends shall be paid only out of profits. The Act allows dividends to be paid out of the following three sources:

1. profits of the company for the year for which dividends are to be paid;
2. undistributed profits of the previous financial years;[3]
3. moneys provided by the Central or a State Government for the payment of dividends in pursuance of a guarantee by the Government concerned.

Payment of dividends out of capital is a breach of trust and the company may require the directors to replace the capital.[4] Thus in the well-known *Flitcroft* case[5] certain bad debts were credited to the accounts and the fictitious profits thus created were paid away as dividends. The directors were held liable. Explaining the reason JESSEL M R said:

> "The creditor has no debtor but that impalpable thing the corporation, which has no property except the assets of the business. The creditor, therefore, gives credit to that capital, gives credit to the company on the faith of the representation that the capital shall be applied only for the purposes of the business, and he has therefore a right to say that the corporation shall keep its capital and not return it to the shareholders...."

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1 GHULAM HASSAN J in *Bacha F. Guzdar* v *CIT*, (1955) 1 SCR 876, 882: AIR 1955 SC 74: (1955) 25 Comp Cas 1.

2 S. 205(1).

3 Payment out of reserves has to be in accordance with the Companies (Declaration of Dividend out of Reserves) Rules, 1975. The restriction envisaged is that the rate shall not exceed the average of the rates at which dividend was declared in five preceding years or 10% of the company's paid-up capital, whichever is less. The amount drawn from reserves should first be applied to set off losses of the year and the reserves must not be depleted to below 15% of the company's paid-up capital.

4 *K. Madhava* v *Popular Bank*, AIR 1970 Ker 131: (1969) 39 Comp Cas 717. They may recover indemnity from the shareholders who have received the dividends. *Moxham* v *Grant*, [1900] 1 QB 88.

5 *Exchange Banking Co, Re, Flitcroft* case, (1882) 21 Ch D 519: 48 LT 86.

Where dividend was paid in face of the auditor's qualified report, the payment was held to be wrong. The statutory requirements cannot be waived by shareholders' resolution in this respect. The recipient of such dividends were held to be constructive trustees for the amounts received by them.[6]

The law will not tolerate even an indirect attempt to pay back capital by way of dividends. Thus *Walters' Deed of Guarantee, Re*:[7]

> *W* guaranteed the payment of the preference dividends for a period of three years and the company agreed to pay him any sums that he might pay under the guarantee.

The agreement was held to be void and *W* could not recover the amounts paid by him in pursuance of the guarantee.

In such cases only that part of the agreement is void by which the company contracts to indemnify the guarantor. But, apart from this, a guarantee for the payment of dividends is valid.[8]

Payment to shareholder-executives

Where the shareholders of a company were also working as its executives and their remuneration for bringing a contract to fruition was paid in circumstances in which dividend distribution would not have been justified, the directors were held to be not guilty of any breach of duty.[9]

Dividend fund

"As dividends can be declared only out of surplus earnings, there must be an exact method of determining whether surplus earnings for that purpose actually exist."[10] But the Act provides no guidance. "There is nothing at all in the Act about how dividends are to be paid, nor how profits are to be reckoned; all that is left and very judiciously and properly left, to the commercial world. It is not a subject for an Act of Parliament to say how accounts are to be kept; what is to be put into a capital account, what into an income account, is left to men of business."[11]

The same truth is reflected by the following observations of RAMACHANDRA AYYAR, CJ, of the Madras High Court:[12]

> "Section 205 of the Act only prescribes that dividend shall be paid out of profits of the company. It does not say further how those profits have to

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6 *Cleveland Trust plc, Re*, [1991] BCLC 424 Ch D; *Precission Dippings Ltd* v *Precission Dippings Marketing Ltd*, [1985] BCLC 385 CA; *Bairstow* v *Queens Moat Houses plc*, [2000] 1 BCLC 549 QBD.

7 [1933] Ch 321: [1933] All ER Rep 430: 148 LT 473.

8 *South Llanharren Colliery Co, Re*, (1879) 12 Ch D 503: 41 LT 567; *Menell et Cie Ltd, Re*, [1915] 1 Ch 759.

9 *Mac Pherson* v *European Strategic Bureau Ltd*, [1999] 2 BCLC 203 Ch D.

10 SHAH J (afterwards CJ) in *CIT* v *Standard Vacuum Oil Co*, [1966] 1 Comp LJ 187: AIR 1966 SC 1393, 1396, quoting from Fletcher, ENCYCLOPAEDIA ON CORPORATIONS, Vol 19, para 9237.

11 LINDLEY LJ in *Lee* v *Neuchatel Asphalt Co*, (1889) 41 Ch D 1: 61 LT 11: [1886-90] All ER Rep 947.

12 *Hariprasad* v *Amalgamated Commercial Traders*, [1964] 1 Comp LJ 339, 349: AIR 1964 Mad 519: (1964) 34 Comp Cas 209, relying upon *Mercantile Trading Co, Re*, (1869) 4 Ch App 475: 20 LT 591.

be ascertained. Profits of a year under the mercantile system of accounting only means the excess of receipts for the year over expenses and outgoings during the same year. It is not necessary that such excess should be in the form of cash in the till of the company. It will be open to a company to declare a dividend on the basis of its accounts... where it is based on the estimated profit, which had not actually come in the form of cash to the company; it will be open to it to pay such dividends from out of other cash in their hands or perhaps even to borrow and pay them off. That will not amount to paying dividend out of capital."

Neither have the courts thought it fit to formulate any rigid rules. The judicial attitude is best reflected by the following observation of Lord MACNAGHTEN in *Dovey* v *Cory*:[13]

> I do not think it desirable for any tribunal to do what Parliament has abstained from doing, i.e. to formulate rules for the guidance and embarrassment of businessmen in the conduct of business affairs.

"[T]he real question for determination, therefore, is whether there are profits available for distribution, and this is to be answered according to the circumstances of each particular case, the nature of the company, and the evidence of competent witnesses. There is no single definition of the word 'profits' which will fit all cases."[14]

Thus "dividend fund" is a fluid concept. The primary concern of the courts has been that the capital is maintained in the form of assets if not equal to the paid-up capital at least sufficient to go round the creditors.[15] Once this is done, a complete latitude is given to businessmen to pay dividends in good faith so as to keep up their company's reputation.

> "People put their money into a trading company to give them an income and the sudden stoppage of all dividends would send down the value of their shares to zero and possibly involve its ruin."[16]

Separate Bank Account for Dividend

Three sub-sections have been added to sub-section (1) of Section 205 by the Amendment Act of 2000. Sub-section (1-A) provides that that the Board of directors may declare an interim dividend. The amount of dividend including interim dividend has to be deposited in a separate bank account within 5 days from the date of declaration of such dividend. Sub-section (1-B) provides that the amount of dividend including interim dividend so deposited shall be used for payment of interim dividend. Sub-section (3) declares that the provisions contained in Sections 205, 205-A, 205-C, 206, 206-A and 207 shall, to the extent possible, apply as much to interim dividend as they apply to regular dividend.

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13 1901 AC 477: [1895-99] All ER Rep 724; *National Bank of Wales Ltd, Re*, [1899] 2 Ch 629: [1895-99] All ER Rep 715, the only case that was taken to the House of Lords on the matter of dividend; sub nom.

14 FARWELL J in *Bond* v *Barrow Haematite Steel Co*, [1902] 1 Ch 353: [1900-03] All ER Rep 484.

15 *See*, LINDLEY LJ in *Verner* v *General & Commercial Investment Trust Co*, [1894] 2 Ch 239: [1891-94] All ER Rep Ext 1409.

16 MACNAGHTEN LC in *Dovey* v *Cory*, 1901 AC 477: [1895-99] All ER Rep 724.

Rule in Lee* v *Neuchatel

The first specimen of this permissiveness is the rule laid down in *Lee* v *Neuchatel Asphalt Co.*[17] The essence of this decision has been thus stated:[18]

> "Suppose that a company has a ship costing £3,00,000 and though good for ten years will at the end of that time have to be broken up. There is, therefore, roughly an annual depreciation or wasting of capital to the extent of £30,000. The company need not, in law, make any allowance for this before declaring a dividend."

In that case, the fixed capital of the company was an asphalt deposit which was being reduced from day to day and so became a wasting asset. Dividend was proposed to be paid out of profits shown by the revenue account in a particular year. A shareholder objected. "It was decided that when assets of the company are in the nature of wasting character depreciated by the efflux of time or exhaustion of material, such as mines, patents or leaseholds, if, for the purpose of carrying on the business of the company and getting a profit the annual consumption of that capital is necessary, there is no obligation by law or statute to create a reserve fund out of revenue to recoup the wasting nature of the capital."[19] LINDLEY LJ said: "The Companies Acts do not require capital to be made up if lost."

There was a storm of disapproval against this decision from business quarters.[20] But even so the ruling was re-affirmed in *Bolton* v *Natal Land and Colonization Co*,[21] where the court held that a decline in the value of the land belonging to a company was not relevant to the calculation of dividend fund.[22]

In the next leading case, namely, *Verner* v *General & Commercial Investment Trust Co*[23] the rule was tightened only to this extent that "circulating capital" must be maintained out of revenue. The facts were:

> A company had invested its capital to the extent of £6,00,000 in investments which had depreciated in value to the extent of £2,50,000. The income, however, left a balance of £23,000 after paying all the charges and expenses. The company proposed to pay a dividend.

The court of appeal allowed it. LINDLEY LJ said:

> Fixed capital may be sunk and lost, and yet the excess of current receipts over current payments may be divided, but floating or circulating capital must be kept up, as otherwise it will enter into and form part of such

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17 (1889) 41 Ch D 1: 61 LT 11: [1886-90] All ER Rep 947.

18 H. Goitein, COMPANY LAW, 189 (1960).

19 *Mellon* v *Mississippi Glass Wi Co, Re*, (1910) 77 NJ Eq 498, cited in Frey, CASES AND MATERIALS ON CORPORATIONS AND PARTNERSHIP, 786 (1951).

20 *See* (1899) 5 LQR 221: (1899) LJ 353. Cristie, *Wasting Assets and Dividends*, (1893) 5 Jurd Rev 2230; Note: *Effect of Depreciation, Depletion and Appreciation of Assets on Payment of Dividends*, (1928) 28 Col LR 231; For another comment *see* (1934) 43 Yale LJ 1336.

21 [1892] 2 Ch 124: 61 LJ Ch 281: 65 LT 786: 8 TLR 148.

22 For a remarkable account of the development of dividend rules *see* Basil S. Yamey, *Aspects of the Law relating to Company Dividends*, (1941) 4 Mod LR 273.

23 [1894] 2 Ch 239: [1891-94] All ER Rep Ext 1409.

excess, in which case to divide such excess without deducting the capital which forms part of it will be contrary to law.[24]

The distinction between "fixed" and "circulating" capital was explained in *Ammonia Soda Co Ltd* v *Chamberlain*.[25] Fixed capital is that which is invested in assets intended to be retained by the company more or less permanently and used in producing an income. Ordinary examples are buildings and mills, ships and land. Circulating capital is "a portion of the subscribed capital intended to be used by being temporarily parted with and circulated in business, in the form of money, goods or other assets, and which, or the proceeds of which, are intended to return to the company with an increment, and are intended to be used again and again, and to always return with some accretion." But this is not a permanent division. The emphasis is on the purpose for which the capital is used for the time being. Fixed capital may in course of time become floating capital and *vice versa*. Moreover, an item of assets which is, in the case of one company, a fixed capital may be circulating capital in the case of another company. Thus, for example, in *Bond* v *Barrow Haematite Steel Co*,[26] FARWELL J held that "the money invested in the leasehold mines, furnaces and cottages was in this company (a smelting company) to be regarded as 'circulating capital', and, therefore, should be maintained, such items coming into the accounts before any profit could be said to be earned."

But it is not necessary to make up losses of circulating capital incurred in previous years before paying dividends out of the current year's earnings.[27]

Unrealised appreciation of assets

Unrealised appreciation of the value of fixed assets was in practice distributed as dividends and was also sanctioned by court decisions. Thus in *Ammonia Soda Co Ltd* v *Chamberlain*:[28]

> A company's land and building stood at the value of £63,246. The directors in good faith appreciated the value to £83,788. The surplus thus created was used to wipe out a debit balance in the profit and loss account and the trading profits were declared as dividends.

It was held that the dividend was properly declared. Another illustration was *Lubbock* v *British Bank of South America*:[29]

> A company's undertaking at Brazil acquired at £5,00,000 was sold for £8,75,000. The company decided not to carry on a similar business. After deducting all expenses, a net surplus of £2,05,000 was allowed to be distributed as dividends.

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24 *Verner* v *General & Commercial Investment Trust Co*, [1894] 2 Ch 239, 266. *See* also *Kingston Cotton Mill Co, Re*, (1896) 1 Ch 331, where depreciation of the mill property of a company was held not relevant to the calculation of the distributable profits.

25 [1918] 1 Ch 266: [1916-17] All ER Rep 708: 118 LT 48 CA.

26 [1902] 1 Ch 353: [1900-03] All ER Rep 484.

27 *National Bank of Wales Ltd, Re*, [1899] 2 Ch 629: [1895-99] All ER Rep 715, affirmed sub nom. *Dovey* v *Cory*, 1901 AC 477: [1895-99] All ER Rep 724.

28 [1918] 1 Ch 266: [1916-17] All ER Rep 708: 118 LT 48 CA.

29 [1892] 2 Ch 198: [1891-94] All ER Rep Ext 1753: 67 LT 74.

The appreciated value should not be blindly or arbitrarily fixed. The directors must in good faith exercise an informed judgment. Further, appreciation in the value of an item of assets should not be taken in isolation. The assets as a whole must be considered. Thus, where certain promissory notes declared as bad debts were unexpectedly paid up in full, the court held that this accretion could not be deemed as profits without reference to the whole accounts taken fairly.[30] It is also necessary that the increase should not be due to temporary market fluctuations and the share capital will remain intact after the distribution.[31] This is known as the 'net assets test'. This has to be observed by public companies. Realised profits cannot be distributed if the amount of the net assets is less then the aggregate of called-up capital and undistributable reserves and the amount of the proposed distribution will not lower the amount of those assets to lower than that aggregate. Net assets means the aggregate of assets less the aggregate of liabilities.[32]

Profits gained on realisation or revaluation of assets is known as capital profit or capital gain. The position of law now is that such profits can be distributed by way of dividend only when it has been actually realised. The English Act of 1980 had to adopt this restriction because of EEC directives. The English Act of 1985 provides that whether or not a profit is a realised profit is to be taken according to the generally accepted accounting principles prevailing at the moment.[33]

The status of accounting standards is that of expert opinion on what is a true and fair view. Considering the evidential role of accounting standards, it has been held that while they are not conclusive and also not rigid rules, they are very strong evidence as to what is the proper standard which should be adopted.

Where assets have been revalued but not realised and by reason of the revaluation a greater amount has to be provided for depreciation, such excess can be treated as realised profit and, therefore, can be utilised for distribution.[34]

STATUTORY PROVISIONS

Depreciation [S. 205]

Since the Amendment Act of 1960, it has become obligatory to provide

30 *Foster* v *New Trinidad Lake Asphalt Co*, [1901] 1 Ch 208. Dividend is declared by the company in general meeting on the recommendation of directors. Distribution of profits or assets by the liquidator in the company's winding up is not a dividend. See, *First ITO* v *Short Bros*, [1966] 1 Comp LJ 279; *Kanhaiya Lal Bhargava* v *Official Liquidator*, [1965] 1 Comp LJ 310.

31 *Dimbula Valley (Ceylon) Tea Co* v *Laurie*, [1961] 1 Ch 353: [1961] 1 All ER 769, noted 24 Mod LR 525.

32 Undistributable reserves include share premium account, capital redemption reserve, unrealised profits and any other reserve which cannot be distributed.

33 Sections 262-263, Sch. IV para 9, English Act, 1985.

34 Part II of Sch. VI, Companies Act, 1956 and Guidance Note on *Treatment of Reserve created on Revaluation of Fixed Assets*, Research Committee, ICAL, New Delhi, 1982. The Financial Accounting Standard Board of USA observed that realisation in the most precise sense means the process of converting non-cash resources and rights into money and is most precisely used in accounting and financial reporting to refer to sale of assets for cash or claims to cash. The related terms "realised" and "unrealised" therefore identify revenue or gains or losses on assets sold and unsold respectively.

for depreciation as required by Section 205(2). Depreciation must be provided for the current year as well as for arrears since the amendment. The sub-section says that depreciation must be provided to the extent specified in Section 350. This section says that depreciation is to be calculated at the rate specified in Schedule XIV.[35] If this Act makes no provision for a particular kind of asset its depreciation may be worked out on a basis approved by the Central Government. Every company has the choice either to adopt the above method, or to work out depreciation "by dividing ninety-five per cent of the original cost of the depreciable asset by the specified period in respect of such asset".

The Act does not require any provision for depletion of a wasting asset. But "if any asset is sold, discarded, demolished or destroyed for any reason before depreciation for such asset has been provided for in full, the excess, if any of the written down value of such asset over its sale proceeds or its scrap value shall be written off in the financial year in which it is sold".[36]

Previous year's losses incurred after the effective date of the Amendment Act of 1960 must also be set off against the profits of any subsequent year or years before any dividend can be paid.[37]

Compulsory reserves [S. 205]

The requirement of creating compulsory reserves has been introduced by the Companies Amendment Act, 1974. Sub-section (2-A) has been added to Section 205. Before any dividend is declared or paid, certain percentage of profits as may be prescribed by the Central Government, but not exceeding 10%, will have to be transferred to the reserves of the company. The company may, however, create greater reserves.[38]

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35 This schedule has been added by the amendment of 1988 which, according to a Govt, clarification has been declared to be effective from April 2, 1987, though the amendment of Ss. 205 and 350 has been enforced w.e.f June 15, 1988. It has also been clarified that the rates contained in the schedule should be taken as the minimum rates and, therefore, after the applicability of the schedule lower rates cannot be charged on assets purchased after the applicability. However, if on the basis of a *bona fide* technological evaluation, higher rates of depreciation are justified, they may be provided with proper disclosure by way of a note forming part of the annual accounts. The clarification further says that a company must necessarily provide SLM (Straight Line Method) depreciation at the rates specified in the schedule calculating them on the basis of years including fractions of years. It is stated that SLM rates corresponding to the WDV (Written Down Value) rates as specified in Sch XIV can be different than those prescribed provided a company continues to determine the rates as provided under S. 205. Thus against SLM rates prescribed under Sch XIV of 11.3 per cent (triple shift rate for general plant and machinery) a company can charge depreciation at the rate of 10.56% (Circular No. 2 of 1989 of March 7, 1989; (1989) 65 Comp Cas 628 St.) Rates of depreciation have been revised with effect from Dec 16, 1993. *See* DCA Circular No. 14/93 of Dec 16, 1993.

36 Proviso to S. 205.

37 S. 205(1), proviso (*b*). The proviso (*c*) empowers the Central Government to waive in any particular case the requirement of providing for depreciation. The word loss would include depreciation, ***Garden Silk Weaving Factory*** v ***CIT***, (1991) 189 ITR 512 SC. There is no reason to give the word "loss", as used in S. 205 a different meaning from one in which it is ordinarily understood only because it has to be read with S. 115 of the IT Act, 1961. *V. V. Trans-investments (P) Ltd* v *CIT*, [1999] 3 Comp LJ 173 SC.

38 Companies (Transfer of Profits to Reserves) Rules, 1975.

If on account of inadequacy of profits in a particular year, the company has to pay dividends out of the previous years' reserves, it should follow such rules as may be made by the Central Government. A departure from such rules can be made only with the previous approval of the Central Government.[39]

Unpaid dividend account [S. 205-A]

A declared dividend has to be paid within thirty days. If this is not done, or the dividend warrant is not claimed by the shareholder within thirty days, the company shall have to open an account in any scheduled bank, to be called, "Unpaid Dividend Account" and transfer the unpaid dividend into it. Dividends which have remained unpaid up to the commencement of the Act, shall also have to be transferred to the account within six months. The amendment of 1988 (Amendment Act, 1999) added this explanation that the expression "dividend which remains unpaid" means any dividend the warrant in respect thereof has not been cashed or which has otherwise not been paid or claimed. The company shall have to pay interest at the rate of 12% for the benefit of the shareholders concerned on any amount of unpaid dividend which is not transferred to the account. [Sub-section (4)]

If the amount remains unclaimed for a period of three years from the date of deposit, the company has to transfer it to the general revenue account of the Central Government. The person entitled to the amount may claim it from the Government.[40] The company has to file the necessary particulars with the Government.

Transfer of unpaid dividend to Investor Education and Protection Fund

Before the Companies (Amendment) Act, 1999 (w.e.f. 31-10-1998), unpaid dividend remained in the company's unpaid dividend account for a period of three years and thereafter it was transferred to the general revenue account of the Government. The amendment has changed this position. The money will remain in the company's account for seven years and will then be transferred to the newly conceived fund known as the Investor Education and Protection Fund.

Investor Education and Protection Fund [S. 205-C]

The Companies (Amendment) Act, 1999 added this new section so as to bring into existence a new fund known as the Investor Education and Protection Fund. The Central Government has to establish this Fund. The following amounts have to be credited to this Fund:

1. the amounts in the unpaid dividend accounts of companies;
2. the application moneys received by companies for allotment of any securities and due for refund;

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39 S. 205-A(3). *inserted* by the Amendment Act, 1974. Creation of reserves is in the discretion of the board. Shareholders' approval is not necessary. *CIT* v *Oswal Woollens*, (1981) 51 Comp Cas 733 P&H. Companies (Declaration of Dividend out of Reserves) Rules, 1975.

40 S. 205-B. An indemnity bond is prescribed [Rule 6(5)] where the amount claimed is more than Rs 2500. Press Note (1989) 65 Comp Cas 573 st. The affected shareholder has to be informed of the fact of the transfer. *See* Rule 4-A of the Central Govt. Rules, 1978.

3. the matured deposits with companies;
4. the matured debentures with companies.

   These four items will be credited to the fund only when they have remained unclaimed or unpaid for a period of five years from the date when they became due for payment.
5. the interest accruing on the above items.
6. grants and donations given to the Fund by the Central Government, State Governments, companies or other institutions for the purposes of the fund, and

An *Explanation* to Section 205-C provides that no claim shall lie against the fund or the company in respect of individual amounts which were unclaimed and unpaid for a period of seven years from the dates that they first became due for payment and no payment can be made in respect of any such claims.

The Fund has to be utilised for promotion of investor awareness and protection of the interests of investors in accordance with the rules as may be prescribed. The utilisation shall be in accordance with the prescribed rules.[41]

The Central Government has to constitute an organ for the management of the fund by notification in the Official Gazette. The Government will specify an authority or a committee. Such organ will administer the fund and maintain separate accounts and other relevant records in relation to the Fund. The form of administration will be prescribed in consultation with the Comptroller and Auditor General of India.[42] The organ shall be competent to spend the moneys out of the Fund for carrying out the objects with which it has been established.[43]

***Payment to registered holders* [Ss. 206 and 206-A]**

Dividend warrant should be sent to the registered holder of the shares or to his order or to his bankers and where share warrants have been issued, to the bearer of the warrant or his bankers. A dividend paid to the registered transferee of shares cannot be recovered back from him by the transferor even if the transfer has been subsequently struck off on a technical ground like inadequacy or non-cancellation of stamps.[44] Such technical error should be pointed out to the transferee within good time (one year) so as to enable him to rectify, otherwise it would be too late.

Where an instrument of transfer of shares has been lodged with the company, but such transfer has not been registered by the company, the amount of dividend should be transferred to the "Unclaimed Dividend Account" unless the company is authorised by the registered holder to pay it to the transferee. The rights or bonus shares in respect of the shares under transfer must be kept by the company in abeyance until the matter is finally disposed of.[45]

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41 S. 205-C(3).
42 S. 205-C(4).
43 S. 205-C(5).
44 *Kothari Industrial Corpn Ltd* v *Lazor Detergents (P) Ltd*, [1994] 1 Comp LJ 178 CLB Mad.
45 Where the documents were rejected by the company, it could not be said that there was a

Declared dividend a statutory debt

Once a dividend is declared it becomes a statutory debt from the company to its shareholders. As pointed out by the Supreme Court in *Bacha F. Guzdar* v *CIT*,[46] "the shareholders' right of participation in the profits of the company exists independently of any declaration of dividend by the company. A declaration is necessary only for the enjoyment of profits. It will follow that once a declaration of dividend is made and it becomes payable, it will partake of the nature of a debt due from the company to the shareholder."[47] But a declaration of dividend subject to remittances from Pakistan or subject to some other condition precedent is not a declaration at all because it does not create an immediately payable debt.[48]

A dividend which has been declared, but not paid nor credited, may be revoked with the consent of shareholders.[49] An interim declared dividend may be revoked before payment.[50]

Interim dividend

The expression "interim dividend" has been defined by the Amendment Act, 2000 by providing that "dividend includes any interim dividend".[51] The declaration of an interim dividend does not create a debt against the company. Dividends can be declared only by a resolution of the shareholders in accordance with the directors' recommendation at a general meeting. But, if so permitted by the articles, the directors can declare an interim dividend between two meetings. "It does not create a debt enforceable against the company, for it is open to the directors to rescind the resolution before payment."[52] Shareholders do not get any vested right under a directors' resolution declaring an interim dividend.[53]

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pending application for transfer. There was nothing wrong in sending bonus shares and rights issue to the transferor. *Nagarajan* v *Lakshmi Vilas Bank Ltd.* (1997) 50 Comp Cas 392 CLB.

46 (1955) 1 SCR 876: AIR 1955 SC 74: (1955) 25 Comp Cas 1.

47 The Court relied upon *Severn & Wye & Severn Bridge Rly Co, Re*, LR [1896] 1 Ch 559; *Kitchner, Re*, LR [1929] 2 Ch 121. *See* also *Godavaribai* v *Amalgamated Commercial Traders*, [1965] 2 Comp LJ 272 Mad.

48 *Jhimi Bajoria* v *CIT*, [1970] 1 Comp LJ 195: 40 Comp Cas 780 Cal.

49 *Kishinchand Chellaram* v *CIT*, (1962) 32 Comp Cas 1046 SC.

50 *Kothari Textiles Ltd* v *CWT*, (1963) 33 Comp Cas 217; Halsbury's LAWS OF ENGLAND 355-56 (4th Edn, Vol. 7).

51 S. 2(14-A).

52 *See* N. Netar, *Company Dividends: Whether to be declared only at the Annual General Meeting*, 1965 JILI 151. No debt arises until directors fix a date for payment. *Potel* v *IRC*, [1971] 2 All ER 504 CD. *See* also *Vazir Sultan Tobacco Co* v *CIT*, (1981) 4 SCC 435, 455, where it has been held that mere recommendation of a dividend by director does not by itself have any effect unless approved by the general meeting. The case had arisen out of a taxation matter, the question being whether recommended dividend and a provision for it be regarded as having become a part of the company's reserves so as to be included in the company's capital computation. The Supreme Court answered the question in the negative. A. N. SEN J expressed dissenting opinion on the ground that a recommended dividend is generally accepted by the shareholders and therefore setting aside a sum of money for payment of such dividend should be treated as a reserve, (1981) 4 SCC 469.

53 *CIT* v *Express Newspapers Ltd*, [1998] 3 Comp LJ 23 SC, the court was concerned with rebate on dividends under the IT Act, 1961.

Mode of Payment [S. 207]

In order to ensure prompt payment of dividend to shareholders, Section 207 imposes a penalty if a dividend has been declared and is not paid within thirty days from the date of declaration.[54] The provision is sufficiently complied with if the dividend warrant is posted within the above time.

Dividend is to be paid in cash.[55] Payment in respect of any share should be made to the registered holder or to his order or to his banker.[56] In the case of a share warrant, payment should be made to the bearer of the warrant or to his bankers.[57]

The rate of dividend can be regulated, if the articles so permit, according to the amount paid up on each share where more amount has been paid up on some shares than on others.[58]

Payment of interest out of capital [S. 208]

"Interest" should be distinguished from "dividends". Interest on capital can be paid out of capital in certain cases provided for in Section 208. Where shares are issued for raising money to meet the expenses of construction of any work, building or plant which cannot be made profitable for a long period, the company may pay interest on the paid up amount of such capital and charge the

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54 The penalty is incurred by every director, provided he is knowingly a party to the default. Punishment is simple imprisonment which may extend to three years. Liability in terms of fine is also incurred. The fine is of one thousand rupees for every day during which the default continues. The proviso to the section says that no offence shall be deemed to have been committed within the meaning of the foregoing provision in the following cases, namely:

(*a*) where the dividend could not be paid by reason of the operation of any law;

(*b*) where a shareholder has given directions to the company regarding the payment of the dividend and those directions cannot be complied with;

(*c*) where there is a dispute regarding the right to receive the dividend;

(*d*) where the dividend has been lawfully adjusted by the company against any sum due to it from the shareholder; or

(*e*) where, for any other reason, the failure to pay the dividend or to post the warrant within the period aforesaid was not due to any default on the part of the company.

But no offence is committed where the dividend is not paid by reason of the operation of any law, or where a shareholder's directions cannot be complied with, or where there is a dispute as to the right, or where the dividend has been set off. See, *Hanuman Prasad* v *Hiralal*, [1966] 3 Comp LJ 136 All; on appeal to the Supreme Court, [1970] 2 Comp LJ 195. The offence is complete at the place of the registered office and, therefore, the courts there would have jurisdiction in the matter, *H. V. Jayaram* v *ICICI Ltd*, (2000) 99 Comp Cas 341 overruling *Ranbaxy Laboratories Ltd* v *Indra Kala*, (1997) 88 Comp Cas 348 Raj. A complaint filed one year after the default was held to be time-barred, *NEPC India Ltd* v *ROC*, (1999) 97 Comp Cas 500 Mad. The company has to prove despatch of the dividend warrant, *Nutech Ltd* v *Ch Mohan Rao*, [2000] CLC 1284 AP. *Nutech Agro Ltd* v *Ch. Mohan Rao*, (2002) 109 Comp Cas 487 AP, the burden is on the company to show that there was timely payment or transfer to the unpaid dividend account. *SOL Pharmaceuticals Ltd* v *ROC*, (2002) 111 Comp Cas 845 AP, delay became excusable when it was shown that the company's financial institutions required it not to pay dividend unless overdues under loans were liquidated.

55 S. 205(3). Dividend warrant should be sent by registered post. Registration is compulsory where the nature of the envelope e.g. window envelope, is such that it reveals its contents.

56 S. 206(*a*).

57 S. 206(*b*).

58 S. 93.

same to the capital account as part of the cost of construction. Following conditions have to be fulfilled to enable the company to make such payments:

1. There should be authority to that effect in the company's articles.
2. Previous sanction of the Central Government should be obtained.
3. The Government may at the expense of the company appoint a competent person to make an inquiry into the matter.
4. The Government sanctions the period for which such interest can be paid and it should not go beyond the close of the half year next after the half year during which the work has been completed.
5. The rate of interest is 12 per cent unless the Government changes it by notification.[59]

Such payment does not operate as reduction of capital.

Reserve fund

Article 87 of Table A empowers directors, before recommending any dividend, to set aside out of the profits any sum as a "reserve fund". Such fund is applicable at the discretion of directors for any purposes to which profits may be applied. It may be used to equalise dividends, or it may be invested in business or may be held in the form of other investments. When it is used in business it does not thereby become capitalised.[60]

Even where there is no provision of this kind in the articles, a reserve may be created.[61] A compulsory reserve has to be maintained in accordance with Companies (Transfer of Profits to Reserves) Rules, 1975.

Capitalisation of profits

A company may in general meeting, on the recommendation of the board, resolve and convert into capital any sum standing to the credit of profit or loss account or reserve fund account or otherwise available for distribution.[62] As a general rule only such funds can be capitalised as would be available for dividend distribution.[63]

"It has been the generally accepted view of the law of this country that, if the surplus on capital accounts results from a valuation made in good faith by competent valuers, and is not likely to be liable to short term fluctuations, it may properly be capitalised."[64]

When a distributable profit is capitalised, it is in essence a declaration of dividend combined with the application of that dividend on behalf of the shareholders entitled to participate in it in paying up shares to be allotted and issued to them in satisfaction of their rights of participation.[65]

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59 *Vide* notification GSR 426 of 8-9-1995.
60 *Hoare & Co Ltd, Re*, [1904] 2 Ch 208: [1904-07] All ER Rep 635 CA.
61 *Burland* v *Earle*, 1902 AC 83: [1900-03] All ER Rep Ext 1452: 85 LT 553 PC.
62 Article 96 of Table A.
63 BUCKLEY J in *Dimbula Valley (Ceylon) Tea Co* v *Laurie*, [1961] 1 Ch 353: [1961] 1 All ER 769.
64 *Id.* at 372. *See* also *IRC* v *Thornton, Kelly & Co.* [1957] 1 WLR 482: [1957] 1 All ER 650.
65 *Hill* v *Permanent Trustees Co.* 1930 AC 720 PC.

The advantage to the company is two-fold. A self-financing of this kind helps the company to rid itself of market influences.[66] Secondly, it makes available capital to carry on a larger and more profitable business.[67]

There must be a clear authority to capitalise profits in the company's articles, for, otherwise, a shareholder can insist upon payment in cash.[68]

It has been held by the Supreme Court in *Gopal Paper Mills* v *CIT*[69] that the shareholders become the owners of bonus shares from the date of resolution and not from the date on which certificates are issued. The Gujarat High Court has, on the other hand, held in *CIT* v *Chunilal Khushaldas*[70] that bonus shares cannot be said to be acquired or held by a shareholder before they come into existence by allotment and issue. The above-mentioned Supreme Court decision was not cited before the court.

Bonus shares

If the articles so authorise, a company has the "power to convert its accumulated undivided profits into bonus shares".[71] "Directors may capitalise any profits and allot to the ordinary shareholders in respect of the net amount capitalised fully paid-up shares of the company."[72] The amount may also be used in paying up any amounts for the time being unpaid on any shares.[73] The two other sources from which bonus shares may be financed are Share Premium Account,[74] and Capital Redemption Reserve Account.[75]

Issue of bonus shares is a bare machinery for capitalising profits. There is no distribution of profit among shareholders. Where a company used its development rebate fund for issuing bonus shares, there was no disbursement of money and the company remained entitled to development rebate.[76] In the words of the Supreme Court:[77]

> "Bonus share is an accretion. A bonus share is issued when the company capitalises its profits by transferring an amount equal to the face value of the share from its reserve to the nominal capital. In other words, the undistributed profit of the company is retained by the company under the head of capital against the issue of further shares to its shareholders. Bonus

66 Paul P. Harbrecht, *The Modern Corporation*, (1964) 64 Col LR 1410, 1415-16.

67 VISCOUNT FINLAY in *IRC* v *Greenwood*, [1921] 2 AC 171, 193.

68 *Wood* v *Odessa Waterworks Co.* (1889) 42 Ch D 636.

69 (1970) 2 SCC 80: AIR 1970 SC 1750.

70 (1974) 44 Comp Cas 90.

71 *Shri Gopal Paper Mills* v *CIT*, (1970) 2 SCC 80.

72 VISCOUNT FINLAY in *IRC* v *Greenwood*, [1921] 2 AC 171, 193.

73 Article 96 of Table A.

74 S. 78(2).

75 S. 80(5). *See* Section M of the SEBI Guidelines, 1992 relating to issue of bonus shares. The Department of Company Affairs' advice to unlisted closely held public companies and private companies is that they should not provide for the issue of bonus shares out of revaluation reserves. *Satish Chandra Sanvalka* v *Tinplate Dealers Assn P Ltd*, (2001) 107 Comp Cas 98 CLB, issue of bonus shares from revaluation reserves by a company which had adopted Table A was held to be not valid.

76 *Hansur Plywood Works Ltd* v *CIT*, [1998] 1 Comp LJ 22 SC.

77 *Standard Chartered Bank* v *Custodian*, (2000) 6 SCC 427: AIR 2000 SC 1488.

shares have, therefore, been described as a distribution of capitalised undivided profit. In the case of issue of bonus share there is an increase in the capital of the company by transferring of an amount from its reserve to the capital account and thereby resulting in additional shares being issued to the shareholders. A bonus share is a property which comes into existence with an identity and value of its own and capable of being bought and sold as such."

Bonus shares cannot be issued as a gift.[78]

A resolution was passed at a meeting of the company for issue of bonus shares to equity shareholders. The directors were authorised to decide the date of issue. A shareholder transferred his shares after the meeting but before the date specified by the directors. It was held that he being no longer a shareholder at the date of the issue, he was not entitled to the bonus shares in respect of the shareholding which he had already transferred.[79]

ACCOUNTS

Books of account or accounting records [S. 209]

Section 209 requires every company to keep at its registered office proper books of account. The first important obligation is to maintain books containing the following disclosures—

(*a*) all sums of money received and expended by the company and the matter in respect of which the receipt and expenditure has taken place;

(*b*) all sales and purchase of goods by the company;

(*c*) all assets and liabilities of the company;

(*d*) in the case of a company engaged in production, processing, manufacturing or mining activities, particulars relating to utilisation of material or labour or other items of cost as may be prescribed by the Central Government.[80]

A view of what constitutes proper books of account appears from the provisions of Section 541. The company should maintain such books of account as are necessary to exhibit and explain the transactions and financial position of the business of the company, including books containing entries made from day to day, in sufficient detail, of all cash received and cash paid. Where the business of the company involves dealings in goods, the records should contain statements of the annual stocktakings. Where the dealings are not by way of

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78 *Eddystone Marine Ins Co, Re*, [1893] 3 Ch 9: 69 LT 363. See, *CIT* v *Khushaldas*, (1974) 44 Comp Cas 90, where BHAGWATI CJ, explains the nature of bonus shares. As to the impact of bonus issue upon value of shares, see *Chandrakant Mulraj* v *TELCO*, (1985) 58 Comp Cas 320 Bom.

79 *Rajiv Nag* v *Quality Assurance Institute (India) Ltd*, (2001) 105 Comp Cas 178 CLB.

80 Clause (*d*) of S. 209(1) has been *inserted* by the Companies (Amendment) Act, 1965. This was considered necessary for the purposes of cost accounting and cost auditing. Small scale industrial undertakings have been exempted from this requirement. The definition of such an undertaking is to be found in Industries (Development and Regulation) Act, 1951. Cost Accounting Record Rules have been prescribed by the Central Government.

retailing of goods, a record should be maintained of all goods sold and purchased showing the goods, and the buyers and sellers of such goods in such sufficient details as to enable those goods and those buyers and sellers to be identified.[81]

Such books may be kept either at the company's registered office or at any other place the board of directors may decide. Within seven days of any such decision, the address of that place must be sent to the Registrar.

Where a company has a branch office, such accounts relating to the branch business must be maintained there and at intervals of three months summarised accounts should be forwarded to the registered office.[82]

True and fair view

Accounts must give a true and fair view of the state of affairs of the company.[83] "A balance sheet must not be a mere inventory. It is supposed to be a pictorial representation of the trading position of the company. To determine whether a statement is false, its effect upon an ordinary investor should be the test. Thus where loans given to an embryonic firm were described as 'other deposits', the accounts were held to be false."[84] That is why sub-section (3) prescribes that proper books of account shall not be deemed to be kept if there are not kept such books as are necessary to give a true and fair view of the state of affairs of the company and if they are not kept on accrual basis according to the double entry system of accounting.[85]

Directors' fiduciary obligations would compel them to make full and frank disclosures so as to help those who are entitled to use the company's accounts for guidance in their decision making. The mode and manner of disclosure must be such as would show the reality of the financial position and working results of the company. Disclosures should be clear and unambiguous and in

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81 Section 541 is in connection with liability in winding and liability follows if such records are not available for the two-year period preceding winding up. The requirement becomes a matter of universal application because winding up may creep in unpredictably.

82 S. 209(2).

83 Ss. 209(3) and 211(1) and (5). As to the meaning of "true and fair view" the general feeling is that the standards adopted by the accounting profession should be followed. It has been said that "although Statements of Standard Accounting Practice (SSAP) has no direct legal effect and is simply a rule of professional conduct for accountants, it is likely to have an indirect effect on the content which English courts will give to the "true and fair" concept because it represents an important statement of professional opinion about the standards which may reasonably be expected in accounts which are intended to be true and fair, and because readers of accounts can expect that they will conform to the standards set by the accounting profession". *See*, K.P.E. Lasok and Edmond Grace, *Fair Accounting*, 1988 JBL 235. For a study of further literature on the subject see the joint opinion of Leonard Hoffman QC and Mary Ardon, ACCOUNTING STANDARDS, 178-182 (1984-85) and a review of that opinion by Peter Bird, *What is a True and Fair View*, 1980 JBL 480. For a study of "off balance sheet accounting" see *Off-Balance Sheet Financing: An Accountant's view*, 1988 JBL 398.

84 *Legal Remembrancer, Bengal* v *Akhil Bandhu Guha*, ILR (1937) 1 Cal 328. For liability for false accounts *see* S. 628 and *P. P. Looke* v *N. J. Mathew*, (1967) 37 Comp Cas 790 Ker: [1967] 2 Comp LJ 146.

85 Government companies have been exempted from the requirement of accrual system. GSR 550(E) dated 16-5-1989.

accordance with fundamental accounting assumptions and the commonly accepted accounting policies.

It has been held under the EEC directives that the requirement of true and fair view was ensured by taking account of all elements (i.e. profits made, liabilities and losses incurred, charges, income) which actually related to the financial year in question.[86]

Accrual basis.—According to the guidance notes[87] there are two basic features of this system of accounting. First, revenue means revenue earned, whether received in cash for the time being or not; second, costs are incurred when they become payable whether actually paid or not. How these methods are to be applied by an enterprise constitutes its accounting policy namely, a method of accounting which reflects the truth so that those for whose information the accounts are meant are able to get a fair view of things. Hence, what is more important is the substance of the financial position of the company and not the forms and formats through which that substance is presented as a true and fair view. Forms and formats are only for guidance. That is why latitude is given to follow as nearly as may be possible under the circumstances of a particular enterprise, with only this obligation that any significant departure from the prescribed method under accounting policy should be disclosed. Schedule VI itself requires disclosure of accounting policy in reference to some items. They are: policy regarding mode of valuation of stock and basis of valuation of investments.

Balance sheet of holding company **[Ss. 212-214]**.— See under "Holding company and subsidiary" in Chapter 19 dealing with "Kinds of Company".

Annexure of profit and loss account **[S. 216]**.—The profit and loss account is required to be annexed to the balance sheet, whereas the auditors' report is only attached to it, including auditors' special, separate or supplementary report. An annexure becomes a part of the thing to which it is annexed. Things attached are only enclosed with or fastened to the main thing. Auditors have to pay attention to all documents which have been given the status of annexure to accounts. They may refer to any particular document which is attached if it is necessary for audit purposes and in that case the document so commented upon will form part of the auditor's report. According to Section 222 the board's report is attached and not annexed. The proviso to the section gives this latitude that the board's report may give information which is required to be given in accounts and in that case the document containing such information shall be annexed to the accounts.

Preservation of account books

Account books for the preceding eight years should be preserved in good condition.[88] Under the SEBI (Registrars to Issue and Share Transfer Agents)

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86 *Tomberger* v *Gebruder Von der Wettern GmbH*, (1996) 2 BCLC 457 ECJ.

87 ICAI Guidance Note on Accrual Basis of Accounting.

88 S. 208(4-A). Failure on the part of officers listed in sub-section (6) is a punishable offence under S. 209(5). *P. S. Bedi* v *ROC*, (1986) 60 Comp Cas 1061 Del.

Rules, 1993, the period prescribed for preservation of documents and records is that of three years. Documents relating to a public issue have been held to be a part of the records under the Act. The period of 8 years would prevail over the period prescribed by SEBI.[89]

Duty of compliance

Persons in charge of the company's management have been put under the duty of compliance. They are required to take all reasonable steps to comply with the accounting requirements. If they fail to do so or by their own wilful act cause a default, they become punishable.[90] It would be a defence to show that a competent and reliable person was charged with the duty of compliance and he was in a position to discharge his duty. This liability is incurred by the managing director, manager, all officers and other employees detailed in Section 240,[91] and in the absence of such persons, every director of the company; or any person made in charge of the matter by the managing director, manager or board of directors.

Accounts to comply with accounting standards

The Companies (Amendment) Act, 1999 has prescribed this requirement by amending Section 211 that every profit and loss account and balance sheet shall comply with accounting standards.[92] It is further provided by the amendment[93] that if there is any deviation from the prescribed standards, the annual accounts shall state:

1. the fact that there has been a deviation;
2. the reasons for such deviation; and
3. the financial implication of the deviation.

It is further provided by the amendment that for the purposes of this section "accounting standards" means such standards of accounting recommended by the Institute of Chartered Accountants of India as may be prescribed by the Central Government in consultation with the National Advisory Committee on Accounting Standards upto such time that the National Advisory Committee is constituted, the standards of accounting specified by the Institute of Chartered Accountants are to be taken as accounting standards.

National Advisory Committee on Accounting Standards [S. 210-A]

This section has been added by the Companies (Amendment) Act, 1999 (w.e.f. 31-10-1998). The object is that of constituting a committee for establishing accounting standards. The National Advisory Committee will be constituted by notification in the Official Gazette. It will advise the Central Government on the formulation and laying down of accounting policies and accounting standards for adoption by companies or a class of companies under the Act.

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89 *Rajesh Gupta* v *SEBI*, (2000) 39 CLA 82 SAT.
90 Imprisonment up to 6 months or fine up to Rs 10,000 or both. S. 209(5).
91 This category would not include bankers, auditors and legal advisers.
92 S. 211(3-A).
93 S. 211(3-B).

The membership of the Committee has to be as follows:[94]

1. A Chairperson who shall be a person of eminence well versed in accountancy finance, business administration, business law, economics and similar discipline.
2. One member each to be nominated by the Institute of Chartered Accountants of India, Institute of Costs and Works Accountants of India and the Institute of Company Secretaries of India.
3. One representative to be nominated by the Central Government.
4. One representative to be nominated by the Reserve Bank of India.
5. One representative to be nominated by the Comptroller and Auditor General of India.
6. Any person who is or has been holding the office of a professor in any University or deemed University in the field of accountancy, finance, or business management.
7. The Chairman of the Central Board of Direct Taxes or his nominee.
8. Two members to represent the Chamber of Commerce and Industry to be nominated by the Central Government, and
9. One representative to be nominated by the Securities and Exchange Board of India.

The Advisory Committee has to give its recommendations to the Central Government on such matters of accounting policies and standards and auditing as may be referred to it from time to time for advice.[95]

The terms of membership will be determined by the Central Government at the time of appointment and any vacancy will be filled by the Central Government in the manner applicable to the appointment of the member who vacated his office.[96]

The non-official members will be entitled to fees, travelling, conveyance and other allowances as are admissible to the officers of the Central Government of the highest rank.[97]

Right of inspection [S. 209-A]

Inspection by directors.—Every director has the right to inspect the books of account during business hours.[98] Where a director is carrying on a personal business of the same kind as that of the company so that if the accounts are thrown open before him, his interest in his personal business and his duty to the company will be in a sharp conflict, the question will be whether his statutory right should prevail over his duty to the company. In a case of this kind before

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94 S. 210-A(2).
95 S. 210-A(3).
96 S. 210-A(4).
97 S. 210(5).
98 S. 209(4). The words "other books and papers" as used in the section do not include "nomination paper for directorship". *K. K. Kanagasabapthy* v *Shanmugham*, (1972) 42 Comp Cas 596 Mad.

the High Court of Delhi,[1] the court was of the opinion that the matter would have to be decided on a balance of equities. The court accordingly diluted the right of the director and ordered the inspection of only the following books: bank statements; accounts with banks, financial institutions and private parties from whom loans had been taken by the company, and the register of movable assets. Where the directors wanted to exercise their right of inspection accompanied by a chartered accountant, the Company Law Board allowed it subject to the undertaking being given by the chartered accountant that he would not disclose the information to any person other than the directors.[2]

Inspection by Registrar, etc.—Section 209-A was introduced by the Amendment Act, 1974. Sub-section (1) provides that the books of account and other books and papers of every company shall be open to inspection during business hours by the Registrar or by any such officer as may be authorised by the Central Government. Such inspection can be made without giving previous notice to the company. The directors, officers and employees are required to produce before the inspector books of account, etc., which are in their control, and to furnish him with any other information that he may desire and also to give him reasonable assistance. The inspector may make copies or make marks of inspection.[3]

The Amendment of 2000 has also conferred the right of inspection upon SEBI authorised officers. This right of inspection extends only to sections covered in Section 55-A.

The person making the inspection has been vested with the powers of a civil court in respect of the following matters—

1. the discovery and production of books of account and other documents at such place and time as may be prescribed by him;
2. summoning and enforcing the attendance of persons and examining them on oath;
3. inspection of any books, registers and other documents of the company at any place.

The inspector has to submit his report to the Central Government. Where the inspection is on behalf of SEBI, the report has to be submitted to SEBI. He will have the power of the Registrar under the Companies Act of making inquiries. A director who commits any default under the section and is convicted

1 *D. Ross Porter* v *Pioneer Steel Co Ltd*, (1990) 68 Comp Cas 145 Del.

2 *M. L. Thukral* v *Krone Communications Ltd*, (1996) 86 Comp Cas 643 CLB.

3 Where irregularities were found by the Asstt Registrar, who granted time to the directors for rectification, he was not allowed to prosecute them one year after the expiry of the granted time. *State* v *S. Seshmal Pandia*, (1986) 60 Comp Cas 889 Mad. Nobody should be prosecuted under the section unless he has given an opportunity to explain his position. In this case, the notice to the director in question was delayed for more than six months and in the meantime the liquidator took the records into his custody. Prosecution was not allowed. *P. Venkatakrishna Reddy* v *Registrar of Cos*, (1996) 85 Comp Cas 572 Mad.

for it, shall vacate his office from the date of conviction and shall remain disqualified from directorship for five years.[4]

The right of inspection under the section is limited to books of account and other books and papers. The inspectors cannot, under the guise of this right, undertake a roving inquiry into all the affairs of the company. It is different from an investigation of affairs under Section 237.[5]

Inspection by members.—Members do not have the right of inspection. Members of a charitable company under Section 25 have been granted the right of inspection by clause 9 of Annexure I to the Companies Regulations, 1956.

Report by way of annual accounts to general meeting [S. 210]

In addition to accounting records the company has to prepare annual accounts showing the results of the company's trading during the relevant period and the company's assets and liabilities at the end of that period. One is known as the profit and loss account and the other as balance sheet.

At every annual general meeting the board of directors have to lay before the meeting the following documents—

1. Balance Sheet.
2. Profit and Loss Account.[6]
3. Report by the company's board of directors.[7]

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4 *Indra Prakash Karnani* v *ROC*, (1985) 57 Comp Cas 662 Cal. The court has jurisdiction to order inspection. *M. K. M. Singh* v *Lake Palace Hotels Ltd*, (1985) 58 Comp Cas 805 Raj. The default is also punishable with a fine of Rs 50,000.

5 *Karuppunni* v *Director of Inspection, CLB*, [1986] 3 Comp LJ 225 Ker; *Swadee Chemicals Ltd* v *Kothari Industrial Corpn Ltd*, (1995) 18 Corpt LA 23 Mad, the inspector here wanted to find out the reasons why the company was not implementing a resolution and that was held to be beyond the scope of this power.

6 In the case of a company not carrying on business for profit, an income and expenditure account shall be laid before the company at its annual general meeting instead of a Profit and Loss Account [S. 210(2)]. According to the requirements of S. 216, profit and loss account has to be annexed and auditors' report has to be attached to the balance sheet. The auditors' special or supplementary report, if any, must also be so attached. Section 218 provides that issuing the balance sheet without authentication as required by S. 215 or without the annexures as required by S. 216 is a punishable offence. According to S. 222 the expression "documents annexed to accounts" shall not include board's and auditors' report or any document attached or required to be attached to the accounts. This became necessary so as to exclude them from the auditor's remarks. In the case of the first annual general meeting of the company, the profit and loss account must come up to a period so as not to make a gap of nine months between the last day of the accounting period and the day of the meeting. In other cases such gap should not be of more than six months. The period of accounting is known as the financial year. It may be less then a calendar year. It should not exceed fifteen months.

7 S. 217. *P.S. Bedi* v *ROC*, (1986) 60 Comp Cas 1061 Delhi, failure in compliance. Section 215 requires that the accounts must be authenticated by or on behalf of the board of directors in the case of a banking company as required by the Banking Companies Act, 1949 and in other cases by the manager or secretary, if any, and by not less than two directors one of whom shall be a managing director where there is one. Where only one director is present in India at the material time, he should sign and also append a statement explaining why the requirement could not be complied with. Authentication should be after approval by the Board. Default is punishable under S. 210(5) and (6).

The directors' report should show the following particulars—

1. the state of the company's affairs:
2. the amounts, if any, which it proposes to carry to any reserves in the balance-sheet;
3. the amount, if any, which it recommends should be paid by way of dividend;
4. material changes and commitments, if any, affecting the financial position of the company;
5. the conservation of energy, technology absorption, foreign exchange earnings and outgo in such manner as may be prescribed.

The report should also deal with any changes which have occurred during the financial year in the nature of the company's business, or in the business of its subsidiaries and the classes of business in which the company has interest.[8]

The Amendment Act, 1974 as further amended in 1988 by inserting Section 217(2-A), requires the directors' report to state the following particulars:

1. A statement showing the name of every employee of the company whose remuneration was not less than a sum as may be prescribed during the financial year or, if employed for a part of the year, not less than a sum as may be prescribed in a month.[9]
2. A statement showing whether any such employee is a relative of any director or manager of the company and, if so, the name of such director and any other particulars as may be prescribed.
3. A statement showing the name of every employee of the company who if employed throughout the financial year or part thereof, was in receipt of remuneration in that year which, in the aggregate, or as the case may be, at a rate which, in the aggregate, is in excess of that drawn by the managing director or whole-time director or manager and holds by himself or along with his spouse and dependent children, not less than two per cent of the equity shares of the company.[10]

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8 Insofar as it is necessary for the proper appreciation of the company's state of affairs and will not, in the opinion of the board, be harmful to the business of the company.[S. 217(2)]. By virtue of S. 221 officers are under a duty to disclose to the company the particulars of any matter pertaining to them which is required to be reflected in the accounts. Non-banking financial companies and non-financial (residuary) deposit taking companies have to furnish in the Board's report certain information prescribed by the RBI Non-banking Financial Companies (Reserve Bank) Directions, 1977; Residuary Non-banking Companies (Reserve Bank) Directions, 1987.

9 The prescribed particulars have to be disclosed in respect of employees who are in receipt of remuneration of not less than Rs 1,44,000 per annum, if employed throughout the financial year and the remuneration of not less than Rs 12,000 per month, if employed for a part of the year. The clarification further says that the limit of Rs 1,44,000 per annum should be considered if the financial year is of 12 months and on *pro rata* basis if the financial year of a company is less or more than 12 months. (Circular No. 3 of 1989; (1989) 65 Comp Cas 558, 561 St) which prescribed Rs 72,000 and Rs 1,44,000 has been replaced by GSR 796(E) of Sept 18, 1990 which prescribed the abovementioned new figures. This liberalisation will lead to economy on the part of companies while preparing annual reports. Companies (Particular of Employees) Rules, 1975.

10 *See*, Companies (Disclosure of Particulars in Report of Board of Directors) Rules, 1988, GSR

Sub-section 2-B, inserted by the Amendment Act, 1999 (w.e.f. 31-10-1998) provides that where the company had gone in for a buy-back of shares but could not complete it within the prescribed time, the Board's reports must state the reasons for such failure.

Directors' Responsibility Statement

The Amendment of 2000 has added sub-section (2-AA) to provide for directors' responsibility statement. The new provision is as follows:

"(2-AA) The Board's report shall also include a Directors' Responsibility Statement, indicating therein,—

(*i*) that in the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures;

(*ii*) that the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit or loss of the company for that period;

(*iii*) that the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;

(*iv*) that the directors had prepared the annual accounts on a going concern basis:"

Accounts are presented to the meeting for the purpose of its adoption. But even if the meeting does not adopt them, further proceedings with reference to them must be conducted as usual. Preparations for the subsequent years' accounts may also continue as usual.[11]

Form and content of balance sheet, profit and loss account [S. 211]

"Balance sheet" is not defined in the Act. But there is a proforma of the balance sheet in Schedule VI which clearly shows its format and its function. It is an endeavour to show the share capital, reserves and liabilities of the company and the manner in which they are distributed over the several type of assets. It is a historical document because it does not show the present realisable value of the assets.[12]

The format of the balance sheet is set out in Part I of Schedule VI. The balance sheet has to be as near thereto as circumstances admit. It may also be in such other form as may be approved by the Central Government either generally

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1029 of Dec 31, 1988; (1989) 65 Comp Cas 391 St.

11 1CAI, Compendium of Opinion, Vol 1, 2nd Edn, 1984.

12 Evidence of the Institute of Chartered Accountants before the Cohen Committee cited in *CIT* v *National Industrial Corpn*, (1982) 52 Comp Cas 535: [1983] 1 Comp LJ 118 Delhi.

or in reference to a particular case. The notes appended to the Part have to be carefully kept in mind in preparing the balance sheet.[13]

The profit and loss account has to be in accordance with Part II of the Schedule. Exemption can be given to any companies in public interest, conditionally or unconditionally. The requirements of the section may also be modified to suit the particular circumstances of a company either on its application or with the consent of its board of directors.[14]

Right of members to copies [S. 219]

A copy of such accounts and the reports must be sent twenty-one days before the meeting to every member of the company,[15] and every trustee for the debentureholders whether he is entitled to the notice of the general meeting or not. The amendment of 1988 provides that in the case of listed companies, it will be enough to send to the members or trustees of debentureholders a copy of the salient features of the accounts and accompanying documents provided that a copy of the accounts is available at the registered office for inspection. The amendment further provides that any member or holder of debentures of a company and any person from whom the company has accepted a sum of money by way of deposit shall, on demand, be entitled to be furnished free of cost, with a copy of the last balance sheet of the company and of every document required by law to be annexed or attached thereto, including the profit and loss account and the auditors' report. Any such demand can be enforced through an application to the Central Government.[16] If a director fails to take reasonable steps in complying with this requirement, he is punishable under Section 210(5), and it will be no defence to say that on account of the want of a quorum a meeting could not be held and, therefore, the duty of laying accounts before the meeting could not be performed.[17] Three copies of such accounts have to be filed with the Registrar also.[18]

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13 Companies falling in a special class, such as, insurance, banking, power generation of which the format is prescribed by their respective governing Acts will proceed according to those Acts in making out their balance sheets and profit and loss account. The true and fair formula is applied to such companies also in accordance with the requirements of their governing Acts. [sub-section (5)].

14 Punishment for failure to comply with the section can be awarded to those very persons and to that very extent as under S. 209.

15 S. 219. The Act permits abridged accounts of which a format has been approved to be sent to members. *See* Form 23-AB.

16 Excepting "debentures with ex facie are payable to the bearer thereof". [S. 219]. Further the proviso to the section adds that the section does not require a copy to be sent to a member or holder of debentures who is not entitled to have notices of the general meetings of the company and of whose address the company is unaware. The statement containing the salient features of the accounts has to be in Form 23-AB. The statement should be approved by the board of directors and signed in accordance with S. 215. Such copy should be attached to the documents filed under S. 220. *See* Rule 7-A of the Companies (Central Govt's) General Rules and Forms, 1956.

17 *Registrar of Companies* v *Radhika Prasad*, (1978) 48 Comp Cas 102 Ori; *Registrar of Companies* v *Radhika Prasad*, (1978) 48 Comp Cas 243 Ori; *Registrar of Companies* v *Utkal Distributors*, (1978) 48 Comp Cas 786; *Registrar of Companies* v *Subimal Chandra Mallick*, (1980) 50 Comp Cas 770 Ori; *M. D. Mundhra* v *Asstt ROC*, (1980) 50 Comp Cas 346 Cal; *Harrison and Crossfield (India) Ltd* v *ROC*, (1980) 50 Comp Cas 426 Ker, where relying upon

Authentication of accounts [S. 215]

The annual accounts are to be signed by the manager or secretary of the company, if any, and by any two directors one of whom should be a managing director, if there is one. They should be approved by the board of directors before they are so signed on behalf of the board and before they are submitted to the auditors for their report. If there is only one director or managing director in India at the material time, he should sign making a statement of reasons why the requirements have not been fully complied with.

Annexed and attached documents **[S. 216]**.—The profit and loss account should be annexed to the balance sheet and the auditors report, including their separate, special or supplementary report, has to be attached to the balance sheet. Section 222 provides that annexed matter will not include board's report and auditors report except for such information as is required to be given in accounts but is given in the board's report.

Signing of Board's report **[S. 217(4)]**.—The board's report and any addenda is to be signed by the chairman if so authorised by the board and, if not so authorised, it would have to be signed in the same manner as annual accounts.

Publication of statement in the form in Table F [S. 223]

A limited banking company, an insurance company or a deposit taking company, provident or benefit society, has to make a statement in the form in Table F in Schedule I or in a form as near to that as circumstances admit. This has to be done before the company commences business and has to be repeated on the first Monday in February and August every year during which it remains in business. A copy of the statement along with the last audited balance sheet as laid before the members has to be displayed until it is taken over by the next following statement. The display must be at some conspicuous place in the registered office of the company and in every branch office or place where the business of the company is carried on. Members and creditors are entitled to copies within a week of the demand on paying a fee of eight annas.[19]

Filing of accounts and penalty provisions [S. 220]

The Act imposes a penalty if a default is made in filing the accounts with the Registrar within 30 days after an annual general meeting. "The company and every officer of the company who is in default" are punishable with fine.[20]

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the circular of the Company Law Board, No. 35/9/72-C-L-III, dated February 2, 1974, the meeting was postponed only for account taking to a date when the takeover value was ascertained.

18 S. 220. *Karnataka Bank Ltd* v *B. Suresh*, (2001) 105 Comp Cas 110 Kant, the court having jurisdiction at the registered office of the company is competent to try the offence under the section. *Rani Joseph* v *ROC*, (2001) 103 Comp Cas 928 Ker, the offence is of continue nature, not barred by limitation.

19 [Fifty paise] Default in complying with requirement is a punishable offence. The section exempts from its operation a life insurance company or provident insurance society to which the provisions as to annual statements of the Insurance Act, 1938 are applicable.

20 S. 220(3). A person's position as a director and as an officer in default and whether he has any defence can be decided in the prosecution itself. *Bachraj Baid* v *State of W.B.*, (1992) 74

"These provisions of the Act have been deliberately enacted to protect the shareholders and the general public and they impose a definite duty upon the directors. It is necessary that these duties should be properly carried out and it is necessary that when the directors fail to do so, the penalties provided for in the Act should be imposed. It was never intended that these sections should only be enforced in cases where fraud or dishonesty was suspected or proved."[21] This explanation of the policy of law was given by the Calcutta High Court in *Bhagirath* v *Emperor*:[22]

> Certain directors of a company were prosecuted for failure to submit accounts within the prescribed time. They were convicted by the lower Court and on appeal they argued that they had no real control of the affairs; they were mere figureheads who did not know that the law had not been complied with.

Rejecting this contention, the Court said: "It is perfectly clear that all the directors of a company are responsible to see that the duties imposed upon a company by the Companies Act are properly carried out. It is clearly the duty of all directors to see that annual returns and the copies of Balance Sheet and Profit and Loss Account are submitted. There is nothing on record to show that these directors made any attempt to see that these duties were carried out. The presumption of law is that these directors knew their duties."

The company is punishable *per se*, that is, by the mere fact of default. Thus where a company in default was acquitted on the ground that the circumstances were beyond its control, but the directors were convicted, the acquittal of the company was quashed.[23]

After a long drawn out controversy between the High Courts, the Supreme Court had held in *State of Andhra Pradesh* v *Andhra Provincial Potteries Ltd*[24] that if the annual meeting is not held, the obligation to file accounts did not arise and consequently no penalty was incurred under Section 220(3). The court distinguished the case from its own decision in *State of Bombay* v *Bandhan Ram Bhandani*,[25] where in reference to the obligation to file annual returns under Sections 159-161 it had been held that the obligation is not excused by any default in calling the meeting. The difference between the two situations, as pointed out by the Supreme Court, is that while annual returns can be prepared independently of a meeting, the accounts have to be first laid before the meeting and then filed with the Registrar. But now this controversy has been set at rest by the Amendment Act of 1977. The effect of the amendment is that accounts have to be filed with the Registrar within 30 days from the latest day on or before which the annual meeting should have been held in accordance with the

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Comp Cas 809 Cal. The DCA has advised companies to file their accounts latest by Oct 31. Circular of Sept. 22, 1992.

21 *See*, for example, *Registrar of Companies* v *Himprastha Financers (P) Ltd*, (1974) 44 Comp Cas 154, where after stating this policy the court said that the offence cannot be disposed of by warning under S. 3 of Probation of Offenders Act.

22 AIR 1942 Cal 42.

23 *Asstt Registrar of Companies* v *Sudarsan Liners Ltd*, (1988) 63 Comp Cas 747 Mad.

24 (1973) 2 SCC 786: (1973) 43 Comp Cas 514: AIR 1973 SC 2429.

25 AIR 1961 SC 186: (1961) 31 Comp Cas 1: (1961) 1 SCR 801.

provisions of the Act. Thus accounts will have to be filed whether a meeting is held or not or whether the meeting does or does not adopt the accounts or is adjourned without adopting the balance sheet.[26]

It has been held[27] that it would be no defence for a failure to file accounts that the "directors were not legally qualified under the articles of association to act as directors inasmuch as they had no shares at all in the company or the requisite number of shares to qualify them as directors. A person who acts as a director cannot set up in answer to a penalty that he was not legally a director. He cannot protect himself from liability by saying "I am not a director *de jure*".[28] Similarly, it is no defence that the account books were seized by the police in connection with a criminal case[29] or that they were lying in a court.[30]

The period of limitation for making a complaint, which is one year under Section 468(2)(*b*) of CrPC, runs from the date on which the Registrar, in the usual course of things, comes to know of the default.[31] The Kerala High Court has held that the offence is of a continuing nature and, therefore, every succeeding day of default would give start to a new period of limitation.[32] The Calcutta High Court had earlier differed. In its view there is only one offence and the period of limitation begins from the last day on which accounts should have been filed,[33] but now it has held that that decision is no longer a good law.[34]

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26 As further amended in 1988. Thus accounts have to be filed whether a meeting is held or not. *Registrar of Companies* v *Orissa Paper Products Ltd.* (1988) 63 Comp Cas 460 Ori.

27 *Tota Ram* v *Emperor*, AIR 1916 Lah 397: 34 IC 962. In this case the Court cited and discussed the following cases: *Gibson* v *Barton*, (1875) 10 QB 329; *Catholic Life & Fire Assurance & Annuity Institute, Re*, (1883) 48 LT 675 and *Queen* v *Tyler*, (1891) 2 QB 588, where it was said that penalty was not intended to be the equivalent for the omission to perform the duty, but is of such a nature that the company cannot by paying the penalty continue to neglect to perform the duty. *See* also *Achhuta Pai* v *ROC*, [1966] 1 Comp LJ 104 Ker.

28 Following further cases on the subject may be consulted: *Lakshmana* v *Emperor*, AIR 1932 Mad 497: 138 IC 317; *Ballav Dass* v *Mohan Lal Sadhu*, AIR 1936 Cal 237: 162 IC 282; *Public Prosecutor* v *B V A Lury Co Ltd*, AIR 1942 Mad 75: [1941] 2 MLJ 487; *Sunder Das* v *Emperor*, AIR 1929 Lah 836; *Chabil Das* v *Emperor*, AIR 1914 Lah 125.

29 *Great India Steam Navigation Co* v *State*, (1967) 37 Comp Cas 135 Cal.

30 *Ramchandra & Sons (P) Ltd* v *State*, [1967] 2 Comp LJ 92. For an enlightening view of the economic utility of disclosures *see* Rita Kishope Dixon Foyle, *Company Law and Economic Development in Sierra Leone*, (1970) 19 JCL 447. A director was held to be not entitled to an automatic or mechanical relief for default under the section though his induction into the company was for the limited purpose of the performance of an export contract of the company. *Shiv Kumar Dalmia* v *Mangal Chand Hukum Chand*, (1996) 86 Comp Cas 366: [1996] 2 Comp LJ 219 MP. *Shree Hanuman Steel Rolling Mills* v *Asstt ROC*, (1996) 2 Cal LJ 64, books of account seized by an investigating agency, failure to submit annual accounts not wilful, prosecution not warranted. *Amita Chadha* v *ROC*, (1998) 74 Delhi LT 537, dispute about access to books.

31 *Sushil Kumar Lahiri* v *ROC*, (1983) 53 Comp Cas 54 Cal. The Assistant Registrar is also competent to file complaints. *Bhaghat Pd Tantia* v *ROC*, (1983) 53 Comp Cas 56 Cal.

32 *Sudarsan Chits (India)* v *ROC*, (1986) 59 Comp Cas 261 Ker, and also *Shivalik Factory & Cold Storage (P) Ltd* v *ROC*, (1988) 64 Comp Cas 113 P&H. Other decisions to the same effect, *Rani Joseph* v *ROC*, (1995) 1 Ker LJ 14; *Oriental Coal Co* v *U. Roy*, (1991) 1 Cal LJ 418.

33 *National Cotton Mills* v *Asstt ROC*, (1984) 56 Comp Cas 222: (1983) Cal HN 180. Overruling its own earlier decision in *Ajit Kumar Sarkar* v *Asstt ROC*, (1979) 49 Comp Cas 909: 83 Cal WN 108. The preponderance of opinion is that the offence is of a continuing nature. *Registrar of Companies* v *Orissa Paper Products Ltd*, (1988) 63 Comp Cas 460 Orissa. For an ex

Default in laying accounts before the general meeting has been held to be a one-time offence and being punishable with fine only, Section 482 of CrPC applied. A complaint filed after six months from the date of default was quashed.[35]

AUDIT

Appointment of auditors [S. 224]

The auditors of a company are appointed at its annual general meeting. An auditor appointed at one annual general meeting holds office from the conclusion of that meeting until the conclusion of the next annual general meeting. Unless he is a retiring auditor, he should be informed of his appointment within seven days and he should inform the Registrar within thirty days whether he has accepted the appointment or not.[36]

At an annual general meeting a retiring auditor is re-appointed, except in the following cases:[37]

1. when he is not qualified for re-appointment;
2. when he has given to the company notice in writing of his unwillingness to be re-appointed;
3. a resolution has been passed at that meeting appointing somebody instead of him or providing expressly that he shall not be re-appointed; or
4. where notice has been given of an intended resolution to appoint some person or persons in the place of a retiring auditor, and by reason of the death, incapacity or disqualification of that person the resolution cannot be proceeded with.

Where at any such meeting no auditor is appointed or reappointed the Central Government should be informed of the fact within seven days,[38] because the Government, in such a case, gets the right to appoint a person to fill the vacancy.[39]

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planation of the difference between a continuing and non-continuing offence, see *C. B. Bhandari* v *Provident Fund Inspector*, (1988) 63 Comp Cas 437 Ker, and also *State of Bihar* v *Deokaran Nenshi*, (1972) 2 SCC 890: 1973 SCC (Cri) 114: AIR 1973 SC 908.

34 *Luxmi Printing Works* v *Asstt ROC*, (1990) 69 Comp Cas 442 Cal. The penal provision contained in Section 162 states that the company and every officer of the company, who is in default, shall be punishable with fine which may extend to Rs 50 for every day during which the default continues. Since the default is visited by a day to day fine, this appears to be a continuing offence. The Division Bench of the Calcutta High Court, Madras High Court and Delhi High Court also supported this view. *Asstt ROC* v *Premier Synthetics (P) Ltd*, (1997) 89 Comp Cas 732: (1997) 26 CLA 269 (Mad).

35 *Rakesh Kumar* v *ROC*, (1995) 82 Comp Cas 681 P&H. *Jayes R. Mor* v *State of Gujarat*, (2002) 109 Comp Cas 232 Guj. the director in question had resigned before due date and Form 32 had also been filed, he was not regarded as a person in default.

36 S. 224(1-A).

37 S. 224(2).

38 S. 224(4). A failure to give this information entails a penalty of fine for the company and every officer in default.

39 S. 224(3).

The first auditors are appointed by the company's board within one month of incorporation and they hold office until the first annual general meeting.[40] If the board fails to do so, the company may in general meeting make an appointment.[41] Moreover, the company may in general meeting replace by another person the auditor appointed by the board.[42] Any casual vacancy may be filled by the board, except when it is due to resignation, in which case it has to be filled by the company in general meeting.[43] Such an appointee holds office until the conclusion of the next annual general meeting.[44]

Restriction of number of auditorships

Two new sub-sections were added to Section 224 by the Amendment Act of 1974, for the purpose of restricting the number of companies in which a person can be appointed as an auditor. In the case of a firm of auditors, "specified number of companies" shall be construed as the number of companies per partner of the firm who is not in full time employment elsewhere. If a person is a partner in more than one firm, the number of companies in reference to him should not exceed the specified number.[45] Where any partner of a firm of auditors is also holding office, in his individual capacity, as the auditor of one or more companies, the number of companies which may be taken into account in his case should not exceed the specified number, in the aggregate. A re-appointment is also not to be conferred on a person who is in full-time employment elsewhere.

A proviso added to Section 224(1) requires every company, appointing or re-appointing an auditor, to obtain a certificate from the auditor that the appointment is within specified limits.

If an auditor is holding at the time of the commencement of the Act, more appointments than the specified number, he should intimate within 60 days to the company or companies whose appointment he would not like to accept from the commencement of the new financial year. The names of such companies should be sent to the Registrar also.[46]

According to the first explanation, specified number means,—

1. in case of companies each of which has a paid-up share capital of less than 25 lakh rupees, twenty such companies;
2. in any other case, 20 companies, of which not more than 10 should have paid-up share capital of twenty-five lakh rupees or more.

The second explanation runs as follows:

> In computing the specified number, the number of companies in respect of which or any part of which any person or firm has been appointed as an

40 S. 224(5).
41 S. 224(5) proviso (*b*).
42 S. 224(5) proviso (*a*).
43 S. 224(6)(*a*).
44 S. 224(6)(*b*). It has been held that it is the duty of the auditor appointed to ascertain whether the requirements of S. 225 were complied with. *Ajit Kumar Idyya* v *Institute of Chartered Accountants of India*, (1994) 80 Comp Cas 197 Kant.
45 S. 224(1-B).
46 S. 224(1-C).

auditor, whether singly or in combination with any other person or firm, shall be taken into account.

It has been further provided by the Amendment of 2000 that private limited companies shall be excluded in reckoning the number of companies which an auditor can audit.

Appointment by special resolution [S. 224-A]

Section 224-A has been introduced by the Amendment Act, 1974, to specify the case in which an auditor can be appointed only by a special resolution. Where 25% or more of the subscribed share capital of a company is held, singly or jointly, by a public financial institution or the Central or State Government, or by any financial or other institution established by any provincial or State Act or in which a State Government holds 51% of the subscribed capital, or by any nationalised bank or an insurance company carrying on general insurance business, the appointment or re-appointment of an auditor can be made only by a special resolution.

If a special resolution has not been passed, it shall be deemed that the appointment has not been made and the Central Government will get the right under Section 224(3) to make an appointment.[47]

Remuneration of auditor

Section 224(8) provides that the remuneration of the auditor of a company may be fixed by the Board of directors, if the appointment has been made by the Board or by the Central Government, if the appointment was made by the Government. Subject to this, the remuneration has to be fixed by the company in general meeting. Where an auditor has been appointed under Section 619 by the Comptroller and Auditor General of India, his remuneration is to be fixed by the company in general meeting or in such manner as the company in general meeting may determine.[48]

Removal of auditors [S. 225]

An auditor can be removed before the expiry of his term by the company in general meeting after obtaining the previous approval of the Central Government.[49] Approval of the Central Government has to be taken before effecting the removal though the resolution for removal can be passed before hand.[50] At the expiry of his term, the company may in general meeting appoint another person in his place. But a special notice of any such resolution will be

47 The *Explanation* to the section says that for the purposes of the section "general insurance business" has the meaning assigned to it in the General Insurance (Emergency Provisions) Act, 1971: "nationalised bank" means a corresponding new bank as defined in Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 or in the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980.

48 Clause (*aa*) added to sub-section (8) of S. 224 by the Amendment of 2000.

49 S. 224(7).

50 *Basant Ram & Sons* v *UOI*, [2000] 4 Comp LJ 55 Delhi, the court is not likely to interfere in the matter without strong legal justification. *Basant Ram & Sons* v *UOI*, (2002) 110 Comp Cas 38 Delhi, general body approval again necessary after Central Government approval. Removal becomes effective from the date of general body approval.

necessary.[51] A copy of the resolution should immediately be sent to the retiring auditor as he has the right of making a representation.[52] A copy of the representation, if any, and if so desired by the auditor, should be sent to every member to whom notice of the meeting has been sent and if this is not done, the representation should be read out at the meeting.[53]

Qualifications [S. 226]

A person cannot be appointed as auditor of a company unless he is a chartered accountant.[54] But a firm may be appointed in its firm name provided all its partners are qualified for appointment.[55]

None of the following persons is qualified for appointment:[56]

(*a*) a body corporate;

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

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

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

(*e*) a person holding any security of the company after a period of one year from the date of commencement of the Companies (Amendment) Act, 2000 (w.e.f. Jan 14, 2001).

An explanation appended to the section says that for the purposes of this section "security" means any instrument which carries voting rights.

Powers and duties [S. 227]

Every auditor has the right of access to the books and accounts and vouchers of the company. He may require from the officers of the company any information he thinks necessary for the performance of his duties.[57]

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51 S. 225. It was held in *Pedley* v *Inland Waterways Assn*, (1977) 1 All ER 209 Ch D that in addition to special notice, the proposed resolution must also satisfy the requirements of circulation of a member's resolution. This was followed in *Amar Nath Malhotra* v *MCS Ltd*, (1993) 76 Comp Cas 469 Delhi. But other High Courts are of the opinion that the right to propose a resolution with a special notice, e.g. for removing an auditor, is an independent right and should not be whittled down by superimposing upon it the requirement of circulation of a member's resolution. *Gopal Vyas* v *Sinclair Hotels and Transportation Ltd*, AIR 1990 Cal 45: [1990] 1 Comp LJ 388: (1990) 68 Comp Cas 516; *Karnataka Bank Ltd* v *A. B. Datar*, (1993) 2 Kant LJ 230: (1994) 79 Comp Cas 417; *Prakash Road Lines Ltd* v *Vijay Kumar Narang*, (1993) 4 Kant LJ 561: (1995) 83 Comp Cas 569 Kant.

52 S. 225(2) and (3).

53 S. 225(3). But the representation need not be sent out to the members or read out at the meeting if, on the application of the company or of any aggrieved person, the Company Law Board is satisfied that the right of representation is being abused to secure needless publicity for defamatory matter.

54 Within the meaning of the Chartered Accountants Act, 1949 (XXXVIII of 1949).

55 S. 226(1) proviso.

56 S. 226(3).

57 S. 227(1). This duty continues even after winding up has commenced and the auditor has been appointed by the Court. *Bhawnagar Vegetable Products, Re*, (1977) 47 Comp Cas 128 Guj.

The auditor has to submit a report on the accounts of the company to the members of the company.[58] "The scheme of the Act... is that the directors must prepare the accounts; the auditor must make a report to the members on the accounts; the report must contain statements on certain specified matters."[59] The report should state whether the accounts are kept in accordance with the provisions of the Act and whether they give a true and fair view of the state of affairs of the company.[60]

By an amendment of Section 227 made by the Companies (Amendment) Ordinance, 1998 it has been made an additional duty of an auditor to report on this fact whether in his opinion the profit and loss account and balance sheet complied with the accounting standards.[61]

The Amendment of 1965 has imposed new duties upon auditors. A new sub-section (1-A) to Section 227 has been introduced which makes it the duty of the auditor to inquire into the following matters—

1. whether loans and advances made by the company on the basis of security have been properly secured and whether the terms are not prejudicial to the interests of the company or its members;
2. whether book-entry transactions are not prejudicial to the interests of the company;
3. where, the company is not an investment, or a banking company, whether any securities have been sold by the company at a price less than that at which they were purchased;
4. whether loans and advances made by the company have been shown as deposits;
5. whether personal expenses have been charged to revenue account;
6. whether cash has actually been received in respect of any shares shown in the books to have been allotted for cash if no cash has been received, whether the position as stated in the books is correct, regular and not misleading.

Sub-section (3) also requires the auditor's report to state:

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

(*b*) whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books, and proper returns adequate for the

58 S. 227(2).

59 PENNYCUICK J in *Thomas Gerrard Son Ltd. Re*, [1967] 2 All ER 525: [1967] 3 WLR 84.

60 According to S. 227(3) the auditor's report has also to state whether he has obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of the audit; whether the company's final accounts are in agreement with the books of account and returns; whether he has received report on the accounts of any branch office.

61 S. 227(3)(*d*).

purposes of his audit have been received from branches not visited by him;

(*bb*) whether the report on the accounts of any branch office audited under Section 228 by a person other than the company's auditor has been forwarded to him as required by clause (*c*) of sub-section (3) of that section and how he has dealt with the same in preparing the auditor's report;

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

(*d*) whether, in his opinion, the profit and loss account and balance sheet comply with the accounting standards referred to in sub-section (3-C) of Section 211.

(*e*) in thick type or in italics the observations or comments of the auditors which have any adverse effect on the functioning of the company;

(*f*) whether any director is disqualified from being appointed as director under clause (*g*) of sub-section (1) of Section 274;

(*g*) whether the cess payable under Section 441-A has been paid and, if not, the details of the amount of cess not paid.

The Central Government has also taken the power by inserting sub-section (4-A) to Section 227 to direct that in the case of a class or description of companies, the auditor's report shall also include a statement on such matters as the Government may direct. The Government may consult the Institute of Chartered Accountants of India on the matter.[62]

If a company has branch offices, the accounts of every branch office shall be audited by the company's auditor or the company may appoint any other auditor for the purpose.[63]

The auditors' report has to be read before the company in general meeting and is open to the inspection of any member of the company.[64]

Right of auditor to attend meetings [S. 231]

Notices and communications relating to meetings which have to be sent to members or to which they are entitled have also to be forwarded to the auditors of the company. The auditors are also entitled to attend any general meeting and is also entitled to be heard on any part of the business which concerns him as an auditor.

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62 *See*, Manufacturing and other Companies (Auditor's Report) Order 1988. GSR 909(E) of September 1988. (1988) 64 Comp Cas 3119-323 st.

63 S. 228(1). Sub-sections (2) to (4) contain further rules relating to audit of branch office accounts. The auditor's report, as required by S. 229, must be signed by the person appointed as an auditor of the company or, in the case of a firm of chartered accounts, by a partner of the firm practising in India. Any other document required by law to be authenticated must also be similarly signed.

64 S. 230.

Penalty [Ss. 232 and 233]

If default is made by a company in complying with any of the provisions contained in Sections 225 to 231, the company and every defaulting officer is punishable with fine extending up to Rs 5000.

Where an auditor's report is made or any document of the company is made or authenticated, otherwise than in conformity with the requirements of Sections 227 and 229, the auditor or any other person who signs or authenticates the report or document and if the default is wilful, is liable to be punished with fine which may extend to Rs 10,000.

Auditors' duty of care

Position of auditors.—Explaining the position of auditors CHAKRAVARTI CJ of the Calcutta High Court said:[65]

> A joint stock company carries on business with capital furnished by persons who buy its shares. The owners of the capital are, however, not in direct control of its application which is left to the executive of the company. In those circumstances, some arrangement is obviously called for by which those who provide the capital know periodically what is being done with their money, how the affairs of the company stand and what the present value of their investment is. The Companies Act, therefore, provides for the employment of an auditor who is the servant of the shareholders and whose duty is to examine the affairs of the company on their behalf at the end of a year and report to them what he has found. That examination by an independent agency such as the auditor is practically the only safeguard which the shareholders have against the enterprise being carried on in an unbusiness like way or their money being misapplied or misappropriated without their knowing anything about it. The Act provides the safeguard in two forms. It makes the duty of the auditor to give an expression of opinion on certain specified matters of a vital character and it makes him liable, along with the directors, for misfeasance, if he fails to perform his duties as required by law and the approved audit procedure.

Thus the auditors owe a number of duties to the company and its shareholders. The foremost among them is to check the accuracy of accounts. But his duty is "not to confine himself merely to the task of verifying the arithmetical accuracy of the balance sheet, but to inquire into its substantial accuracy, and to ascertain that it was properly drawn up, so as to contain a true and correct representation of the state of the company's affairs".[66] They should not act merely as mechanical adder-uppers and subtractors.[67] Thus, where an

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65 *Dy Secretary* v *S. N. Das Gupta*, AIR 1956 Cal 414: (1955) 25 Comp Cas 413: 60 Cal WN 124.

66 *See*, STIRLING J in *Leeds Estate Co* v *Shepherd*, (1887) 36 Ch D 787, 802: 57 LT 684. *See also* RIGBY LJ, *London & General Bank, (No 2), Re*, [1895] 2 Ch 673, 692: 73 LT 304: [1895-99] All ER 953.

67 *See*, L DENNING in *Fomento (Sterling Area) Ltd* v *Selsdon Fountain Pen Co*, [1958] 1 All ER 11, 23.

auditor of a banking company failed to verify the cash balance claimed by the management and the actual cash in hand turned out to be much less than was shown in the books, he was held guilty of neglect of duty.[68] The court said:

> A certificate from the management can obviously be no substitute for such verification. The whole object of an audit is an examination of what the management have done and if the statements of the very persons who constitute the management were to be accepted in all matters, even in matters capable of direct verification, an audit would be an idle farce.[69]

But in certain matters of technical nature, for example, valuation of stock-in-trade, the auditor will have to rely on some skilled person. Accordingly, an auditor could not be held guilty of breach of duty when, in the absence of suspicious circumstances, he relied for this purpose on the manager of a cotton mill.[70]

Where the accountants assisted the directors in connection with the preparation of a circular for rights issue, they were held not liable to shareholders for statements made to the directors in respect of profit forecasts.[71] An action against auditors for negligence could not succeed though the investor relied on the audited accounts and also on informal discussions with the auditors. There was insufficient evidence to show that the accountants had assumed any duty towards the particular investor.[72]

Standard of care and skill.—Secondly, it has always been the law that an auditor must exercise reasonable care and skill in the discharge of his duty.[73] Referring to this duty ROMER J said in *City Equitable Fire Ins Co, Re*:[74]

> ....He must be honest, i.e., he must not certify what he does not believe to be true and he must take reasonable care and skill before he believes that what he certifies is true. What is reasonable care in any particular case must depend upon the circumstances of that case. Where there is nothing to excite suspicion very little inquiry will be reasonably sufficient. Where suspicion is aroused more care is obviously necessary; but, still an auditor is not bound to exercise more than reasonable care and skill even in a case of suspicion and he is perfectly justified in acting on the opinion of an expert where special knowledge is required.

In another case LOPES LJ said: "He (the auditor), is a watchdog, but not a bloodhound."[75] "He is not an insurer."[76]

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68 *Dy Secretary* v *S. N. Das Gupta*, AIR 1956 Cal 414: (1955) 25 Comp Cas 413: 60 Cal WN 124.

69 Quoting ROMER J in *City Equitable Fire Ins Co, Re*, [1925] Ch 407 481: [1924] All ER Rep 485: 133 LT 520.

70 *Kingston Cotton Mill Co, Re*, [1896] 2 Ch 279: 74 LT 568, *see* the judgment of LINDLEY LJ at 286-87. Cited *Thomas Gerrard & Son, Re*, [1967] 2 All ER 525: [1967] 3 WLR 84.

71 *Abbott* v *Strong*, [1998] 2 BCLC 420 (Ch D).

72 *Electra Private Equity Partners* v *KPMG Peat Marwick*, [1998] PNLR 135.

73 PENNYCUICK J in *Thomas Gerrard & Son Ltd, Re*, [1967] 2 All ER 525: [1967] 3 WLR 84.

74 [1925] Ch 407, 481-82: [1924] All ER Rep 485: 133 LT 520.

75 *Kingston Cotton Mill Co, Re*, [1896] 2 Ch 279, 288: 74 LT 568.

76 ROMER J in *City Equitable Fire Insurance Co, Re*, [1925] Ch 407 at 481: [1924] All ER Rep 485: 133 LT 520.

If the company owns securities the auditor should see that they are in proper custody. "He should not be content with a certificate that securities are in the possession of a particular company, firm or person unless the company, etc., is trustworthy, or is respectable and further is one that in the ordinary course of business keeps securities for its customers."[77] Thus, where the stockbrokers of a company certified to its auditors that they were holding the company's securities, when in fact they did not do so and the company suffered loss, the auditors were held guilty of negligence. They should have at once set the matter right or reported it to the shareholders.[78] Similarly, in a case before the Calcutta High Court:[79]

> The auditor of a company found that the accounts presented by the directors showed that selling agency commission was paid to the managing agents in addition to their remuneration, but was not included in remuneration, nor was it shown as an item of expenditure, but was deducted from the sale proceeds of the goods sold by them.

CHAKRAVARTI CJ held that the auditor ought to have required the directors to explain why the selling agency commission was not included in remuneration and whether a special resolution had been passed to authorise the payment of a separate commission. "His failure to ask for such information betrays negligence in the performance of his duties."

An auditor is, however, not concerned with the policy of the company. In the words of LINDLEY LJ:[80]

> It is no part of an auditor's duty to give advice, either to directors or shareholders, as to what they ought to do. An auditor has nothing to do with the prudence or imprudence of making loans with or without security. It is nothing to him whether the business of a company is being conducted prudently or imprudently, profitably or unprofitably. It is nothing to him whether dividends are properly or improperly declared, provided he discharges his own duty to the shareholders. His business is to ascertain and state the true financial position of the company at the time of the audit....

On the facts of the case, however, the auditor was held guilty of breach of duty. He presented a confidential report to the directors calling their attention to the insufficiency of the securities on which the capital of the company was invested, and the difficulty of realising them. But his report to the shareholders merely stated that the value of the assets was dependent on realisation. As a result the shareholders were deceived as to the condition of the company and a dividend was declared out of the capital and not out of income. It was held that the auditor was guilty of misfeasance and was liable to make good the amount

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77 ROMER J in *City Equitable Fire Insurance Co, Re*, [1925] Ch 407 at 481: [1924] All ER Rep 485: 133 LT 520.

78 *City Equitable Fire Ins Co, Re*, [1925] Ch 407: [1924] All ER Rep 485: 133 LT 520, but the auditors were protected from liability under special provisions of the company's articles.

79 *Ganesan* v *A. K. Joscelyne*, AIR 1957 Cal 33: [1957] 27 Comp Cas 114.

80 *London & General Bank, (No 2), Re*, [1895] 2 Ch 673, 682: 73 LT 304: [1895-99] All ER 953.

of dividend paid. But his liability does not end there. He would also be liable for the costs of recovering the extra tax, if any, which has been paid on the basis of the false accounts and also for any of the extra tax which is not recoverable.[81]

Duty to company and to third parties

The traditional concept of auditors' duty has been that they owe their duty to the company and the company only. This concept was fortified by the judgment of CARDOZO CJ in *Ultramares Corporation* v *Touche*:[82]

> The defendants, a firm of public accountants, were employed by a company to prepare and certify a balance sheet of the company. The company, to the knowledge of the accountants, had borrowed large sums of money from banks and other lenders. They also knew that their certified balance sheet would be exhibited to other lenders to induce them to lend money. Accordingly, when the balance sheet was made up, it was shown to the plaintiffs, who, acting on the faith of it, lent and lost huge sums of money.

The court found that there was evidence of negligence by the defendants in making their report but held that this would not make them liable to the plaintiffs. CARDOZO CJ said:

> The defendants owed to their employer a duty imposed by law to make their certificate without fraud, and a duty growing out of contract to make it with the care and caution proper to their calling. Fraud includes pretence of knowledge when knowledge there is none. To creditors and investors to whom the employer exhibited the certificate, the defendants owed a like duty to make it without fraud. A different question develops when we ask whether they owed a duty to them to make it without negligence. If liability for negligence exists, a thoughtless slip or blunder; the failure to detect a theft or forgery beneath the cover of deceptive entries, may expose accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class.

It means that nothing less than a fraudulent report will make an auditor liable to an outsider who has been deceived by it. Fraud must be proved in the terms of its definition as laid down by LORD HERSCHELL in *Derry* v *Peek*.[83] A negligent misstatement is not the same thing as fraud. This has been pointed out by the court of appeal in *Candler* v *Crane, Christmas & Co*:[84]

> The plaintiff, who desired to invest £2,000 in a limited liability company, was put in touch with the company's accountants by the manager. The accountants knew that the plaintiff was a potential investor. They prepared and showed the accounts to the plaintiff and also talked with him.

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81 *Thomas Gerrard & Son, Re*, [1967] 3 WLR 84; [1967] 2 All ER 525.

82 (1931) 255 NY Rep 170. Reported in Thurston and Seavy, CASES ON TORTS, (1942) 757 and cited in *Candler* v *Crane, Christmas & Co*, [1951] 2 KB 164; [1951] 1 All ER 426.

83 (1889) 14 App Cas 337.

84 [1951] 2 KB 164; [1951] 1 All ER 426.

The plaintiff invested his money in the company. The accounts were carelessly prepared, contained numerous false statements and gave a wholly misleading picture of the state of the company, which was wound up within a year, the plaintiff losing the whole of his investment.

Even so it was held by a majority that the accountants were not liable to the plaintiff. Their Lordships said that a false statement, carelessly, as contrasted with fraudulently, made by one person to another, though acted on by that other to his detriment, was not actionable in the absence of any contractual or fiduciary relationship between the parties. DENNING LJ in his dissenting opinion observed:

> I think that the law would fail to serve the best interests of the community if it should hold that accountants and auditors owe a duty to no one but their client....The accountant, who certifies the accounts of his client, is always called on to express his personal opinion as to whether the accounts exhibit a true and correct view of his client's affairs; and he is required to do this, not so much for the satisfaction of his own client, but more for the guidance of shareholders, investors, revenue authorities, and others who have to rely on the accounts in serious matters of business. (Yet) the persons who are misled cannot complain because the accountants owe no duty to them. If such be the law, I think it is to be regretted, for it means that the accountant's certificate, which should be a safeguard, becomes a snare for those who rely on it. In my opinion accountants owe a duty of care not only to their clients, but also to those whom they know will rely on their accounts in the transactions for which those accounts are prepared.

The decision in *Candler* v *Crane, Christmas & Co* has been overruled by the House of Lords in *Hedley Byrne & Co* v *Heller & Partners*:[85]

> Here a firm of advertising agents had lost a huge sum of money by placing advertising orders for a company. They asked their bankers to inquire into the company's financial stability and their bankers made inquiries of the respondents, who were the company's bankers. The respondents gave favourable reference but stipulated that these were "without responsibility". In reliance on those references the appellants placed orders which resulted in the loss.

The bankers would have been held liable but for the express disclaimer of responsibility. Lord MORRIS explained the principle thus:

> I consider that it should now be considered as settled that if someone possessed of a special skill undertakes, quite irrespective of contract, to apply his skill for the assistance of another person who relies upon such skill, a duty of care will arise. Furthermore, if in a sphere in which a person is so placed that others could reasonably rely upon his judgment or his skill or upon his ability to make a careful inquiry or a person takes upon himself to give information or advice to, or allows his information or advice to be

85 [1963] 3 WLR 101: 1964 AC 465: [1963] 2 All ER 575.

passed on to, another person who, as he knows or should know, will place reliance upon it, then a duty of care will arise.

There is a wind of change in the United States also. For example, it was observed in *Texas Tunnelling Co* v *City of Chattanooga*,[86] "that there have been significant changes in the American society during the thirty years that have elapsed since the decision in *Ultramares case*. The continued growth and expansion of industry, the growth of population, the urbanization of society, the growing complexity of business relations and the growing specialization of business functions all require more and more reliance in business transactions upon the representation of specialists."[87]

The principle of the *Hedley Byrne* case has been followed by the Canadian Court in *Haig* v *Bamford*[88] where an auditor, who issued a certificate without verification, was held liable to a person who was misled by the certificate.[89] A similar liability has been imposed upon an auditor who participated in the negotiations for the sale of a company's shares on the basis of the balance sheet audited and certified by him. The value thus determined turned out to be unreal because the balance sheet was not satisfactory. The court emphasised that if the auditor had not participated in the negotiations, the result would have been different.[90]

Where an auditor is appointed to check the accounts of the Employees' Provident Fund maintained by a company, he owes his duty not merely to the company, but also to the beneficiaries of the fund and will be responsible to them for professional misconduct if he fails to report that the trustees have allowed irregular loans to the company out of the fund.[91] If this were not so, the accountants and auditors could as well say: "You may inspect the accounts... of X Company Ltd, but do not expect these documents to have been prepared with any degree of skill or care." "It is our view that the auditor or accountant owes a duty of care to the investor, creditor, and others to prepare proper audits or accounts."[92]

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86 204 F Supp 821 (E.D. Tenn 1962), reversed in 329 F 2d 402 (6th cir 1964). Borrowed from 1966 JBL 190.

87 *See*, Edwin J Bradley, *Liability to third Persons for Negligent Audit*, 1966 JBL 190; Seavey, *Candler* v *Crane, Christmas & Co, Negligent Misrepresentation by Accountants*, 67 LQR 466 (1951); *Accountants Liabilities for False and Misleading Statements*, (1967) 67 Columbia Law Rev 1437; Michael Dean, *Hedley Byrne and the Enger Business Man*, (1968) 31 Mod LR 322 and 1967 JBL 359; R. Baxt, *The Modern Company Auditor—A Nineteenth Century Watchdog*, (1970) 33 Mod LR 413 and *True and Fair Accounts—A Legal Anachronism*, (1970) 44 Aust LJ 541.

88 (1972) 32 DLR (3d) 67 Sask Q. B. noted, Current Law, June, 1973.

89 All such cases have been analysed by R. Baxt, *The Liability of Accountants and Auditors for Negligent Statements in Company Accounts*, (1973) 36 Mod LR 42. *See* further *Arenson* v *Casson, Beckman, Rutlay & Co*, [1975] 3 WLR 815 and *Esso Petroleum* v *Mardon*, (1976) 2 WLR 583, noted, 1976 Mod LR 462.

90 *Diamond Mfg Co Ltd* v *Hamilton*, [1968] NZLR 705, considered. R. Baxt, *Negligent Statement in Company Accounts*, (1973) 36 Mod LR 47. A similar liability has been imposed in *Arenson* v *Casson, Beckman, Rutlay & Co*, [1975] 3 WLR 815.

91 *Institute of Chartered Accountants of India* v *P. K. Mukherjee*, (1968) 2 Comp LJ 211.

92 For liability in respect of financial statements, see *Kuwait Asian Bank EC* v *National Mutual Life Nominees Ltd*, [1990] 3 All ER 404 PC.

A Civil Aviation Authority was refusing to renew the air travel company's licence due to unsatisfactory financial position unless certain confirmations were given by the auditors in their final report as to the finances of the company. The auditors submitted the requisite information to the Authority. The company collapsed. The accounts were negligently prepared. The Authority's claim against the auditors was allowed as they had assumed responsibility towards the Authority for exercising due care and caution in preparing the company's accounts.[93]

Duty in connection with takeover.—A three-point formula has been propounded by the Court of Appeal in England[94] on the auditor's duty to the investing public. The court said that in determining the auditor's duty of care to those relying on accounts audited by him, it must be shown that—

1. It was foreseeable that the persons relying on the accounts would suffer harm if the auditor was negligent;
2. The auditor and the user of the accounts stood in a relationship of sufficient proximity;
3. The circumstances made it just and reasonable to impose such a duty on the auditor.

One company was taking over another company. It relied upon the company's audited accounts and suffered loss because there was a negligent inaccuracy in the accounts. The plaintiff company was a shareholder of the other company and was also a potential investor. The court readily conceded that it was foreseeable that the shareholders of the company would suffer economic loss if the auditors were negligent in the matter of the company's accounts. Since they stand between the company and the shareholders and make their report to the shareholders, they owe a responsibility to the individual shareholders so as to put the auditors under a duty of care towards them and there was nothing to make it unfair or unreasonable to impose a duty of care on the auditors towards the investing shareholders of the company, but that there was no such duty towards the non-shareholders who relied on audited accounts to buy the shares of the company under takeover.

Stressing this point again in a subsequent case, HOFFMAN J said:[95]

> The directors and financial advisers of the target company in a contested takeover bid owe no duty of care to a known takeover bidder regarding the accuracy of profit forecasts, financial statements and defence documents prepared for the purpose of contesting the bid since the reason such documents are prepared is to advise the shareholders of the target company whether to accept the bid and they are not meant for the guidance of bidders. Accordingly, there does not exist sufficient proximity between the directors and financial advisers of the target company and the bidder to give rise to a duty of care.

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93 *Andrew* v *Kounnis Freeman*, [1999] 2 BCLC 641 CA.

94 *Caparo Industries plc* v *Dickman*, 1989 BCLC 154; [1989] 1 All ER 798 CA, on appeal from *Caparo Industries plc* v *Dickman*, 1988 BCLC 387 QBD.

95 *Morgan Crucible Co plc* v *Hill Samuel Bank Ltd*, [1990] 3 All ER 331 Ch D.

It was, therefore, held that the defendants did not owe any duty of care to the plaintiff to ensure that pre-bid financial statements and the profit forecast were accurate. At the time that the plaintiff announced the takeover bid for another company, the recently published financial statements of the company were its reports and accounts for the years 1984 and 1985 which had been audited by a firm of accountants and an unaudited interim statement for six months. These statements were cited in all the circulars sent to the shareholders for their guidance. Another circular forecast a 38% increase in profits in the year up to Jan 31, 1986. This document included a letter from the accountants stating that it had been properly compiled in accordance with the company's accounting policies and a letter from the bank expressing the opinion that the forecast had been made after due and careful inquiry. On this basis the shareholders were advised not to accept the proposed bid. The plaintiff then increased the bid- amount and the same was recommended to the shareholders and accepted by them. Subsequently it was discovered that the accounting policy adopted in the pre-bid financial statement and the profit forecast were negligently misleading and had the effect of grossly overstating the profits and that the company was worthless at the time the bid was made with the result that if the plaintiff had known the true facts, it would never had made the bid, let alone increased it. But even so those who prepared the statements from the company's side for the guidance of its shareholders were held not liable to the plaintiff.[96]

Where the audit partner of a firm of accountants expressly vouched for a set of accounts which his firm had audited, the firm would be liable in negligence if those accounts were defective. It was a known fact that the bid would not proceed unless this undertaking that the accounts were true and fair was given.[97]

The duty of an auditor of a subsidiary company to its holding company was explained in *Baring Plc* v *Cooper & Lybrand*.[98] The court was of the view that there is no legal principle that a holding company is not entitled to recover damages for loss in the value of its subsidiary resulting directly from a breach of duty owed to the company itself as distinct from the duty owed to the subsidiary. The auditors of the subsidiary are supposed to be aware of the fact that their duty to see the true and fair aspect of the subsidiary's accounts and their report on it is the only basis on which the true and fair view of all the companies in the group (consolidated group accounts) would be ensured. Thus the holding company had the direct right of action against the subsidiary's auditors for their failure to detect a dealer's fraud.[99]

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96 The court referred to *Caparo Industries plc* v *Dickman*, [1990] 1 All ER 568; [1990] 2 WLR 358 HL; 1990 BCLC 273. For a further survey of cases on the subject of responsibility for financial statements, see *Kuwait Asian Bank EC* v *National Mutual Life Nominees Ltd*, [1990] 3 All ER 404 PC.

97 *ADT Ltd* v *BDO Binder Hamlyn*, 1996 BCLC 808.

98 (1997) 1 BCLC 427 CA.

99 The court followed the principle laid down in *George Fischer (Great Britain) Ltd* v *Multi Construction Ltd*, (1995) 1 BCLC 260.

Default in disclosing fraud

The auditors of a company discovered that a senior employee had been defrauding the company at a grand scale and that he was in a position to go on doing so. The court said that in such a situation it would be the auditors' duty to report the matter to the company's management and not to postpone it till they submit their report.[1]

Liability for fraudulent misrepresentation

The liability for fraudulent misrepresentation was explained by CARDOZO CJ in these words:[2]

> Accountants may, however, be liable to third parties even where there is lacking deliberate or active fraud. A representation certified as true to the knowledge of the accountants when knowledge there is none, a reckless misstatement, or an opinion based on grounds so flimsy as to lead to the conclusion that there was no genuine belief in its truth, are all sufficient upon which to base liability. A refusal to see the obvious, a failure to investigate the doubtful if sufficiently gross, may furnish evidence leading to an inference of fraud.[3]

Accountants' lien

It has been held that an accountant, like a solicitor, is not entitled to exercise a lien over the books and documents of a registered company which are required to be kept at a particular place and made available for inspection. The expression "books of account" would include accounting records such as sale and purchase invoices, cheque books, pay in books and bank statements.[4]

Special audit [S. 233-A]

The Central Government has the power in the following cases to direct the special audit of a company's accounts:

1. when the affairs of any company are not being managed in accordance with sound business principles or prudent commercial practice; or
2. when any company is being managed in a manner likely to cause serious injury or damage to the interests of the trade, industry or business to which it pertains; or
3. when the financial position of any company is such as to endanger its solvency.

A prayer for an order of special audit was made in a petition for prevention of oppression and mismanagement. The Company Law Board did not accede to the request because the allegations of low profitability and inflated expenses

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1 *Sasea Finance Ltd* v *RMPG*, [2000] 1 All ER 676 CA; *Law Society* v *KPMG Peat Marwick*, [2000] 1 All ER 515.

2 *Ultramares Corpn* v *Touche*, (1931) 235 NY Rep 170.

3 For an account of such liability *see* Jon H. Holyork, *Accountancy and Negligence*, 1986 JBL 120.

4 *DTC (CNC) Ltd* v *Gary Sargeant & Co*, (1996) 1 BCLC 529 Ch D.

were not supported by specific facts and figures. The alleged expenses had been approved by the Income Tax Authorities.[5]

The Government may appoint the company's auditor or any other chartered accountant to conduct the audit. Such a special auditor will have the same powers and duties as an auditor of the company, except that he has to submit his report to the Central Government.[6]

On receipt of this report the Central Government may take such action as it considers necessary in accordance with the provisions of the Act or any other law.[7] But where no action is taken within four months, the Government may send the report to the company requiring it to circulate the same to the members or read it to them at the next general meeting.

Power of registrar to call for special information [S. 234]

A company has to submit several documents to the Registrar under the Act. While perusing any such document, the Registrar may form an opinion that any information or explanation is necessary in respect of a matter to which a particular document relates. He may, in such a case, require the company to furnish the same. If the company fails to do so, or submits an inadequate explanation, the Registrar may require the company to produce the necessary books and papers. The company and its officers may be punished for further default. Further, if the information or explanation discloses an unsatisfactory state of affairs or does not disclose a full and fair statement of the matter in question, the Registrar shall report it to the Central Government.[8]

Seizure of documents by Registrar [S. 234-A]

Sometimes the Registrar may have reasonable ground to believe that the books of accounts of a company or of its managerial agencies may be destroyed or falsified or otherwise tampered with. In such a case he may apply to a Magistrate of the First Class or a Presidency Magistrate, who may authorise him to enter and search the place where such books are kept and seize them. The Registrar has to return such books within thirty days, but he may make copies.

Audit of cost accounts [S. 233-B]

Section 209, as amended by the Amendment Act of 1965, provides that a company pertaining to any class of companies engaged in production, processing, manufacturing or mining activities, should keep proper books of account showing such particulars relating to utilisation of material or labour or to other

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5 *Mahendra Singh Mewar* v *Lake Palace & Metals (P) Ltd*, (1999) 96 Comp Cas 757 CLB.

6 S. 233-A(3).

7 S. 233-A(6).

8 S. 234(5) and (6). *See* also *Barium Chemicals Ltd* v *Company Law Board*, [1966] 2 Comp LJ 151: AIR 1967 SC 295: (1966) 36 Comp Cas 639. Where a written petition was filed to find out whether a foreign company had acquired interest in a company without compliance with Foreign Exchange Regulation Act, 1974, the court said that it would have been better to seek information from the affected company under S. 234. *R. Venkataswamy Naidu* v *Enforcement Directorate*, (1993) 78 Comp Cas 87 Mad.

items of cost as may be prescribed, if such class of companies is required by the Central Government to include such particulars in the books of account.

When a company is required to include in its books of account the above particulars, the Central Government may, whenever it is necessary so to do, direct that an audit of cost accounts of the company should be conducted. The conduct of audit will take place in such manner as may be prescribed in the order. The auditor shall be a cost accountant within the meaning of the Cost and Works Accountants Act, 1959. If cost accountants are not available in sufficient numbers the Government may by notification authorise the appointment of chartered accountants.[9] The appointment will be made by the Board of Directors with the previous approval of the Central Government and also subject to the constraints as to the number of audits specified in Section 224(1-B).[10] A person disqualified under Section 226(3) or (4) or who has been appointed as an auditor of the company is disqualified from appointment [Section 233-B(5)]. If a cost auditor becomes disqualified after appointment he should cease to conduct audit from the date of disqualification [Section 233-B(5)(*c*)]. The company is under an obligation to provide all facility and assistance to the cost auditor [Section 233-B(6)]. He has all the powers of an auditor, but he submits his report to the Company Law Board with a copy to the company [Section 233-B(4)]. If the report carries any reservation or qualification, the company should inform the Central Government within thirty days [Section 233-B(7)]. The Government may demand further information [Section 233-B(8)]. The Government may then take necessary action [Section 233-B(9)]. The Government may direct the company to circulate the report to the members along with the notice calling the next annual meeting.[11]

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9 Proviso to S. 233-B(*i*) *inserted* by the Amendment Act, 1970.

10 S. 233-B(1) *substituted* by *ibid.* The Government tried to fix 30 cost audits per auditor. Delhi High Court in *R. Nanabhoy* v *UOI*, (1983) 53 Comp Cas 454, struck it down. Cost audit is not a regular or annual affair. It has to wait for an order of the Central Govt. The restrictions would have crippled the growth of the profession. A certificate should be taken from the appointee that his case is not covered by the constraints of S. 224(1-B). *Rakesh Singh* v *UOI*, (2002) 110 Comp Cas 624 Delhi, the power of approval also includes a power to disapprove a particular person. A complaint against the proposed cost auditor was pending before the Institute of Cost and Works Accountants.

11 S. 233-B(10). Sub-section (*ii*) contains penalty provisions. The Andhra Pradesh High Court refused to quash a complaint filed on the ground that despite several reminders, the petitioners, who were "officers in default" failed to apply to the Central Government for appointment of a cost auditor. The petitioners were directors at the material time and they allowed the default to continue. *Bimal Kumar Nopany* v *ROC*, (1990) 68 Comp Cas 567 AP.

13

Borrowing, Lending, Investments and Contracts

BORROWING

A company cannot borrow money unless it is so authorised by its memorandum. In the case of a trading company, it is not, however, necessary that the objects clause of its memorandum should expressly authorise it to borrow. As borrowing is incidental to trading, such a company has implied power to borrow.[1] Other companies must have a borrowing power clearly specified in the memorandum.

Consequences of unauthorised borrowing

Borrowing without express or implied authority is *ultra vires*. The consequences of such a borrowing as worked out in various cases are as follows:

1. *No Loan*

In the first place, an *ultra vires* lender has no legal or equitable debt against the company. Consequently he cannot sue the company to recover his loan.[2] *Ultra vires* borrowings are forbidden on grounds of public policy. To allow such borrowing to be recovered would be an evasion of that policy.[3]

2. *Injunction*

But if the money advanced to the company has not been spent, the lender may by means of an injunction restrain the company from parting with it.[4]

3. *Subrogation*

Where the money of an *ulta vires* lender has been used to pay off lawful debts of the company, he would be subrogated to the position of the debtor paid off and to that extent would have the right to recover his loan from the company.[5] Subrogation is allowed for the simple reason that when a lawful debt has been paid off with an *ultra vires* loan, the total indebtedness of the company remains the same. By subrogating the *ultra vires* lender, the courts are able to protect him from loss, while the debt burden of the company is in no way increased.

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1 *See* Memorandum of Association, Objects Clause, *ante*, and *Introductions Ltd, Re*, [1969] 2 WLR 791: [1969] 1 All ER 887 CA: [1968] 2 Comp LJ 28.

2 This was so held in *National Permanent Benefit Building Society, Re*, (1869) 5 Ch App 309 and followed by the Madras High Court in *Madras Native Permanent Fund Ltd, Re*, (1931) 60 MLJ 270, where at 273 the court said: "*ultra vires* loans are void and in truth have no existence. They do not create the relationship of creditor and debtor."

3 See *Sinclair* v *Brougham*, 1914 AC 398: 111 LT 1: [1914-15] All ER Rep 622: 83 LJ Ch 465: 30 TLR 315.

4 The reason for this rule is that the loan is *ultra vires*, the company, therefore, does not become the owner of that money. The lender continues to be the owner and he has the right to take back the property in *specie*.

5 For an illustration of subrogation, see *Neath Building Society* v *Luce*, (1889) 43 Ch 158.

But the subrogated creditor will not enjoy the priority of the original creditor. The best illustration is *Wrexham, Mold & Connah's Quay Rly Co Ltd, Re*:[6]

> A company had borrowed to the full extent of its powers by issuing three different series of debentures, *A*, *B* and *C*. *A* had priority over *B* and *B* over *C*. The company took a fresh *ultra vires* loan from the plaintiff to pay interest on *A* debentures. It was held that to the extent to which the plaintiff's money was used to pay off legal debts, he became a legal creditor, but he was not entitled to the priority of *A* debentures.

4. *Identification and Tracing*

Fourthly, as long as the money of the lender is in the hands of the company in its original form or its products are still capable of identification, he may claim that money or its products. But the problem is much more difficult when the lender's money and that of the company have become mixed up. There is only a common fund composed of the lender's money and the company's money, but no part of it is traceable as belonging to one or the other. In such a case the lender may perhaps be helpless. But in the winding up of the company he may claim *pari passu* distribution of the assets with the shareholders. This was done in the complicated case of *Sinclair* v *Brougham*:[7]

> A building society started banking business which was *ultra vires* the society. On its winding up the assets appeared to have been composed partly of the shareholders' money and partly of the depositors' money. But it was not possible to trace out which part of the mixed fund belonged to the shareholders or the creditors. Nor were the assets sufficient to pay both in full. It was, therefore, held that the entire remaining amount should be apportioned between the depositors and the shareholders in proportion to the amount paid by them, respectively. Nearest approach practicable to substantial justice would be done.

Regular borrowings

Where, on the other hand, the borrowing is within the powers of the company, the lender would not be prejudiced simply because its officers have applied the loan to unauthorised activities, provided that the lender had no knowledge of the intended misuse.[8] Thus, for example, in *V. K. R. S. T. Firm* v *Oriental Investment Trust Ltd*:[9]

> Under the authority of a company, its managing director borrowed large sums of money and misappropriated them. The company was nevertheless held liable.

But where a lender provides finance for a business which (within his knowledge) is not within the company's objects, the loan is *ultra vires* and the lenders cannot enforce the security.[10]

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6 [1899] 1 Ch D 440: [1895-9] All ER Rep Ext 1519: 80 LT 130.
7 1914 AC 398: 111 LT 1: [1914-15] All ER Rep 622: 83 LJ Ch 465: 30 TLR 315.
8 *David Payne & Co, Re*, [1904] 2 Ch 608: [1904-7] All ER Rep Ext 1501.
9 AIR 1944 Mad 532.
10 *Introductions Ltd, Re*, [1969] 2 WLR 791: [1969] 1 All ER 887 CA: [1968] 2 Comp LJ 28.

Another problem that may sometimes arise in this connection is where borrowing is within the company's power but it is beyond the powers of those managing the company. Whether the company would be liable in such a case was the question in *T. R. Pratt (Bom) Ltd* v *E. D. Sasoon & Co Ltd*:[11]

> There was no limit on borrowing for business in the memorandum of a company. But the directors could not borrow beyond the limit of the issued share capital of the company without the sanction of the general meeting. The directors borrowed money from the plaintiff beyond their powers.

It was held that "the money having been borrowed and used for the benefit of the principal either in paying its debts, or for its legitimate business, the company cannot repudiate its liability on the ground that the agent had no authority from the company to borrow. When these facts are established a claim on the footing of money had and received would be maintainable."

But in *Equity Insurance Co Ltd* v *Dinshaw & Co*:[12]

> It was held that "where the managing agent of a company who is not authorised to borrow, has borrowed money which is not necessary, neither bona fide, nor for the benefit of the company, the company is not liable for the amount borrowed."

The Companies Act, in Section 293(1)(*d*), provides that directors should not borrow beyond the paid-up capital of the company and its free reserves. Sub-section (5) further declares that such a loan shall not be valid, "unless the lender proves that he advanced the loan in good faith and without knowledge that the limit had been exceeded".

Where a loan has not been taken in the name of the company it will not be liable even though it may have benefited. An illustration in point is *Suraj Babu* v *Jaitly & Co*:[13]

> *P & Co* were the managing agents of *L & Co* which was in liquidation. *P* was the manager. *P* borrowed a sum of money from *J* in his own name. In one letter to *J* he indicated that the loan was for a requirement of *L & Co* and that company had actually benefited. But it was held that there was no intention to bind *L & Co*. "The mere fact that the company had benefited was not in itself sufficient to bind the company."

Where a promissory note was executed on a paper the top of which bore the rubber stamp of the company and was signed "*Joshi, Treasurer*", an intention to bind the company was held to be clear.[14] But where a note was endorsed in this manner:

> "Mitter and Sons,
> Managing Agents,

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11 AIR 1936 Bom 62. Followed in *Kumar Krishna Rohatgi* v *State Bank of India*, (1980) 50 Comp Cas 722 Pat, where the company used the money. *See* also *C. K. Siva Sankara Panicker* v *Kerala Financial Corpn*, (1980) 50 Comp Cas 217 Ker, where the act of mortgaging the assets of a company for the help of its sister concern, was held to be valid.

12 AIR 1940 Oudh 202.

13 AIR 1946 All 372.

14 *Poona Chitrashala Steam Press* v *Gajanan Industrial & Tramway Co*, AIR 1923 Bom 29.

Lister Antiseptic Co Ltd",[15]

it was held that the intention to involve the responsibility of the company was not clear from the endorsement.

MORTGAGES AND CHARGES

Registration of charges [S. 125]

The power to borrow includes the power to mortgage the company's assets or to create a charge upon them. The reason is that lenders always insist on some security and the only security that a company can give is to charge its assets. Any charge or mortgage created on any of the following assets of a company must be registered with the Registrar of Companies under Section 125 of the Act:[16]

1. a charge for the purpose of securing any issue of debentures;
2. a charge on uncalled share capital of the company;
3. a charge on any immovable property, wherever situate or any interest therein;
4. a charge on any book debts of the company;[17]
5. a charge, not being a pledge, on any moveable property of the company;
6. a floating charge on the undertaking or any property of the company including stock in trade;
7. a charge on calls made, but not paid;
8. a charge on a ship or any share in a ship;[18]
9. a charge on goodwill, or a patent or a licence under a patent, on a trademark, or on a copyright or a licence under a copyright.

The Registrar has to issue a certificate under his hand of the registration of any charges stating the amounts secured. The certificate is conclusive evidence that the requirements as to registration have been complied with.[19]

Registration must be effected within thirty days of the creation of the charge.[20] However, the Registrar may extend the time up to next thirty days. He

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15 *Sreelal Mangatulal* v *Lister Antiseptic Dressing Co Ltd*, AIR 1925 Cal 1062.

16 S. 124 says that in this part, the expression "charge" includes a mortgage. Where the company defaulted in registering the charge, the court, at the instance of the chargee, compelled the company to comply with the requirement of registration. *ICICI Bond Ltd* v *Rlen & Marshall Manufacturers & Exporters Ltd*, [2000] 4 Comp LJ 411 CLB.

17 The right of retention contained in a financing agreement is not a charge on book debts so as to require registration, because it is not possible for a charge to be created in favour of debtor over his own indebtedness to a creditor and there is no relevant property capable of forming the subject matter of a charge. *Charge Card Services Ltd, Re*, [1986] 3 All ER 289 Ch D. The item "cash at bank" is also not a book debt, *Brightlife Ltd, Re*, [1986] 3 All ER 673 Ch D. A charge over all the future book debts has been held to be a floating charge. *Rhodes* v *Allied Dunlar Pension Services Ltd*, 1988 BCLC 186 Ch D; *Offshore Ventilation Ltd, Re*, 1988 BCLC 186 Ch D; *A company (No 005009 of 1987) Re, ex p Copp*, 1989 BCLC 13 Ch D, where the charge was on the book and other debts from time to time due and owing. A fixed charge on book debts is also possible. *See* Robert A Pearce, *Fixed Charge over Book Debts*, 1987 JBL 18. A charge on book debts and other debts was held to be a floating charge, *Portbase Clothings Ltd, Re*, (1993) 3 All ER 829 Ch D.

18 A charge on a share in horses has been held to be not a floating charge because they are choses-in-action. *Sugar Properties (Derisley Wood) Ltd, Re*, 1983 BCLC 146 Ch D.

19 S. 132.

20 Registration may be effected either by the company or by any interested party. S. 134. A copy

has to be convinced that there was a sufficient cause for the default. The company has to pay an additional fee as may be required by the Registrar but it should not exceed ten times the amount of fee specified in Schedule X. The advantage of registration is that the charge becomes binding on the company even in its winding up and also on every subsequent purchaser or incumbrancer of the property covered by the charge.[21] The effect of non-registration is that the charge would be void against the liquidator and any creditor of the company.[22] The lender would not have the benefit of the charge, although his loan stands and it shall become immediately repayable.[23]

It has been said that "the section makes void the security, not the debt, nor the cause of action, but the security, and not as against everybody, not as against the company grantor, but against the liquidator and against any creditor, and it leaves the security to stand as against the company while it is a going concern. It does not make the security binding on the liquidator as successor of the company."[24]

A charge on all the products, movable property and book debts of the company was held to be void because the prescribed particulars were not filed with the Registrar within time nor any extension of time was sought for the purpose.[25]

The possessory lien of a warehouse keeper for his charges which included the power to sell the goods to realise the outstanding charges was held as not amounting to a charge on the goods so as to require registration.[26] In a

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of the charge should be kept at the registered office. S. 136, S. 145 provides that pre-existing charges would also have to be registered if they were not satisfied at the time that the registration requirements came into force.

21 S. 126.

22 *Capital Finance Co* v *Stokes*, [1968] 3 All ER 625: [1969] 1 Comp LJ 341: [1969] 1 Ch 261: [1968] 3 WLR 899. Noted 1968 JBL 153. A charge cannot be avoided by the liquidator without proving that it was not registered. *Hindustan Forest Co (P) Ltd* v *United Commercial Bank*, (1994) 79 Comp Cas 669 P&H.

23 In many cases debenture holders could not enforce the security because of non-registration. *See*, for example, *Dinshaw & Co, Bankers Ltd, Re*, AIR 1937 Oudh 62; *Krishna Ayyangar* v *Nallaperumal Pillai*, AIR 1920 PC 56; *Maheshwari Bros* v *Official Liquidators of Indra Sugar Works Ltd*, AIR 1942 All 119; *Indus Film Corpn Ltd, Re*, AIR 1939 Sind 100: 181 IC 681; *Ranjit Ray* v *D. A. David*, AIR 1935 Cal 218; *Molton Finance Ltd, Re*, [1967] 3 WLR 1561: [1967] 3 All ER 843; *F. L. E. Holdings Ltd, Re*, [1967] 1 WLR 1409: [1967] 3 All ER 553; *Calcutta National Bank* v *Kangaroo Tea Co*, AIR 1969 Cal 578. A court decree under which any property of a company may be attached is not a charge. *Suryakant Natvarlal Surati* v *Kamani Bros (P) Ltd*, (1985) 58 Comp Cas 121 Bom; *Praga Tools Ltd* v *Official Liquidator*, (1984) 56 Comp Cas 214 Cal. Registration is necessary only when the company's properties are charged, and not those of a director who guaranteed the company's debts. The charge against the director's property was effective though the charge on the company's property was not registered. *Maharashtra State Financial Corpn* v *Masvi & Co (P) Ltd*, (1993) 76 Comp Cas 168 at 193 Bom. As a consequence of winding up a creditor under an unregistered charge becomes an unsecured creditor, *Rajasthan Financial Corpn* v *Official Liquidator, Jaipur Spg and Wvg Mills Ltd*, (1986) 2 Ker 269; *Indian Bank* v *Official Liquidator Chemmeens Exports (P) Ltd*, (1998) 5 SCC 401: AIR 1998 SC 2111, a preliminary decree passed on the basis of an unregistered charge not objected to, nor appeal filed by the official liquidator, the company could not declare under S. 446 the decree to be void at the instance of the Official Liquidator.

24 *Monolithic Building Co, Re*, [1915] 1 Ch 643 CA, per PHILLIMORE J. cited with approval in *Smith* v *Bridgend Country Borough Council*, [2000] 1 BCLC 775 CA.

25 *Deutsche Bank* v *S. P. Kala*, (1999) 98 Comp Cas 841 Bom.

26 *Hamlet International plc, Re*, [1999] BCLC 506 CA.

transaction for sale of goodwill and other rights to, the company, it promised to pay the price by instalments. This was held to be not a charge on the assets of the company so as to require registration.[27]

An undertaking by a company with the backing of a resolution to create a charge on its assets was held to be not a present charge so as to require registration.[28]

Rectification of register [S. 141]

By Section 141, the Central Government has been empowered to allow extension of time for filing the particulars of a charge. An extension is allowed only where the omission was accidental, or due to inadvertence, or to some other sufficient cause, or it is not of nature as to prejudice the position of creditors or shareholders of the company or that on other grounds it is just or equitable to grant relief. No extension was allowed where there was an unexplained delay of two years and the only argument offered was that the creditor thought that the company must have obtained the registration.[29] Generally no extension is allowed once the company has gone into liquidation. Accordingly, refusing the relief in *Dinshaw & Co Bankers Ltd, Re,*[30], the court cited with approval the following observation from *Spiral Globe Co Ltd, Re*:[31]

> Upon a winding up the rights of the whole body of creditors intervene and their position would be very much prejudiced if time for registration were unconditionally extended.

In *Radha Kishen Moti Lal Chamaria* v *Ram Narain*[32] an extension was allowed but with due safeguards to the rights acquired by certain persons prior to the actual registration. Similarly it has been held in *Heathstar Properties Ltd, (No 2), Re*,[33] that—

> ...notwithstanding that an action was proceeding in which the validity of the equitable charge was in issue, the Court would, in the exercise of its discretion, extend the time for registering particulars of the charge,...where the risk of injustice to the company by extending the time of registration was far less than the risk of injustice to the chargeholder by refusing to extend the time.[34]

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27 *M. M. Hussain* v *Laminated Package P Ltd*, [2000] CLC 330 AP.

28 *ICICI* v *Official Liquidator, Usha Automobiles & Engg Co Ltd*, (2000) 100 Comp Cas 150 CLB.

29 *Reshma Estate (P) Ltd, Re*, (1977) 47 Comp Cas 447 Bom.

30 AIR 1937 Oudh 62.

31 [1902] 1 Ch 396. *See* also *Ehrmann Bros Ltd, Re*, [1906] 2 Ch 697 and *Chandbali Steamer Service Co, Re*, (1955) 60 CWN 278; *Heathstar Properties Ltd, Re*, [1966] 1 All ER 628: [1966] 2 Comp LJ 26; *Kris Cruisers Ltd, Re*, [1948] 2 All ER 1105.

32 AIR 1927 Oudh 300.

33 [1966] 1 All ER 1000: [1966] 2 Comp LJ 246 Ch D: [1966] 1 WLR 993.

34 PLOWMAN J at 251; *see* also *United Bank of India* v *K. C. Mullick & Sons*, [1966] 2 Comp LJ 255, where the Calcutta High Court held that where a company created a charge in 1954 which was registered and another charge in 1957 in favour of a bank, but was not registered, the former charge would survive against the liquidator of the company. Extension of time was refused where winding up was inevitable and not merely imminent. Administrators had concluded that rescue was not possible and creditors had finalised proposals for sale of assets

Rectification of the register was ordered where the registration form happened to mention only the movable property whereas both movable and immovable were to be covered.[35]

A company awaited credit facilities from a bank undertaking to offer the bank a charge on a block of assets after obtaining the consent of the first chargeholders' on those assets. It was held that the charge impliedly came into existence on the day the undertaking was given. The Company Law Board [now Central Government] ordered the charge to be registered within thirty days of the order.[36]

Where the application for rectification was filed after a long lapse of about five years and there was also the imminence of liquidation, the CLB [now Central Government] refused extension as it would have defeated the interest of other creditors.[37] Where due to inadvertence, the particulars relating to immovable property covered by the charge were not included in the form and without that the security was not worthwhile and no objection was received from any quarter, rectification was allowed.[38] Where the memorandum of satisfaction signed both by the company and the lending bank happened to be filed due to oversight while the charge was still subsisting, rectification of the register for restoring the charge was allowed.[39]

Rectification of the register was allowed where the particulars submitted for registration failed to disclose the correct registration number of the company. The registration number was a particular of the mortgagor and not that of the mortgage. The charge was validly registered.[40] A company assigned its interest in its immovable properties to another company but failed to register the assignment as a charge within the meaning of Section 125. An application by the assignee company for extension of time was allowed by the CLB [now Central Government]. The High Court refused to interfere in the matter.[41]

The Central Government does not have the power to examine the validity of the charge. It cannot order deletion of a charge which is already entered in the

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towards winding up. *Victoria Housing Estates Ltd, Re*, [1982] 3 All ER 665 and *Barrow Borough Transport Ltd, Re*, 1989 BCLC 653 Ch D: [1989] 1 WLR 858.

35 *Kesaria Tea Co Ltd, Re*, (1998) 91 Comp Cas 407 CLB. The Board can order rectification of omission or misstatements.

36 *Central Bank of India* v *Saraf Textile Industries Ltd*, (1998) 28 Corpt LA 62 CLB.

37 *Ravi Constructions* v *ROC*, [2000] 1 Comp LJ 115; *Karnataka Telecom Ltd* v *Ravi Constructions*, (2000) 23 SCL 14 CLB. No rectification is allowed where the charge is not registrable in its inception. *S. T. Patil* v *ROC*, (1998) 91 Comp Cas 578, here guarantee for payment of consideration for shares was given by the transferee and he understood not to retransfer shares till payment and there being no commitment from the company, hence, there was no charge requiring registration.

38 *R. K. Nutrisnax (India) P Ltd, Re*, (2000) 4 Comp LJ 185 CLB.

39 *IFB Finance Industries Ltd, Re*, (2000) 38 CLA 215 CLB. Where the CLB condoned delay but also passed remarks on the merits of the transaction, the High Court directed the Registrar to proceed according to law in rectifying the register without taking any influence of other remarks, *Choudhary Builders P Ltd* v *Sanghi Bros (Indore) Ltd*, [2000] 1 Comp LJ 236.

40 *Grove* v *Advantage Health (TIO) Ltd*, [2000] 1 BCLC 661 Ch D.

41 *Chaudhary Builders P Ltd* v *Sanghi Bros (Indore) Ltd*, (2000) 37 CLA 341 MP.

register. There is no power in this jurisdiction to require one creditor to deliver the original title deeds relating to the charge to another creditor.[42]

Appeal against Registrar's order

The order of the Registrar under Section 125(1)(proviso) or that of the Central Government under Section 141 is appealable whether it extends the time or rejects the application. The appellate court can take into account fresh evidence, because it is not a rehearing but a fresh exercise of discretion. The words "just and equitable" confer the widest possible discretion on the court and this carries the issue even beyond the matters specified in the section. Imminence of winding up is only one factor and not the final thing. Accordingly, the failure of the bank's solicitor in breach of his duty in getting the charge registered and the promptitude of the bank in taking immediate action on discovering the omission, was held to be a justifiable cause for an extension.[43]

Unregistered charge while company going concern

However, while the company is a going concern, a charge or mortgage, even though not registered under the Act, is valid. This was held in *Aung Ban Zeya* v *CRMA Chettiar Firm*,[44] where the High Court of Rangoon cited with approval the following observation from *Monolithic Building Co, Re*:[45]

> "Of course the deed is not void to all intents and purposes. It is a perfectly good deed against the company as long as it is a going concern."

Thus the purchaser of the assets of a company which were under an unregistered mortgage was held bound by the mortgage.[46]

Even in winding up, an unregistered charge has been allowed to stand where it was comprised in a decree and no objection was raised by the liquidator.[47]

The Oudh High Court enforced an agreement to create a charge even though the company, after making the agreement but before executing the charge, had gone into liquidation.[48] Referring to the section[49] the court said that it applies only when the charge is created by the company, and not when it arises by operation of law. The Bombay High Court, on the other hand, refused to order the specific enforcement of an agreement to create a charge after the

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42 *Times Bank Ltd* v *Shri Shardaparrameshwari Textiles Ltd*, (2000) 38 CLA 270 CLB. *Saradha Finance* v *Alsa Investment P Ltd*, (2002) 110 Comp Cas 713, CLB, the CLB (now Central Government) was approached for a direction to the company to file particulars of charge. The company disputed the creation of a charge and also the grant of credit facility to it. Disputed matters not to be adjudicated upon under this jurisdiction.

43 *Braemar Ltd, Re*, 1988 BCLC 556 Ch D. For further study, *see* Gerard McCormack, *Extension of Times for Registration of Company Charges*, 1986 JBL 282.

44 AIR 1927 Rang 288.

45 [1915] 1 Ch 643: 84 LJ Ch 441: 112 LT 619: [1914-15] All ER Rep 249.

46 *Marturi Umamaheshwara Rao* v *Pendayala Venkatarayudu*, (1970) 40 Comp Cas 751: AIR 1970 AP 225.

47 *Presidency Industrial Bank* v *H. L. Industries*, AIR 1969 Bom 84 at 89. A purchaser of property subject to an unregistered charge cannot say that he is also free from the charge. *Umamaheshwara* v *Venkatarayudu*, AIR 1970 AP 225.

48 *Hukam Chand* v *Pioneer Mills Ltd*, AIR 1927 Oudh 55.

49 S. 109 of the Act of 1913 (now S. 125).

commencement of winding up as that would amount to converting an unsecured creditor into a secured one.[50]

Procedure of Registration

Registration is effected by filing with the Registrar particulars of the charge or mortgage. The Registrar shall give a certificate of registration which shall be endorsed by the company on every debenture or certificate or debenture stock. Registration can also be obtained by the creditor himself. All that has to be done is to file the particulars within the prescribed time. Accordingly, it was held by the Allahabad High Court in *Benares Bank Ltd* v *Bank of Bihar Ltd*[51] that the section was complied with when particulars of the charge were sent within twenty-one days (now thirty days), although the Registrar neglected to register it for two and a half years. Nothing done by the Registrar on his own account after proper documents have been filed can affect the validity of the charge.

Pledge

A pledge of movable property does not require to be registered. Pledge is characterised by delivery of possession of the goods pledged to the creditor. Once the goods pass into the control of the creditor, the company does not enjoy a free use of them. This prevents the company from charging the goods over again. Hence no registration is necessary in such a case.[52]

Acquisition of Property Subject to Charge

If a company acquires a property which is subject to a subsisting charge, such a charge must also be registered in the same manner as if it were a charge created by the company itself. The registration must be effected within thirty days after the date of acquisition.[53]

Series of Debentures

Where a charge is created by virtue of a series of debentures issued by a company which entitle the debenture-holders to a *pari passu* distribution of the

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50 *Maneklal Mansukhbhai* v *Saraspur Mfg Co Ltd*, AIR 1927 Bom 167.

51 AIR 1947 All 117. To the same effect, *State Bank of India* v *Haryana Rubber Industries (P) Ltd*, (1986) 60 Comp Cas 472 P&H; *State Industrial and Investment Corpn of Maharashtra* v *Maharastra State Financial Corpn*, (1988) 64 Comp Cas 102 Bom; *State Bank of India* v *Depro Foods Ltd*, (1988) 64 Comp Cas 324; *Siva Sankara Panicker* v *Kerala Financial Corpn*, (1980) 50 Comp Cas 817 Ker; *N. Babu Janardhanam* v *Official Liquidator, Golden Cine Studios (P) Ltd*, (1993) 78 Comp Cas 490 Mad, where the documents were filed within time, but actual registration was done some eight months later when a winding up petition was pending and the registration was held to be effective.

52 S. 125. Registration is necessary for non-possessory securities. For illustrations see *R. Radhakrishnan Chettiar* v *Official Liquidator of Madras, Peoples Bank Ltd*, AIR 1943 Mad 73; *F. D. Jones & Co Ltd* v *Ranjit Roy*, AIR 1927 Cal 682; *Bank of Baroda* v *H. B. Shivdasani*, AIR 1926 Bom 427: 96 IC 417; *Tansukhrai M. Karundia* v *Official Liquidator of Andhra Paper Mills Ltd*, [1949] 2 MLJ 66.

53 S. 127. A penalty of Rs 5000 is leviable for default in complying with the requirements of the section.

assets charged, the application for registration will have to indicate the following particulars:[54]

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

(*b*) date of the resolution authorising the issue and the date of the deed;

(*c*) a general description of the property charged; and

(*d*) the names of the trustees, if any, for the debenture-holders.

A copy of the deed containing the charge has to be filed or, if there is no such deed, a copy of one of the debentures.

Payment of Commissions etc.

If any commission or allowance is paid to a person for subscribing or procuring subscription for debentures, the rate thereof must be indicated.[55] However, an omission to comply with this minor detail will not affect the validity of the charge.

Certificate of Registration

The Registrar gives a certificate of registration which indicates the amount secured. The certificate is conclusive evidence that the requirements as to registration have been complied with and that the mortgage or charge is properly registered, even though the particulars put forward are incomplete and the entry on the Registrar's register is defective.[56] Thus where a company demised its factory including chattels but in the application for registration the fact of chattels being included was not mentioned and the Registrar registered accordingly, it was held that the charge was nonetheless effective against the chattels.[57] The principle has been applied to other cases including where a wrong date was mentioned apparently to keep the application for registration within 21 days (now 30);[58] where the Registrar effected registration after the expiry of time without condoning the delay[59] and where the certificate was issued without putting the charge on the register.[60] In such cases the Registrar's decision is open to judicial review. Where the original proforma submitted for registration carried no date on it, the Registrar returned it for re-submission and then registered it from the earlier date, the Court of Appeal held that the Registrar's decision was open to judicial review.[61]

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54 S. 128.

55 S. 129. S. 142 contains penalty provisions for defaults.

56 The certificate of registration was held to be effective even where no other record of registration was available. *Maharashtra State Financial Corpn* v *Masvi & Co (P) Ltd*, (1993) 76 Comp Cas 168 Bom.

57 See ATKIN LJ in *National Provincial & Union Bank of England* v *Charnley*, [1924] 1 KB 431, 452: 130 LT 465. His Lordship relied upon *Yolland, Husson & Birkett Ltd, Re*, [1908] 1 Ch 152.

58 *Eric Holmes (Property) Ltd, Re*, [1965] 2 All ER 333. [1966] 1 Comp LJ 19: [1965] Ch 1052: *Mechanisations (Eaglescliffe) Ltd, Re*, [1964] 3 All ER 840: [1966] Ch 20: [1965] 2 WLR 702.

59 *Desraj, Voluntary Liquidator* v *Punjab Financial Corpn*, (1970) 40 Comp Cas 551 P&H.

60 *Bank of Maharashtra* v *Official Liquidator*, (1973) 43 Comp Cas 505 Mys.

61 *R* v *ROC, ex p. Central Bank of India*, [1986] 1 All ER 105 CA; *R* v *ROC*, [1985] 2 All ER 79 QBD.

But the rule will not allow a person to take the advantage of his own wrong. Thus where a banker's solicitor, having omitted to register a charge for quite a few months, ultimately got it registered under a wrong description, and winding up having followed within a few days, the Court held that the certificate was not conclusive.[62] If a person intentionally abstains from mentioning a part of his security, he cannot rely on the conclusiveness of the certificate as against a person who has been misled by the partial registration.[63]

A copy of the certificate has to be endorsed on every debenture.[64] Any alteration in the terms and conditions of the charge must be intimated to the Registrar,[65] otherwise the modification would be ineffective. In a case before the Madras High Court,[66] a company increased the rate of interest in consideration of the lender not enforcing the security for sometime, but did not inform the Registrar, it was held that the agreement had become void after the commencement of winding up, but that the increased interest already paid was not recoverable.[67] The Registrar must again be intimated when the charge is satisfied or paid off.[68] On the receipt of this intimation the Registrar informs the chargeholder and if he raises no objection, a memorandum of satisfaction is entered in the register of charges.[69] If any objection is raised, the Registrar records the same and informs the company accordingly.[70] The Registrar may enter such a memorandum of satisfaction even when no such intimation has been received from the company provided he is satisfied on evidence that the charge has been paid off or the property has been cleared of it. But he must inform the company.[71]

Register of charges

A register of charges has to be maintained both by the Registrar[72] and the company.[73] The Registrar has to keep in respect of each company a register

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62 *C. L. Nye Ltd, Re*, [1969] 2 All ER 587; Affirmed on appeal, [1970] 3 WLR 158.

63 An *obiter* observation of ATKIN LJ in *Charnley* case, [1924] 1 KB 431 at 454.

64 S. 133. A default in complying with the requirements of the section is punishable with fine up to Rs 10,000.

65 S. 135.

66 *Official Liquidator* v *Bharatpur Princess Trust, Mysore*, (1971) 41 Comp Cas 978 Mad.

67 Relying upon its own decision in *Tyagrajan* v *Official Liquidator*, (1960) 30 Comp Cas 381: [1959] 2 MLJ 294.

68 S. 138. Satisfaction (payment of the debt) of the charge has to be brought on the Registrar's record within 30 days of payment. As a matter of practice, a letter of satisfaction from the chargeholder is filed. Where the bank delayed in giving to the company its letter and consequently the company also delayed filing of satisfaction, the CLB condoned the delay on the part of the company because the company had relied on a circular of the Deptt of Company Affairs. *Swaraj Mazda Ltd, Re*, (1992) 73 Comp Cas 569 CLB. The matter is also clarified in the Deptt's Circular No 26/91 and No 10/91.

69 S. 138(3). Where the Registrar entered the memorandum of satisfaction before the expiry of the time allowed to the chargeholder for stating his objection, the entry was struck down. See *Walford Transport Ltd* v *ROC*, (1980) 50 Comp Cas 600 Gau.

70 S. 138(4).

71 S. 139.

72 S. 130. S. 131 requires the Registrar to keep the register in chronological index, in the prescribed form and with prescribed particulars relating to the charges registered with him.

73 S. 143. There are penalty provisions in the section.

containing the particulars of all the charges requiring registration. The company is under a duty to forward to the Registrar the necessary particulars in such form and on payment of such fee as may be prescribed. The Registrar's register has to show the particulars relating to the charge such as the date of a charge. the amount secured, the property covered and the persons entitled to the charge and if a property already under a charge has been purchased, the date of purchase. The same particulars have to be shown by the company's register. The instruments creating charges and the register of charges are open to the inspection of any creditor or member without fee and to any other person on payment of such fee as may be prescribed.[74]

Rights of chargee

Chargee's rights depend upon the terms and conditions agreed upon by the parties. To such express rights, a new kind of right by implication has been added by a decision of the English Court of Appeal.[75] A colonising company's progress of work, which was financed through a bank, was very slow so that the funds were exhausted and interest accumulated. The bank agreed to provide more money if the architects who were the cause of delay, were changed by a more respectable firm. That was accordingly done. The firm so removed sued the bank for the tort of inducing breach of contract. It was held that a charge-holder becomes so closely identified with the project that he gets the right to bring about suitable changes in the staff.

Loans to companies [S. 370]

[Provisions stated here have been changed by the Companies (Amendment) Ordinance, 1999. *See* under S. 372-A]

INVESTMENTS

Investment in other companies [S. 372]

[Provisions stated here have been changed by the Companies (Amendment) Ordinance, 1999. *See* under S. 372-A]

Inter-corporate Loans and Investments [S. 372-A][76]

By an amendment introduced by the Companies (Amendment) Act, 1999, the provisions of S. 370 relating to inter-corporate loans and those of S. 372 relating to inter-corporate investments have been revised by abrogating them first and then substituting them by a single section, namely, Section 372-A. The

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74 S. 144. Particulars have to be filed with the Registrar in Form 13 with a fee of Rs 10. Form 13 has to be accompanied with Form 8, 10 or 17 as the case may be (Rule 6). The register is open to inspection by any person on payment of fee of Rs 10 for each inspection. [Rule 6-A, Companies (Central Government's) General Rules and Forms, 1956]. Delay in filing the form would require condonation of the CLB under S. 141. Deptt of Co Affairs, No 3123/89 CLV of 21-3-1990; 1990 Chartered Secy 294. The company's register and instruments can be inspected on payment of Rs 10. Rule 21-A of the Companies (Central Government's) General Rules and Forms, 1956. There are penalty provisions in the section.

75 *Edwin Hill & Partners* v *First National Finance Corpn*, 1989 BCLC 89 CA.

76 The Ordinance was first promulgated in Oct 1998 and made effective from Oct 31, 1998. It was subsequently converted into a Bill with some changes. The Bill became an Act in 1999, enforcement date remaining the same.

amendment has the effect of saying that the provisions of Sections 370 and 372 shall not apply and those of Section 372-A will take over the matter of such loans and investments. The main and the most primary change is that the requirement of the Central Government approval has been dispensed with. Companies are now thus free from the shackles of control on inter-corporate loans and investments. The only control mechanism now is wholly internal. The Board of directors can invest or advance up to 60% of their own decision and beyond that with the special resolution of the shareholders.

The new provisions are as follows:

A company can advance loans to other companies or invest in the securities of other companies up to 60% of the paid-up share capital and free reserves or up to 100% of free reserves, which is more. The transactions covered under the provision are:

(*a*) loans to any body corporate;

(*b*) guarantee or security for any loan given or taken by a body corporate;

(*c*) acquiring, by way of subscription, purchase or otherwise the securities of any body corporate.

The notice of a meeting of shareholders called for the purpose of giving previous approval of loans and investment beyond 60% must disclose clearly the specific limits, the particulars of the body corporate in which the investment is proposed to be made or loan or security or guarantee to be given, the purpose of the investment, etc, specific sources of funding and other allied details.

The Board of directors can give a guarantee without the authority of a special resolution:

(*a*) if the Board is so authorised by its own resolution to give the guarantee in accordance with the provisions of the section;

(*b*) if some exceptional circumstances are preventing the process of obtaining a special resolution;

(*c*) if the resolution of the Board is confirmed at a general meeting within 12 months or at the annual general meeting held after the guarantee whichever is earlier.

The requirements of sub-section (1) and (2) are not to apply to any loan made by a holding company to its wholly-owned subsidiary; any guarantee given on any security provided by a holding company in respect of loans made to its wholly-owned subsidiary; or acquisition by a holding company, by way of subscription, purchases or otherwise, the securities of its wholly owned subsidiary.

A company which has defaulted in making payment of fixed deposits or interest due on them cannot, during the period of such default, make any loans, investments or provide any guarantee.

The rate of interest to be charged on loans must not be less than the prevailing bank rate of interest, which shall mean the standard rate made public under Section 49 of the RBI Act, 1934.

The decision of the Board of directors must be at a meeting sanctioning the transaction by a resolution passed with the consent of all the directors present at

the meeting and also prior approval of any such public financial institution must be taken whose term loan with the company is subsisting. Prior approval of a financial institution is not required where the 60% limit is not to be exceeded and there are no defaults in payments towards the institution.

Register of investments-loans [S. 372-A(5)].—The company has to keep a register showing the particulars about investments, loans, guarantees and securities:

1. the name of the body corporate;
2. the amount, terms and purpose of the investment or loan or security or guarantee;
3. the date on which the investment or loan has been made;
4. the date on which a guarantee or security has been provided in connection with a loan.

The particulars should be entered in the register chronologically within seven days of the making of loans or investment, etc.

This register has to be kept at the registered office of the company. It should be available for inspection to members who may also take extracts and may demand copies on a similar fee as is applicable in respect of the register of members.[77]

Rule-making power.—The Central Government may prescribe regulations for the purposes of this section.[78]

Exceptions.—The provisions of the section do not apply in respect of the following transactions:[79]

1. a banking company, insurance company or a housing finance company for transactions made in the ordinary course of business, a company established with the sole object of financing industrial enterprises or for providing infrastructural facilities;
2. a company whose principal business is the acquisition of shares, stock, debentures or other securities.
3. a private company, unless it is the subsidiary of a public company.

Sub-section (8) exempts subscription of shares pursuant to Section 81(1)(*a*) (further issue of capital) from compliance with the provisions.

Penalty provisions [S. 372-A(9)].—Two kinds of default have been identified and given different treatment, one is the violation of the main provision and the second is default in maintaining the register. A very light penalty is provided in the matter of the register. The company and every officer of the company who is in default is punishable with fine extending to Rs 5000 and also with a further fine up to Rs 500 for every day during which the default continues.

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77 Provisions of S. 163 would apply. Sub-s. (6).
78 S. 372-A(7).
79 S. 372-A(8).

For failure to comply with the main provisions of the section, the company and every officer of the company who is in default is liable to be punished with fine extending to fifty thousand rupees or imprisonment which may extend to two years. Where any loan or investment made in violation of the section has been recovered, the punishment by way of imprisonment is not to be inflicted and where recovery is only partial, the term of imprisonment is to be appropriately reduced.

Where the company suffers any loss because of the contravention, as for example, loans have become irrecoverable, the investment has been lost, or the security has been attached by the security holder or payment under guarantee has been enforced, all the persons who were knowingly a party to the contravention would be jointly as well as severally liable to make good the company's loss.

Loans.—The *Explanation* to the section says that for the purposes of the section "loan" includes debentures or any deposit of money made by one company with another company, except where the depositee company is a banking company.

Free reserves.—"Free reserves" means those reserves which, as per the latest audited balance sheet of the company, are free for distribution as dividend. It also includes the amount of premium received on issue of securities but does not include share application money.[80]

Investments in own name [S. 49]

Section 49 requires that "all investments made by a company on its own behalf shall be made and held by it in its own name". If the company's nominee or director becomes on its behalf a director in another company and is required to hold qualification shares, they may be held jointly in the name of the company and such person.[81] Where a company advances money to another company by way of a loan to enable the borrowing company to make investment in its shares, that does not amount to investment in shares by the lending company in another company's name.[82]

The section recognises a few exceptions also. Firstly, the section does not apply to investments made by a company whose principal business consists of buying and selling of shares or securities.[83] Secondly, a company may hold shares in its subsidiary company in the name of one or more nominees if it is necessary to ensure the number of members from going below the statutory minimum.[84] Thirdly, a company may deposit with its bankers, shares or securities for collection of dividends or to facilitate their transfer.[85] If the transfer is not effected

80 *Explanation* (*b*).

81 S. 49(2). Company's shares held jointly with a director did not constitute him into exclusive owner for exercising ownership rights of his own. *Exchange Travel (Holdings) Ltd. Re*, (1991) BCLC 728 Ch D.

82 *Hemangini Finance & Leasing (P) Ltd* v *Tamil Nadu Mercantile Bank Ltd.* (1996) 86 Comp Cas 875 CLB.

83 S. 49(4).

84 S. 49(3).

85 S. 49(5).

within six months, they shall be held back by the company in its own name.[86] Fourthly, a company may transfer its shares or securities to another person as a security for a loan or the performance of an obligation.[87]

A further exception has been added under the consequential amendment of the section by the Depositories Act, 1996. A company can hold investments in the name of a depository when such investments are in the form of securities held by the company as a beneficial owner. All such exceptional transactions have to be entered in a register so as to enable their identification and the name in which they are held.

Form of contracts [S. 46]

The brief purpose of the section is to declare that contracts of a company can be made in the same manner in which they can be made by an individual whether they be written or oral. Accordingly, the section says that a written contract can be made on behalf of a company by any person acting under its authority, whether express or implied. An oral contract can also be made in the same manner. Where a debenture was signed not by the director of a company but by the person to whom the director had given his power of attorney, the company was not permitted to question the validity. Section 9(1) of the European Communities Act, 1972 presumes good faith in favour of a person dealing with a company and he is not bound to inquire either into the limitations on the powers of directors or the capacity of the company.[88] (New provisions in the 1989 Act [English] are in Sections 35-A and 35-B).

No personal liability arises under contracts signed for the company. A clause in the contract providing for personal liability of the signatory would be ineffective unless both sides understand that the contract is being on the basis of personal liability.[89]

Execution of deeds and use of seal [S. 48]

Formal deeds can be executed only through a power of attorney. Section 48 accordingly provides that a company may, by writing under its common seal, appoint any person as its attorney and he may, in the exercise of his power, execute deeds on behalf of the company. Such a deed binds the company to the same effect as if it were under the company's common seal.[90] The seal is a method of making a physical impression upon the documents of the company of its name etc. The seal can be used by the authority of the directors or of a

86 *Ibid.*, proviso.

87 S. 49(5)*(b)*.

88 *ICB Ltd* v *Gray*, [1986] 1 All ER 587 Ch D 7.

89 *Montogomery Litho Ltd* v *Maxwell*, [2000] Scot Cases 56, HL—Scotland.

90 For documents to be executed outside India, S. 50 lays down the procedural requirements. It says that a company whose business requires transactions outside India, it may, in accordance with its articles, have a seal in that territory, which shall be facsimile of the common seal of the company, mentioning in addition the name of the place where it is going to be used. A person should be authorised in writing to use that seal in that area. Authority of any such person shall remain effective during the specified period, if any, or until revoked. The person using the seal must mention the date and place.

committee of directors authorised by directors.[91] The directors may determine who shall sign any instrument to which the seal is affixed, otherwise such a document has to be signed by a director and by the secretary. A company transacting business in foreign countries may have in accordance with its articles its official seal in a foreign country, which is a facsimile of the company's common seal and should include the name of the place where it is to be used.

The requirement of common seal has been dispensed with under S. 36-A(3) of the English Companies Act, 1985. Hence, it is no longer necessary for authenticating the company's formal documents.

Section 48 comes into play when a person wants to enforce obligations against a company arising out of a contract and the company denies the contract or disputes its liability. The section cannot be used where the proceeding is by the company. The validity of the appointment of a person as an adviser of the company was not allowed to be questioned by the appointee because of the lack of any formality. The company had not denied its obligation under the appointment.[92]

Authentication of documents and proceedings [S. 54]

Documents or proceedings which require to be authenticated by the company, may be signed by any director, or manager, or secretary or by any other authorised officer of the company. Common seal would not be necessary in such a case. A representation signed on behalf of a company by a duly authorised agent acting within the scope of his authority or by an officer or employee of the company acting in the course of his duties in the business of the company constitutes a representation made by the company and signed by it.[93]

A suit for recovery of insurance money was filed by the managing director of the claimant company. He could not produce any authentic document showing his authority to proceed on behalf of the company. The suit was not allowed.[94] A criminal complaint on behalf of the company which was the payee of a cheque must be filed with the authority of the Board of directors or in accordance with the company's article or rules governing the management of the company's affairs. A complaint filed by the manager was held to be not competent because he had nothing to show his authority for institution of proceedings.[95]

A writ petition filed with no material to show that the person signing the petition was authorised by the Board of directors was held to be not competent.[96]

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91 *G. Subba Rao* v *Rasmi Die Castings Ltd*, AIR 1998 AP 95, memorandum of understanding signed about a debt by the MD of the company but not indicating that he was signing for and on behalf of company he was also not authorised to affix common seal, company not bound.

92 *Sociedade de Fomento Industrial Ltd* v *Ravindranath Subraya Kamar*, AIR 1999 Bom 158.

93 *UBAF Ltd* v *European American Bkg Corpn*, [1984] 2 All ER 226 CA.

94 *H.P. Horticultural Produce Marketing & Processing Corpn Ltd* v *United India Ass Co Ltd*, AIR 2000 HP 11; *Rajendra Paper Mills* v *Indian Security Press*, (2000) CLC 1438 Delhi, no proof that the director who filed the suit was duly authorised.

95 *Nayagam Lourds Prakash* v *Standard Chartered Bank*, (2003) 115 Comp Cas 161 (AP).

96 *Klen & Marshalls Manufacturers & Exporters Ltd* v *State of J&K*, (2000) 100 Comp Cas 180 Kant.

Bill of exchange and promissory note [S. 47]

In the case of legal persons, who cannot act by themselves, and who can act only through representatives, the mode of authentication also becomes very important. The signature must be that of an authorised person and the name of the company has to be mentioned in such a manner as to make the intention to bind the company quite explicit. Section 47 of the Companies Act, 1956 declares:

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

Whether the person signing is actually authorised or not depends upon the arrangements of the company with its officers, as examined in the light of principles of the law of agency, but the mode of signature is an external matter. Where a promissory note was executed on a paper the top of which bore the rubber stamp of the company and was signed: "*Joshi, Treasurer*", an intention to bind the company was held to be clear.[1] But where a note was endorsed in this manner:

> "Mitter & Sons,
> Managing Agents,
> Lister Antiseptic Co Ltd.",

it was held that the intention to involve the responsibility of the company was not clear from the endorsement.[2] Misdescription of the name of the company may not, however, affect the liability of the company. "A limited company has characteristics other than its name by reference to which it can be identified."[3] Those signing, however, do incur personal liability when they misdescribe the name of the company.[4]

> Where cheques were drawn on behalf of a company without using the formal word "for" or "on behalf of", and were paid by the bank because the persons signing were duly authorised and the intention to operate the company's account was also clear, the bank was held to be discharged from its liability.[5]

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1 *Poona Chitrashala Steam Press* v *Gajanan Industrial & Tramway Co*, AIR 1923 Bom 29. See also *P. Rangaswami Reddiar* v *R. K. Reddiar*, (1973) 43 Comp Cas 232 Mad. *Kirlampudi Sugar Mills Ltd* v *G. Venkata Rao*, (2003) 114 Comp Cas 563 AP, promissory note for borrowing money signed by the chief executive on behalf of the company made the company liable though the borrowing was not reflected by the company's account books.

2 *Sreelal Mangatulal* v *Lister Antiseptic Dressing Co Ltd*, AIR 1925 Cal 1062.

3 *Goldsmith (Sicklesmere) Ltd* v *Baxter*, [1969] 3 WLR 522: [1969] 3 All ER 733: [1970] 1 Ch 85: (1970) 40 Comp Cas 809.

4 *Hendon* v *Adelman*, The Times, June 16, 1973; (1973) New LJ 637 and S. 147 of the Companies Act.

5 *B. M. Bank* v *Oriol Industries*, AIR 1956 Bom 57; on appeal to the Supreme Court, *Oriol Industries* v *B. M. Bank*, AIR 1961 SC 993.

Where a promissory note was executed by the chief executive of the company for the money borrowed for the purposes of the company on which the company's seal was affixed, it was held that the new management of the company could not deny the execution of the note and was liable as a successor-in-interest.[6]

Liability for dishonour

The company, every person who was incharge of the company's affairs at the time of the issue of the cheque and every other officer whose connivance or negligence brought about the debacle can be prosecuted under Section 138 of the Negotiable Instruments Act, 1881 for dishonour of the company's cheque.[7] A prosecution was not quashed although the director in question asserted that he was not participating the company's affairs. He was however, exempted from personal attendance.[8] A notice sent to the managing director, who was the signatory of the cheques, at the company's address was held to be good notice for prosecuting him.[9]

EMPLOYEES' SECURITIES AND PROVIDENT FUNDS

Deposit of employees' securities [S. 417]

Money received from employees by way of security deposit must be deposited in the manner prescribed by the section within 15 days from the date of receipt. The openings for depositing the money which are allowed are a Post Office account or a special account with the State Bank or a Scheduled Bank or, where the company itself is a Scheduled Bank, in a special account to be opened by the company in itself, or in the State Bank or any Scheduled Bank.

The money or securities so received are not to be used for any purposes except those agreed to in the contract of service. A receipt granted for money deposited with the company is not a security for the purposes of this section and, therefore, ought to be treated as money received. Any other way of handling such money may amount to breach of trust.[10]

Provident funds of employees [S. 418]

A company constituting a provident fund for its employees or any section of them must deposit contributions from both sides and accruals within 15 days in a Post Office account or in a special account in the State Bank or any Scheduled Bank. But where the company itself is a Scheduled Bank, it may keep the amount with itself in a special account or in the State Bank or any Scheduled Bank. Alternatively, the amount may be invested in trust securities as enumerated in clauses (*a*) to (*e*) of Section 20 of the Indian Trusts Act, 1882. The interest yielded by the investment is the maximum that an employee can

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6 *Kirlampudi Sugar Mills Ltd* v *G. Venkata Rao*, (2003) 114 Comp Cas 563 AP.
7 *Anil Hada* v *Indian Acrylic Ltd*, (2000) 99 Comp Cas 56 SC.
8 *V. K. Jain* v *UOI*, (2000) 100 Comp Cas 827 SC.
9 *Bilakchand Gyanchand & Co* v *A. Chinnaswami*, (1999) 98 Comp Cas 573.
10 See *Satpal Bakshi* v *Durgadas*, [1988] 1 Comp LJ 77 Del, where, however, the prosecution failed owing to lack of proper proofs.

claim even if the rules governing the fund or the contract with the employees contain different provisions.

Where the fund becomes a recognised fund within the meaning of clause (*a*) of Section 58-A of the Indian Income Tax Act, 1922 or where the rules of the fund contain provisions corresponding to Rules 4-9 of the Indian Income Tax (Provident Fund Relief) Rules, an employee shall have the right to withdraw the sum standing to the credit of his account or take advances from it.

Where a trust has been created of such a fund, the money must be given to the trustees within 15 days. Other things will remain the same except that instead of the company, it shall be the responsibility of trustees to administer the fund.[11]

Employees or their trustees have the right to look at the bank receipts.[12] Section 420 spells out penalties for contravention.

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11 See *Anil Mohan Banerjee* v *ROC*, (1979) 49 Comp Cas 338 Cal.

12 S. 419. The word "employee" means present employee and not a past one whether retired or removed. *State* v *Gridharilal Bajaj*, AIR 1962 Bom 130: (1962) 32 Comp Cas 1114.