

## PAPER – 3 : BUSINESS AND CORPORATE LAWS

Question Nos. 1 and 7 are compulsory.

Candidates are required to attempt four questions out of Questions Nos. 2, 3, 4, 5 and 6 and two questions out of Questions Nos. 8, 9 and 10

### Question 1

Answer any four of the following:

- (a) Point out with reasons whether the following agreements are valid or void:
- (i) Kamala promises Ramesh to lend Rs. 50,000 in lieu of consideration that Ramesh gets Kamala's marriage dissolved and himself marries with her.
  - (ii) Sohan agrees with Mohan to sell his black horse. Unknown to both the parties, the horse was dead at the time of agreement.
  - (iii) Ram sells the goodwill of his shop to Shyam for Rs. 4,00,000 and promises not to carry on such business forever and anywhere in India.
  - (iv) In an agreement between Prakash and Girish, there is a condition that they will not institute legal proceeding against each other without consent..
  - (v) Ramamurthy, who is a citizen of India, enters into an agreement with an alien friend.
- (5 Marks)
- (b) A, B and C were joint owners of a truck and possession of the said truck was with B. X purchased the truck from B without knowing that A and C were also owners of the truck. Decide in the light of provisions of the Sale of Goods Act, 1930, whether the sale between B and X is valid or not ?
- (5 Marks)
- (c) What are the provisions regarding set on and set off of the allocable surplus under the Payment of Bonus Act, 1965 ?
- (5 Marks)
- (d) What do you mean by "implied authority" of the partners in a firm? Point out the extent of partner's implied authority in case of emergency, referring to the provisions of the Indian Partnership Act, 1932.
- (5 Marks)
- (e) Bharat executed a promissory note in favour of Bhushan for Rs. 5 crores. The said amount was payable three days after sight. Bhushan, on maturity, presented the promissory note on 1<sup>st</sup> January, 2008 to Bharat. Bharat made the payments on 4<sup>th</sup> January, 2008. Bhushan wants to recover interest for one day from Bharat. Advise Bharat, in the light of provisions of the Negotiable Instruments Act, 1881, whether he is liable to pay the interest for one day ?
- (5 Marks)
- (f) Explain the provisions of the Employees' Provident Fund and Miscellaneous Provisions Act, 1952 regarding the following:
- (i) rate of interest on amount due from the employer under the Act.
  - (ii) maximum limit of interest rate

(iii) the period for which the employer is liable to pay the said interest. (5 Marks)

Answer

(a) Validity of agreements (The Indian Contract Act, 1872)

- (i) Void Agreement: As per Section 23 of the Indian Contract Act, 1872 an agreement is void if the object or consideration is against the public policy.
- (ii) Void Agreement: As per Section 20 of the Indian Contract Act, 1872 the contract caused by mistake of fact are void. There is mistake of fact as to the existence of subject-matter.
- (iii) Void agreement: As per Section 27 of the Indian Contract Act, 1872 an agreement in restraint of trade is void. However, a buyer can put such a condition on the seller of good will, not to carry on same business. However, the conditions must be reasonable regarding the duration and the place of the business.
- (iv) Void agreement: An agreement in restraint of legal proceedings is void as per Section 28 of the Indian Contract Act, 1872.
- (v) Valid agreement: An agreement with alien friend is valid, but an agreement with alien enemy is void.

(b) Sale by joint owner (Sale of Goods Act, 1930)

This problem is based on Section 28 of the Sale of Goods Act, 1930 which lays down an exception to the general rule that a person cannot transfer a better title than that he himself possess. A person who is one of joint owners may transfer a better title that he possesses. Section 28 provides that – “if one of several joint owners of goods has the sole possession of them by permission of the co-owners, the property in goods is transferred to any person who buys them to such joint owner in good faith and has not at the time of the contract of sale notice that the seller has not authority to sell”.

The given problem fulfills all such requirements. A, B and C are joint owners of Truck. B had its sole possession. In such a case if X has purchased the truck from B in good faith without notice that at the time of sale B had no authority to sell, then X acquires good title and becomes full owner although B was not the full owner.

(c) Set on and set off of allocable surplus (The Payment of Bonus Act, 1965)

Where for any accounting year the allocable surplus exceeds the amount of maximum bonus payable to the employees in the establishment under Section 11, then the excess shall, subject to a limit of 20% of the total salary or wage of the employees employed in the establishment in that accounting year, be carried forward for being set on in the succeeding accounting year and so on up to and inclusive of the 4<sup>th</sup> accounting year. This excess is to be utilized for the purpose of payment of bonus, in the manner illustrated in Fourth Schedule.

There may be a case where there is no allocable surplus or where the allocable surplus falls short of the amount of minimum bonus payable to the employee under Section 10 and there is no amount or sufficient amount carried forward and set on under the

aforesaid provisions which could be utilized for paying minimum bonus. In such a situation minimum amount or the deficiency as the case may be, shall be carried forward for being set off in the succeeding accounting year and so on up to and inclusive of the 4<sup>th</sup> accounting year in the manner illustrated in Fourth Schedule.

Where in any accounting year any amount has been carried forward and set on or set off under this Section, then in calculating bonus for the succeeding accounting year, the amount of set on or set off carried forward from the earliest accounting year shall first be taken into account.

(d) Implied authority of partner (Indian Partnership Act, 1932)

As per Section 19 of the Indian Partnership Act, 1932 "Subject to the provisions of Section 22, the act of a partner which is done to carry on, in the usual way, the business of the kind carried on by the firm binds the firms". The authority of a partner to bind the firm conferred by this section is called his 'implied authority'. Section 21 of the Act provides that a partner has authority in an emergency to do all such act for the purpose of protecting the firm from the loss as would be done by a person of ordinary prudence, in his own case, acting under similar circumstances, and such acts bind the firm. Conditions for the authority of a partner in an emergency:

- (i) The act should be done by the partner in an emergency
- (ii) The act of the partner should be for the purpose of protecting the firm from loss.
- (iii) The act should be, as a person of ordinary prudence would do in his own case.
- (iv) Such act should bind the firm.

To protect the firm, a partner has an authority to do all such acts in emergency to save the firm from loss. It may be noticed that the powers of a partner to act in an emergency are similar to those of an agent in similar circumstances under Section 139 of the Indian Contract Act, 1872.

(e) Claim of Interest (the Negotiable Instruments Act, 1881)

Section 24 of the Negotiable Instruments Act, 1881 states that where a bill or note is payable after or after sight or after happening of a specified event, the time of payment is determined by excluding the day from which the time begins to run.

Therefore, in the given case, Bharat will succeed in objecting to Bhushan's claim. Bharat paid rightly "three days after sight". Since the bill was presented on 1<sup>st</sup> January, Bharat was required to pay only on the 4<sup>th</sup> and not on 3<sup>rd</sup> April, as contended by Bharat.

(f) Rate, limit and period of payment of interest (The EPF and MP Act, 1952)

As per Section 7Q of the Employees Provident Fund and Miscellaneous Provisions Act, 1952

- (i) the employer shall be liable to pay simple interest at the rate of 12 per cent per annum or at such higher rate as may be specified in the Scheme on any amount due from him under this Act.
- (ii) although limit of interest rate is not given in the Act, but it is clearly given the higher

rate of interest specified in the Scheme cannot exceed the lending rate of interest of any scheduled bank.

- (iii) the period for which the employer is liable to pay the interest is from the date which the amount has become so due till the date of its actual payment.

#### Question 2

- (a) Ravi sent a consignment of goods worth Rs. 60,000 by railway and got railway receipt. He obtained an advance of Rs. 30,000 from the bank and endorsed and delivered the railway receipt in favour of the bank by way of security. The railway failed to deliver the goods at the destination. The bank filed a suit against the railway for Rs. 60,000. Decide in the light of provisions of the Indian Contract Act, 1872, whether the bank would succeed in the said suit? (5 Marks)
- (b) State the privileges of a Cooperative Society registered under the Cooperative Society Act, 1912 relating to the exemption from Income-tax, Stamp duty and Registration fee. (5 Marks)

#### Answer

- (a) Rights of Bailee (The Indian Contract Act, 1872)

As per Sections 178 and 178A of the Indian Contract Act, 1872 the deposit of title deeds with the bank as security against an advance constitutes a pledge. As a pledge, a banker's rights are not limited to his interest in the goods pledged. In case of injury to the goods or their deprivation by a third party, pledgee would have all such remedies that the owner of the goods would have against them. In *Morvi Mercantile Bank Ltd. vs. Union of India*, the Supreme Court held that the bank (pledgee) was entitled to recover not only the amount of the advance due to it, but the full value of the consignment. However, the amount over and above his interest is to be held by him in trust for the pledgor. Thus, the bank will succeed in this claim of Rs. 60,000 against Railway.

- (b) Privileges of society under the Cooperative Societies Act, 1912

Section 28 of the Co-operative Societies Act, 1912 provides privilege to the registered society an exemption from payment of income tax Stamp duty and registration fees as follows:

- (i) The Central Government may, by notification in the Official Gazette, remit the income tax payable in respect of the profits of any registered society or class of registered society, or of the dividends or other payments received by the members of the society on account of profits [Sub-Section (1)].
- (ii) The Government, by way of notification in the Official Gazette, may, in the case of registered society, remit
- (a) the stamp duty with instruments executed by or on behalf of a registered society or by an officer or member and relation to the business of such society, are chargeable and

(b) any fees payable under the law of registration [Sub-Section (2)]

In sub-section (2), 'Government' means Central Government in relation to stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts and in relation to any stamp duty falling within Entry 96 in List I in the Seventh Schedule to the Constitution. Same as aforesaid, 'Government' means the State Government.

### Question 3

(a) R is the wife of P. She purchased some sarees on Credit from Q. Q demanded the amount from P. P Refused. Q filed a suit against P for the said amount. Decide in the light of provisions of the Indian Contract Act, 1872, whether Q would succeed?

(5 Marks)

(b) A, B and C are partners in a firm. As per terms of the partnership deed, A is entitled to 20 percent of the partnership property and profits. A retires from the firm and dies after 15 days. B and C continue business of the firm without settling accounts. What are the rights of A's legal representatives against the firm under the Indian Partnership Act, 1932?

(5 Marks)

### Answer

(a) Problem on Agency (Indian Contract Act, 1872)

Problem as asked in the question is based on the provisions related with the modes of creation of agency relationship under the Indian Contract Act, 1872. Agency may be created by a legal presumption; in a case of cohabitation by a married woman (i.e. wife is considered as an implied married agent, of her husband). If wife lives with her husband, there is a legal presumption that a wife has authority to pledge her husband's credit for necessaries. But the legal presumption can be rebutted in the following cases:

- (i) Where the goods purchased on credit are not necessaries.
- (ii) Where the wife is given sufficient money for purchasing necessaries.
- (iii) Where the wife is forbidden from purchasing anything on credit or contracting debts.
- (iv) Where the trader has been expressly warned not to give credit to his wife.

If the wife lives apart for no fault on her part, wife has authority to pledge her husband's credit for necessaries. This legal presumption can be rebutted only in cases (iii) and (iv).

Applying the above conditions in the given case 'Q' will succeed. He can recover the said amount from 'P' if sarees purchased by 'R' are necessaries for her.

(b) Retirement / Death of Partner (Indian Partnership Act, 1932)

Section 37 of the Indian Partnership Act, 1932 provides that where a partner dies or otherwise ceases to be a partner and there is no final settlement of account between the legal representatives of the deceased partner or the firms with the property of the firm, then, in the absence of a contract to the contrary, the legal representatives of the

deceased partner or the retired partner are entitled to claim either.

- (i) Such shares of the profits earned after the death or retirement of the partner which is attributable to the use of his share in the property of the firm; or
- (ii) Interest at the rate of 6 per cent annum on the amount of his share in the property.

Based on the aforesaid provisions of Section 37 of the Indian Partnership Act, 1932 A, in the given problem, A shall be entitled, at his option to:

- (i) the 20% shares of profits (as per the partnership deed); or
- (ii) interest at the rate of 6 per cent per annum on the amount of A's share in the property.

#### Question 4

- (a) Mr. Amit was shopping in a self-service Super market. He picked up a bottle of cold drink from a shelf. While he was examining the bottle, it exploded in his hand and injured him. He files a suit for damages against the owner of the market on the ground of breach of condition. Decide, under the Sale of goods Act, 1930, whether Mr. Amit would succeed in his claim? (5 Marks)
- (b) State the eligibility and disqualification of the members of a Multi-State Cooperative Society under the provisions of the Multi-State Cooperative Society Act, 1984 (as amended by the Act of 2002). (5 Marks)

#### Answer

- (a) Essentials of Sale (the Sale of Goods Act, 1930)

The problem as given in the question is based on Section 16(2) of the Sales of Goods Act, 1930, which states that where goods are bought by description from a seller who deals in goods of that description (whether he is the manufacturer or producer or not), that is an implied condition that the goods shall be of merchantable quality. Though the term 'merchantable quality' is not defined in the Act. It means that in the present case, the bottle must be properly sealed. In other words, if the goods are purchased for self-use, they should be reasonably fit for a purpose for which it is being used. In the instant case, on an examination of the bottle of cold drink, it exploded and injured the buyer. Applying the provision of Section 16(2) Mr. Amit would succeed in claim for damage from the owner of the shop.

- (b) Eligibility and Disqualification of Members (Multi-State Cooperative Society)

Persons eligible to become members of Multi-State Cooperative Society (Section 25 Multi State Cooperative Societies Act, 1984 (as amended by Act of 2002)

- (a) an individual competent to contract under section 11 of the Indian Contract Act;
- (b) any Multi-State Co-operative Society; or any Co-operative Society,
- (c) the Central government
- (d) a State Government

- (e) the National Co-operative Development Corporation established under the National Co-operative Development Corporation Act, 1962
- (f) any other corporation owned or controlled by Government
- (g) any Government company as defined in Section 617 of the Companies Act, 1956;
- (h) such class or classes of persons or association of persons as may be permitted by the Central Registrar having regard to the nature and activities of Multi-State Co-operative Society.

However, no individual person shall be eligible for admission as a member of a national Co-operative Society or a Federal Co-operative (Section 25(2)).

Disqualification for member of a multi-state Cooperative Society (Section 29)

- (1) his business is in conflict or competitive with the business of such Multi-State cooperative society; or
- (2) he used for two consecutive years the services below the minimum level specified in the bye laws; or
- (3) he has not attended three consecutive general meetings of the multi-State Cooperative Society and such absence has not been condoned by the members in the general meeting; or
- (4) he has made any default in payment of any amount to be paid to the Multi-State Co-operative Society under the bye-laws of such society.

#### Question 5

- (a) X draws a cheque in favour of Y. After having issued the cheque he informs Y not to present the cheque for payment. He also informs the bank to stop payment. Decide, under provisions of the Negotiable Instruments Act, 1881, whether the said acts of X constitute an offence against him? (5 Marks)
- (b) Vimal is an employee in a Company. The following payments were made to him during the previous year:
  - (i) Piece rate wages
  - (ii) Productivity bonus
  - (iii) Additional dearness allowance
  - (iv) Value of Puja gift.

Examine as to which of the above payments form part of "basic Wage" of Vimal under the Employees Provident Fund and Miscellaneous Provisions Act, 1952. (5 Marks)

#### Answer

- (a) Problem: Offence under the Negotiable Instruments Act, 1881  
This problem is based on the case of Modi Cements Ltd. Vs. Kuchil Kumar Nandi, 1998.

In this case the Supreme Court held that once a cheque is issued by the drawer, a presumption under Section 139 of the Negotiable Instruments Act, 1881 follows and merely because the drawer issues a notice thereafter to the drawee or to the bank for stoppage of payment, it will not preclude an action under Section 138. The object of Section 138 to 142 of the Act is to promote the efficacy of the banking operations and to ensure credibility in transacting business through cheques. Section 138 is a penal provision in the sense that once a cheque is drawn on an account maintained by the drawer with his banker for payment of any amount of money to another person from out of that account for the discharge in whole or in part of any debt or the liability, is informed by the bank unpaid either because of insufficient of amount to honour the cheques or the amount exceeding the arrangement made with the bank, such a person shall be deemed to have committed an offence.

(b) Basic Wages (EPF and MP Act, 1952)

As per Section 2 of the Employees Provident Fund and Miscellaneous Provision Act, 1952, the "Basic Wages" means all emoluments which are earned by an employee while on duty or on duty or on leave or on holidays within wages in either case in accordance with the terms of the contract of employment and which are paid or payable in cash to him, but does not include:

- (i) the cash value of any food concessions;
- (ii) any dearness allowance (that is to say all cash payments, by whatever name called, paid to an employee on account of rise in the cost of living), house rent allowance, overtime allowance, bonus, commission or pay and other similar allowance payable to the employee in respect of his employment or of work done in such employment; or
- (iii) any presents made by the employer.

Applying the above provisions of the Act to the given problem, the Basic wages of X will include only piece rate wages but it excludes the Productivity bonus, additional dearness allowance and value of puja gift.

Question 6

- (a) X is an employee in a Company. The amount of bonus payable to him during the year 2007-08 is Rs 14,000. The company deducted a sum of Rs 4,000 against the "Puja Bonus" already paid to him during the said year and paid the remaining amount. X files a suit against the company for recovery of the deducted amount. Decide, under the Payment of Bonus Act, 1965, whether X would be given any relief by the Court?

(5 Marks)

- (b) State the ways in which a Society, registered under the Cooperative Societies Act, 1912 may invest its own funds. Whether the amount of such fund can be given to the members of the Society by way of profit?

(5 Marks)

Answer

(a) Deduction of Bonus (Payment of Bonus Act, 1965)

The problem as given in the question is based on Section 17 of the Payment of Bonus Act, 1965. As per Section 17, if in any accounting year, an employer has paid any puja bonus or other customary bonus to any employee, then the former shall be entitled to deduct the amount of bonus so paid from the amount of bonus payable by him to the employee under this Act in respect of that accounting year. The employee shall be entitled to receive only the balance. The employer can do the same thing even in a case where he has paid off the bonus payable under this Act to an employee before the date on which such bonus payable becomes payable.

In the instant case X would not get any relief by the course because employer is empower to deduct Rs. 4,000/- from the total bonus (Rs.14,000) of Mr. X.

(b) Investment of funds (Cooperative Societies Act, 1912)

A registered society may invest or deposit its funds –

- (i) in the Government savings bank; or
- (ii) in any of the securities specified in Section 20 of the Indian Trusts Act, 1882; or
- (iii) in the shares or on the security of any other registered society; or
- (iv) with any bank or person carrying on the business of banking, approved for his purpose by the Registrar; or
- (v) in any other mode permitted by the rules. (Section 32)

Fund not to be divided by way or profit (Section 33): Generally, no part of the funds of a registered society shall be divided by way of bonus or dividend or otherwise among its members. However, where the liability is limited, at least one-fourth of the net profits in any year must be carried to a reserve fund and payments from the remainder of such profits and from any divisible profits of past years may be found among the members to such extent and under such conditions as may be prescribed by the rules or by-laws. In the case of societies with unlimited liability, no distribution of profits shall be made without the permission of the State Government.

Question 7

Answer any four of the following:

- (a) ABC Pvt. Ltd., Company is a Private Company having five members only. All the members of the company were going by car to Mumbai in relation to some business. An accident took place and all of them died. Answer with reasons, under the Companies Act, 1956 whether existence of the company has also come to the end? (5 Marks)
- (b) Before the incorporation of the company, the promoters of the company entered into an agreement with Mr. Jainson to buy an immovable property on behalf of the company. After incorporation, the company refused to buy the said property. Advise Mr. Jainson whether he has any remedy under the provisions of the Companies Act, 1956? (5 Marks)

- (c) Explain the doctrine of “Ultra-vires”. What are the legal effects of ultra-vires transactions under the Companies Act, 1956? (5 Marks)
- (d) Under the Articles of Association of Sunshine Ltd. Company directors had power to borrow up to Rs.10,000 without the consent of the general meeting. The Directors themselves lent Rs.35,000 to the company without such consent and took debentures of the Company. Decide under the provisions of the Companies Act, 1956, whether the company is liable? If so, what is the extent of liability of the company in this case? (5 Marks)
- (e) Explain the provisions and main contents of “Return of Allotment” under the Companies Act, 1956. (5 Marks)

Answer

- (a) Death of all members of a Private Limited Company, The Companies Act, 1956
- A joint stock company is a stable form of business organization. Its life does not depend upon the death, insolvency or retirement of any or all shareholder(s) or director(s). The provision for transferability or transmission of the shares helps to preserve the perpetual existence of a company. Law creates it and law alone can dissolve it. Members may come and go but the company can go on forever. So in such case, the ABC Pvt. Ltd. Co. does not cease to exist. By way of transmission of shares, shares are transmitted to their legal representatives. The company ceases to exist only on the winding up of the company. Therefore, even with the death of all members (i.e. 5), ABC (P) Ltd. does not cease to exist.
- (b) Pre-Incorporation Contracts, The Companies Act, 1956
- The present case is related to the pre-incorporation contract. The promoters of the company usually enter into contracts to acquire some property or right for the company which is yet to be incorporated. As such contracts are nullity and the company cannot sue or be sued on such contract when company comes into existence. So in such case ‘A’ has remedy against the promoters only. They are liable personally for those contracts that are made on behalf of the company not come into existence. Even the company cannot ratify such contracts after its registration. Such contacts are deemed to have been entered into personally by the promoters.
- (c) Doctrine of Ultra Vires, The Companies Act, 1956
- A company has the power to do all such things as are:
1. Authorised to be done by the Companies Act, 1956;
  2. Essential to the attainment of its objects specified in the Memorandum.
  3. Reasonably and fairly incident to its objects.
- Everything else is ultra vires the company. The term ‘ultra vires’ means that the doing of the act is beyond the legal power and authority of the company. If an act is ultra vires the company, no legal relationship or effect ensues there from. Such an act is absolutely

void and even the whole body of shareholders cannot ratify it and make it binding on the company. The leading case on the point is *Ashbury Rly. Carriage & Iron Co. Ltd. Vs. Riche* a company being a corporate person should not be fined or punished for its own acts or an act of its agent, if it is beyond its powers and privileges. Main features of the doctrine of ultra vires are:

1. when an act is performed or a transaction is carried out which, though legal itself, is not authorized by the objects clause in the memorandum or by Statute, it is said to be ultra vires the company.
2. if an act is ultra vires the company, it cannot be ratified even by the whole body of shareholders.
3. if an act is ultra vires the directors, but intra vires the company, it can be ratified by the whole body of shareholders.
4. if an act is ultra vires the Articles, it can be ratified by altering the Articles by a special resolution at a general meeting.

Effect of ultra vires transaction and borrowing: An ultra vires transaction being void does not vest the transferee with any right; nor does it divest the transferor. It means the transferor does not lose any right and the transferee does not get any right.

(d) Directors' Power to Borrow, The Companies Act, 1956

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

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

(e) Return of Allotment (Section 75, Companies Act, 1956): Within thirty days of allotment of shares, a company is required to send the Registrar a report, known as the "return as to allotment". It must contain the following particulars:

1. The number of nominal amount of shares allotted; the names, addresses the occupation of the allottees; the amount, if any, paid or payable on each share. No share should be shown as allotted for cash unless cash has actually been received in respect of the allotment.
2. Contracts in writing under which shares have been allotted for any consideration other than cash, must be produced for examination of the Registrar.
3. Where bonus shares have been issued, the returns must show the nominal amount of the shares allotted; names and addresses and occupations of the allottees and a

copy of the resolution authorizing the issue of such shares.

4. Where the shares have been issued at a discount, the return must include a copy of the resolution authorizing such an issue, a copy of the Tribunal's order sanctioning the issue, and where the rate of discount is more than ten percent, a copy of the order of the Central government permitting the issue.

Question 8

- (a) Explain the concept of "Sweat Equity Shares". Point out, under provisions of the Companies Act, 1956, the conditions of issuing of such shares and their position in the Share-capital of the Company. (5 Marks)
- (b) Peek Ltd. Co. issued and published its prospectus to invite the investors to purchase its shares. The said prospectus contained false statement. Mr. X purchased some partly paid shares of the company in good faith on the Stock Exchange. Subsequently, the company was wound up and the name of Mr. X was in the list of contributors. Decide:
- (i) Whether Mr. X is liable to pay the unpaid amount?
- (ii) Can Mr. X sue the directors of the company to recover damages? (5 Marks)

Answer

- (a) Sweat Equity Shares, The Companies Act, 1956

The expression 'Sweat Equity Shares' means equity shares issued by the company to employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called. (Explanation II to Section 79A, Companies Act, 1956)

Conditions for issue of Sweat Equity:

- (a) The shares should be of a class which has already been once issued.
- (b) The issue should be authorized by a special resolution at a general meeting of the company.
- (c) The resolution should specify the number of shares and their current market price and also the class or classes of directors or employees to whom they are to be issued and consideration for the sweat equity shares proposed to be issued.
- (d) At least one year must have elapsed between the commencement of business by the company and the date of such issue.
- (e) Such shares shall be issued in accordance with SEBI Regulations. Where the shares are not listed at a stock exchange, they can be issued as sweat equity.

Shares issued as sweat equity shares are to be treated for all purposes like other shares and, therefore, all the limitations, restrictions and provisions relating to equity shares will be applicable to them.

- (b) False Statement in Prospectus, the Companies Act, 1956
- (i) Yes, X is liable to pay the unpaid amount on the shares. As X has purchased partly paid shares, so he is liable for the remaining part of the shares. At the time of winding up he is liable to contribute a contributory. The related case law in this subject matter is Peak (v) Gurvey.
  - (ii) No. X cannot sue the directors to recover damages for the misstatement. The shareholder must have relied on the statement in the prospectus in applying for shares. If a person purchases shares in open market, the prospectus ceases to be operative. In the present case, Mr. X purchased shares in good faith on the stock exchange. He had not relied on the statement in prospectus. So he cannot sue.

Question 9

- (a) The Articles Association of PQR Ltd. provided that documents upon the company may be served only through E-mail. Arvind sent a document to the company by registered post. The company did not accept the document on the ground that sending documents to the company by post was in violation of the Articles. As a result Arvind suffered loss. Decide the validity of argument of the company and claim of Arvind for damages in the light of provisions of the Companies Act, 1956. (5 Marks)
- (b) The Directors of Mars India Ltd. desire to alter capital clause of Memorandum of Association of their company. Advise them, under the provisions of the Companies Act, 1956 about the ways in which the said clause may be altered and procedure to be followed for the said alteration. (5 Marks)

Answer

- (a) Service of Documents, the Companies Act, 1956
- Section 51 of the Companies Act, 1956 contains the law relating to service of documents on company. The Section provides that a document may be served on a company or an officer thereof by sending it to the company or officer at the registered office of the company by post under a certificate of posting or by registered post, or by leaving it at its registered office.
- Since, as per Section 9 of the Companies Act, any provision in the Articles of Association contrary to the provisions of the Act shall be void, the requirement in the Articles that documents shall be served on the company only through E-mail is not valid. Accordingly, company's refusal to accept the document is not valid and company shall be held liable in damages to Arvind.
- (b) Alteration of Capital (Section 94) the Companies Act, 1956
- A limited company with a share capital can alter the capital clause of its memorandum of association in any of the following ways, provided authority to alter is given by; the articles.
- (i) it may increase its capital by issuing new shares
  - (ii) consolidated the whole or any part of its shares capital into shares of larger amount

- (iii) convert shares into stock or vice versa
- (iv) sub-divide the whole or any part of its share capital into shares of smaller amount
- (v) cancel those shares which have not been taken up and reduce its capital accordingly.

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

#### Question 10

- (a) The Chairman of the meeting of a company received a Proxy 54 hours before the time fixed for the start of the meeting. He refused to accept the Proxy on the ground that the Articles of the company provided that a Proxy must be filed 60 hours before the start of the meeting. Decide, under the provisions of the Companies Act, 1956 whether the Proxy holder can compel the Chairman to admit the Proxy? (5 Marks)
- (b) Ramesh, who is a resident of New Delhi, sent a transfer deed, for registration of transfer of shares to the company at the address of its Registered Office in Mumbai. He did not receive the shares certificates even after the expiry of four months from the date of dispatch of transfer deed. He lodged a criminal complaint in the Court at New Delhi. Decide, under the provisions of the Companies Act, 1956, whether the Court at New Delhi is competent to take action in the said matter? (5 Marks)

#### Answer

- (a) Proxy, The Companies Act, 1956

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

- (b) Jurisdiction of Court, now Tribunal, the Companies Act, 1956

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

The facts of the given case are similar to H.V. Jaya Ram Vs. ICICI Ltd. 1998. In this case the Special Court for Economic Offences in the State of Karnataka rejected the

appellant's complaint against the respondent company on the ground that since the company had its registered office at Mumbai it is only the court which has territorial jurisdiction over the registered office of the company that can entertain the petition and not the court located in the State of Karnataka where the shareholder is residing. The High Court also upheld the order of the Special Court. On appeal Supreme Court held that cause of action for failure to deliver share certificate arises where the registered office of the company is situated and not in the jurisdiction of the Court located in the place where the complaint resides.

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