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Chapter – 6: The Companies Act, 2013

Company and foreign Company [Section 2 (20)]

Question 1

Mike Limited company incorporated in India having Liaison office at Singapore. Explain in detail meaning of Foreign Company and analysis on whether Mike Limited would be called as Foreign Company as it established a Liaison office at Singapore as per the provisions of the Companies Act, 2013? [Dec 20 - 3 Marks]

Answers:

Foreign company [Section 2 (42)]	Company [Section2 (20)]
Means any company or body corporate incorporated outside India which, — (a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and (b) conducts any business activity in India in any other manner.	Means a company incorporated under this Act or under any previous company law.

In the instant case mike limited incorporated in India having liasion office at Singapore.

In the light of the above provision and facts of the case we conclude that Mike limited cannot be called as foreign company because the basic condition to be called as foreign company is that the company must be incorporated outside India. In the present case Mike limited is incorporated in India i.e. incorporated under this Act (Companies Act, 2013) or under any previous company law. Therefore, mike limited can be called as company but cannot be called as foreign company.

Related Question: Mike LLC incorporated in Singapore having an office in Pune, India. Analyse whether Mike LLC would be called as a foreign company as per the provisions of the Companies Act, 2013? Also explain the meaning of foreign company. [Nov 22 - 3 Marks]

Answer: Provision same as above

Mike LLC is incorporated in Singapore and having a place of business in Pune, India. Since, Mike LLC is incorporated outside India and having a Place of business in India, hence it is a foreign Company.

Private Company [Section 2(68)]

Question 2

Jagannath Oils Limited is a public company and having 220 members of which 25 members were employee in the company during the period 1st April, 2006 to 28th June 2016. They were allotted shares in Jagannath Oils Limited first time on 1st July, 2007 which were sold by them 1st August, 2016. After some time, on 1st December, 2016, each of those 25 members acquired shares in Jagannath Oils Limited which they are holding till date. Now company wants to convert itself into a private company. State with reasons:

(I) Whether Jagannath Oils Limited is required to reduce the number of members.

(II) Would your answer be different if above 25 members were the employee in Jagannath Oils Limited for the period from 1st April, 2006 to 28th June, 2017? [MTP Nov 21 - 4 Marks] [RTP May 22]

Answer:

According to Section 2(68) of Companies Act, 2013, "Private company" means a company having a minimum paid-up share capital as may be prescribed, and which by its articles, —

(a) restricts the right to transfer its shares;

(ii) except in case of One Person Company, limits the number of its members to two hundred:

Provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this clause, be treated as a single member:

Provided further that—

(A) persons who are in the employment of the company; and

(B) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased, shall not be included in the number of members; and

(iii) prohibits any invitation to the public to subscribe for any securities of the company.

(I) Following the provisions of Section 2(68), 25 members were employees of the company but not during present membership which was started from 1st December 2016 i.e. after the date on which these 25 members were ceased to the employee in Jagannath Oils Limited. Hence, they will be considered as members for the purpose of the limit of 200 members. The company is required to reduce the number of members before converting it into a private company.

(II) On the other hand, if those 25 members were ceased to be employee on 28th June 2017, they were employee at the time of getting present membership. Hence, they will not be counted as members for the purpose of the limit of 200 members and the total number of members for the purpose of this sub-section will be 195. Therefore, Jagannath Oils Limited is not required to reduce the number of members before converting it into a private company.

Related Question: Flora Fauna Limited was registered as a public company. There are 230 members in the company as noted below: . [MTP March 19, 3 Marks] [RTP May 19] CS LLM Arjun Chhabra

Directors and their relatives	190
Employees	15
Ex-Employees (Shares were allotted when they were employees	10
5 couples holding shares jointly in the name of husband and wife (5*2)	10
Others	5

The Board of Directors of the company propose to convert it into a private company. Also advise whether reduction in the number of members is necessary

Answer: Provision same as above

In the instant case, Flora Fauna Limited may be converted into a private company only if the total members of the company are limited to 200.

Total Number of members

(i)	Directors and their relatives	190
(ii)	5 Couples (5x1)	5
(iii)	Others	5
	Total	200

Therefore, there is no need for reduction in the number of members since existing number of members are 200 which does not exceed maximum limit of 200.

Related Question: ABC Limited was registered as a public company. There were 245 members in the company. Their details are as follows:

Directors and their relatives	190
Employees	15
Ex — employees (shares were allotted when they were employees)	20
Others (Including 10 joint holders holding shares jointly in the name of father and son)	20

The Board of directors of the company propose to convert it into a private company. Advice whether reduction in the number of members is necessary for conversion. [Jan 21 – 4 Marks]

Answer: Provision same as above

In the instant case, ABC Limited may be converted into a private company only if the total members of the company are limited to 200. Total Number of members-

(i)	Directors and their relatives	190
(ii)	Others (10 joint holders holding shares in the name of father and son)	10
	Total	200

Therefore, there is no need for reduction in the number of members since existing number of members are 200 which does not exceed maximum limit of 200.

Related Question: BC Private Limited and its subsidiary KL private limited are holding 90,000 and 70,000 shares respectively in PQ Private Limited. The paid-up share capital of PQ Private Limited is 30 Lakhs (3 Lakhs equity shares of 10 each fully paid). Analyse with reference to provisions of the Companies Act, 2013 whether PQ Private Limited is a subsidiary of BC Private Limited. What would be your answer if KL Private Limited is holding 1,60,000 shares in PQ Private Limited and no shares are held by BC Private Limited in PQ Private Limited? [Dec 21 – 3 Marks] [RTP Dec 23]

Answer: Provision same as above given u/s 2(87)

In the instant case, as BC private limited together with its subsidiary KL private limited holding more than one-half of the total paid up share capital (voting power) in PQ private limited i.e., 90000 equity shares are held by BC private limited plus 70000 equity shares are held by KL private limited respectively in PQ private limited amounting to 160000 equity share out of total equity shares of 300000.

In the light of the above provision and facts of the case:

1. PQ private limited is subsidiary of BC private limited.
2. In the second case also, the answer would be the same as above i.e., PQ private limited is subsidiary of BC private limited irrespective of the fact that no shares are held by BC Private Limited in PQ Private Limited.

Related Question: The paid-up capital of Ram Private Limited is Rs.10 Crores in the form of 7,00,000 Equity Shares of Rs.100 each and 3,00,000 Preference Shares of Rs. 100 each. Lakhan Private Limited is holding 3,00,000 Equity Shares and 3,00,000 Preference Shares in Ram Private Limited. State with reason, Whether Ram Private Limited is subsidiary of Lakhan Private Limited? (MTP Oct 21 - 4 Marks)

Answer: Provision same as above given u/s 2(87)

It is to be noted that Preference share capital will also be considered if preference shareholders have same voting rights as equity shareholders.

As in the given problem it is not clear that whether Preference Shares are having voting rights or not, it can be taken that there is no voting right with these shares. On the basis of provisions of Section 2(87) and facts of the given problem, Lakhan Private Limited is holding 3,00,000 Equity Shares of total equity paid up share capital of Ram Private Limited.

Therefore, as Lakhan Private Limited does not exercises or controls more than one-half of the total voting power in Ram Private Limited, Ram Private Limited is not subsidiary of Lakhan Private Limited.

Related Question: A company, ABC limited as on 31.03.2023 had a paid-up capital of Rs. 1 lakh (10,000 equity shares of Rs. 10 each). In June 2023, ABC limited had issued additional 10,000 equity shares of Rs.10 each which was fully subscribed. Out of 10,000 shares, 5,000 of these shares were issued to XYZ private limited company. XYZ is a holding company of PQR private limited by having control over the composition of its board of directors.

Now, PQR private limited claims the status of being a subsidiary of ABC limited as being a subsidiary of its subsidiary i.e. XYZ private limited. Examine the validity of the claim of PQR private limited.

State the relationship if any, between ABC limited & XYZ private limited as per the provisions of The Companies Act, 2013. **(June 24 - 7 Marks)**

Related Question: The paid-up capital of Darshan Photographs Private Limited is Rs. 1 Crores in the form of 50,000 Equity Shares of Rs. 100 each and 50,000 Preference Shares (not carrying any voting rights) of Rs. 100 each. Shadow Evening Private Limited is holding 25,000 Equity Shares in Darshan Photographs Private Limited. State with reason,

(a) Whether Darshan Photographs Private Limited is subsidiary of Shadow Evening Private Limited?

(b) Whether your answer would be different in case Shadow Evening Private Limited is holding 25,000 Equity Shares and 5,000 Preference Shares in Darshan Photographs Private Limited? **(MTP 1 June 24 - 7 Marks)**

Answer: Provision same as above given u/s 2(87)

It is to be noted that Preference share capital will also be considered if preference shareholders have same voting rights as equity shareholders.

In the instant case, Darshan Photographs Private Limited is having paid-up capital of Rs. 1 Crores in the form of 50,000 Equity Shares of Rs. 100 each and 50,000 Preference Shares of Rs. 100 each. Shadow Evening Private Limited is holding 25,000 Equity Shares in Darshan Photographs Private Limited.

(a) On the basis of provisions of Section 2(87) and facts of the given problem, Shadow Evening Private Limited is holding one - half of total equity paid up share capital of Darshan Photographs Private Limited. Therefore, Darshan Photographs Private Limited cannot be considered as subsidiary company of Shadow Evening Private Limited as for being subsidiary company other company should control more than one - half of the total voting power.

(b) Answer would remain same even if Shadow Evening Private Limited is also holding 5,000 preference shares as they do not have voting rights.

Government Company [Section 2(45)]

Question 4

SK Infrastructure Limited has a paid-up share capital divided into 6,00,000 equity shares of INR 100 each 2,00,000 equity shares of the company are held by Central Government and 1,20,000

equity shares are held by Government of Maharashtra Explain with reference to relevant provisions of the Companies Act, 2013, whether SK Infrastructure Limited can be treated as Government Company. [Jan 21- 3 Marks] [RTP May 21]

Answer:

Government company [Section 2(45)]: Government Company means any company in which not less than 51% of the paid-up share capital is held by-

(i) the Central Government, or

(ii) by any State Government or Governments, or

(iii) partly by the Central Government and partly by one or more State Governments, and the section includes a company which is a subsidiary company of such a Government company.

Explanation: For the purposes of this clause, the" paid up share capital" shall be construed as "total voting power," where shares with differential voting rights have been issued.

In the present case, SK Infrastructure Limited shall be treated as a Government Company because the Central Government and the Government of Maharashtra both are holding 53.33% equity shares of SK Infrastructure Limited (32,00,006.00,000 × 100 = 53.33%) which is more than 51% of the paid-up share capital SK Infrastructure Limited.

Related Question: Narendra Motors Limited is a government company. Shah Auto Private Limited is a private company having share capital of ten crores in the form of ten lacs shares of Rs. 100 each. Narendra Motors Limited is holding five lacs five thousand shares in Shah Auto Private Limited. Shah Auto Private Limited claimed the status of Government Company. Advise as legal advisor, whether Shah Auto Private Limited is government company under the provisions of Companies Act, 2013? [RTP Nov 21] [RTP Dec 23]

Answer: Provision – Section 2(45) & Section 2(87) as given above

By virtue of provisions of Section 2(87) of Companies Act, 2013, Shah Auto Private Limited is a subsidiary company of Narendra Motors Limited because Narendra Motors Limited is holding more than one-half of the total voting power in Shah Auto Private Limited.

Further as per Section 2(45), a subsidiary company of Government Company is also termed as Government Company. Hence, Shah Auto Private Limited being subsidiary of Narendra Motors Limited will also be considered as Government Company.

Related Question: The State Government of X, a state in the country is holding 48 lakh shares of Y Limited. The paid up capital of Y Limited is Rs. 9.5 crore (95 lakh shares of Rs. 10 each). Y Limited directly holds 2,50,600 shares of Z Private Limited which is having share capital of Rs. 5 crore in the form of 5 lakh shares of Rs. 100 each. Z Private Limited claimed the status of a

subsidiary company of Y Limited as well as a Government company. Advise as a legal advisor, whether Z Private Limited is a subsidiary company of Y Limited as well as a Government company under the provisions of the Companies Act, 2013? **(Dec 23 - 4 Marks)**

Answer: Provision – Section 2(45) & Section 2(87) as given above

In the instant case, the State Government of X, a state in the country is holding 48 Lakh shares in Y Limited which is below 51% of the paid up share capital of Y Limited i.e. 48.45 Lakh shares (51% of 95 Lakh shares). Hence Y Limited is not a Government Company-

Further, Y Limited directly holds 2,50,600 shares in Z Private Limited, which is more than one-half of the total shares of Z Limited i.e. 2,50,000 shares (50% of 5 Lakh shares). Thus, the Company controls more than one-half of the total voting power of Z Limited. Hence Z Private Limited is a subsidiary of Y Limited.

Therefore, we can conclude that Z Private Limited is a subsidiary of Y Limited but not a Government Company since Y Limited is not a Government Company.

Related Question: XYZ is a company incorporated under The Companies Act, 2013. The paid up share capital of the company is held by others as on 31.05.2024 is as under:

(1) Government of India **20%**

(2) Life Insurance Corporation of India (Public Institution) **8%**

(3) Government of Tamil Nadu **10%**

(4) Government of Rajasthan **10%**

(5) ABC Limited (owned by Government Company) **15%**

As per above shareholding, state whether XYZ limited be called a government company under the provisions of The Companies Act, 2013. (June 24 - 4 Marks)

Associate Company [Section 2(6)]

Question 5

ABC Limited has allotted swifts with voting rights to XYZ Limited worth Rs. 15 Crores and issued Non-Convertible Debentures worth Rs. 40 Crores during the Financial Year 2019-20. After that total Paid-up Equity Share Capital of the company is Rs. 100 Crores and Non-Convertible Debentures Stands at Rs. 120 Crores. Define the Meaning of Associate Company and comment on whether ABC Limited and XYZ Limited would be called Associate Company as per provisions of the Companies Act, 2013? [Dec 20 4 Marks] [RTP May 21]

Answer: Provision – Section 2(6) as given above

In the light of the above provision and facts of the case, as XYZ Ltd. hold 15 crore equity shares with voting right in total of 100 crore paid up equity of ABC Ltd. which is only 15 percent and

holding of non-convertible debenture of Rs. 40 crores in ABC Ltd. will not be taken into account for observing the relationship of associate company.

Therefore, ABC Limited and XYZ Limited cannot be called Associate Company as per provisions of the Companies Act, 2013.

Related Question: Manicar Limited has allotted equity shares with voting rights to Nanicar Limited worth Rs. 10 Crores and issued Non-Convertible Debentures worth Rs.30 Crores during the Financial Year 2017-18. After that total Paid-up Equity Share Capital of the company is Rs.100 Crores and Non-Convertible Debentures stands at Rs.150 Crores.
Define the Meaning of Associate Company and comment on whether Manicar Limited and Nanicar Limited would be called Associate Company as per the provisions of the Companies Act, 2013? [MTP Nov 21 – 3 Marks]

Answer: Provision – Section 2(6) as given above
In the given case, as Manicar Ltd. has allotted equity shares with voting rights to Nanicar Limited of Rs. 10 crores, which is less than requisite control of 20% of total share capital (i.e. 100 crore) to have a significant influence of Nanicar Ltd. Since the said requirement is not complied, therefore Manicar Ltd. and Nanicar Ltd. are not associate companies as per the Companies Act, 2013.

Further holding/allotment of non-convertible debentures has no relevance for ascertaining significant influence. Hence, the issue of non-convertible debentures will not make both the companies Associate Company.

Related Question: ABC Limited has allotted equity shares with voting rights to XYZ Limited worth Rs. 15 crores and convertible preference shares worth Rs. 10 crores during the financial year 2022-23. After that the total share capital of the company is Rs. 100 crores. Comment on whether XYZ Limited would be called an Associate Company as per the provisions of the Companies Act, 2013? Also define an Associate Company. (June 23) (4 Marks)

Answer: Associate company [Section 2(6) of the Companies Act, 2013] in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company.
The expression "significant influence" means control of at least twenty per cent of total voting power, or control of or participation in business decisions under an agreement.

The term "joint venture" means a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

In the instant case, ABC Limited has allotted equity shares with voting rights to XYZ Limited worth & 15 crore and convertible preference shares worth Rs.10 crore during the financial year 2022-23 out of the total share capital of ABC Limited of & 100 crore.

Since XYZ Limited is holding only 15% significant influence R 15 crore equity shares with voting rights) in ABC Limited, which is less than twenty per cent, XYZ Limited is not an Associate company of ABC Limited.

Important Note: It can be assumed that the convertible preference shareholders are having voting rights and due to this, XYZ Limited is holding overall 25% paid up share capital in ABC Limited (with voting rights). Hence, XYZ limited is having significant control over ABC Limited and therefore XYZ is an Associate company of ABC Limited.

Small Company [Section 2(85)]

Small Company means a company, other than a public company—

- paid-up share capital of which does not exceed four crore rupees or such higher amount as may be prescribed which shall not be more than ten crore rupees and
- turnover of which as per profit and loss account for the immediately preceding financial year does not exceed forty crore rupees or such higher amount as may be prescribed which shall not be more than one hundred crore rupees:

Limits	Till 31st March, 2021	1st April 2021 till 14th September, 2022	15th September 2022 onwards
Paid-up share capital	Maximum paid-up share capital can be Rs. 50 Lakhs	Maximum paid-up share capital is increased to Rs. 2 Crores	Maximum paid-up share capital is increased to Rs. 4 Crores
Turnover (In the immediately preceding financial year)	Maximum turnover for qualifying as a Small Company was Rs. 2 Crores	Maximum turnover for qualifying as a Small Company is increased to Rs. 20 Crores	Maximum turnover for qualifying as a Small Company is increased to Rs. 40 Crores

Provided that nothing in this clause shall apply to—
(A) a holding company or a subsidiary company;
(B) a company registered under section 8; or
(C) a company or body corporate governed by any special Act;

Related Question: ABC Private Limited is a registered company under the Companies Act, 2013 with paid up capital of Rs. 35 lakhs and turnover of Rs. 2.5 crores. Whether the ABC Private Limited can avail the status of a Small Company in accordance with the provisions of the Companies Act, 2013? Also discuss the meaning of a Small Company. (June 23 - 3 Marks)

Answer:
In the instant case, since the paid-up capital of ABC Private Limited is Rs. 35 Lakhs and turnover is Rs. 2.5 crore, it can avail the status of a small company as both the requirements with regard to paid-up share capital as well as turnover are fulfilled by the Company.

Classification of Companies on the basis of liability [Section 2 (21) (22) (92)]

Question 6

Explain the meaning of Guarantee Company? State the similarities and dissimilarities between a 'Guarantee Company' and 'Company Limited by Shares.' [MTP March 18, 6 Marks] [MTP April 19, 6 Marks] [July 21 – 3 Marks]

Answer:

Meaning of Guarantee Company: Section 2(21) of the Companies Act, 2013 defines a Company Limited by Guarantee as a company

- having the liability of its members
- limited by the memorandum
- to such amount
- as the members may respectively undertake
- to contribute
- to the assets of the company
- in the event of its being wound up

Thus, the liability of the members of a guarantee company is limited to a stipulated amount in terms of individual guarantees given by members and mentioned in the memorandum. The members cannot be called upon to contribute more than such stipulated amount for which each member has given a guarantee in the memorandum of association.

Similarities and dis-similarities between the Guarantee Company and the Company limited by shares:

1. The common features between a "guarantee company" and the "company limited share" are legal entity and limited liability.
2. In case of a company limited by shares, the liability of its members is limited to the amount remaining unpaid on the shares held by them.
3. Both these types of companies have to state this fact in their memorandum that the members' liability is limited.

However, the dissimilarities between a 'guarantee company' and 'company limited by shares' is

1. In the former case the members will be called upon to discharge their liability only after commencement of the winding up of the company and only to the extent of amounts guaranteed by them respectively;
2. Whereas in the case of a company limited by shares, the members may be called upon to discharge their liability at any time, either during the life of the company or during the course of its winding up.

Related Question: Nolimit Private Company is incorporated as unlimited company having share capital of Rs. 10,00,000. One of its creditors, Mr. Samuel filed a suit against a shareholder Mr. Innocent for recovery of his debt against Nolimit Private Company. Mr. Innocent has given his plea in the court that he is not liable as he is just a shareholder. Explain, whether Mr. Samuel will be successful in recovering his dues from Mr. Innocent? [RTP Nov 22]

Answer:

Section 2(92) of Companies Act, 2013, provides that an unlimited company means

- a company not having any limit on the liability of its members.
- The liability of each member extends to the whole amount of the company's debts and liabilities, but he will be entitled to claim contribution from other members.
- In case the company has share capital, the Articles of Association must state the amount of share capital and the amount of each share.
- So long as the company is a going concern the liability on the shares is the only liability which can be enforced by the company.
- The creditors can institute proceedings for winding up of the company for their claims.
- The official liquidator may call the members for their contribution towards the liabilities and debts of the company, which can be unlimited.

On the basis of above, it can be said that Mr. Samuel cannot directly claim his dues against the company from Mr. Innocent, the shareholder of the company even the company is an unlimited company. Mr. Innocent is liable upto his share capital. His unlimited liability will arise when official liquidator calls the members for their contribution towards the liabilities and debts of the company at the time of winding up of company.

Listed & Unlisted Companies [Section 2 (52)]

Question 7

Explain listed company and unlisted company as per the provisions of the Companies Act, 2013. [Nov 22 - 2 Marks]

Listed company: As per the definition given in the section 2(52) of the Companies Act, 2013, it is a company which has any of its securities listed on any recognised stock exchange.

Provided that such class of companies, which have listed or intend to list such class of securities, as may be prescribed in consultation with the Securities and Exchange Board, shall not be considered as listed companies.

Whereas the word securities as per the section 2(81) of the Companies Act, 2013 has been assigned the same meaning as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956.

Unlisted company means company other than listed company.

One Person Company [Section 2(62)]

Question 8

Define OPC (One Person Company) and state the rules regarding its membership. Can it be converted into a non-profit company under Section 8 or a private company? [RTP Nov 18] [May 18, 6 Marks] [MTP Oct 19, 6 Marks] [RTP Nov 20] CS LLM Arjun Chhabra

Related Question: Ram wants to incorporate a company in which he will be the only member. According to provisions of The Companies Act, 2013, what type of company can be incorporated? What are the salient features of this type of company? **(June 24 - 7 Marks)**

Answer:

One Person Company (OPC) [Section 2(62) of the Companies Act, 2013]: The Act defines one person company (OPC) as a company which has only one person as a member.

Rules regarding its membership:

- Only one person as member.
- The memorandum of OPC shall indicate the name of the other person, who shall, in the event of the subscriber's death or his incapacity to contract, become the member of the company.
- The other person whose name is given in the memorandum shall give his prior written consent in prescribed form and the same shall be filed with Registrar of companies at the time of incorporation.
- Such other person may be given the right to withdraw his consent.
- The member of OPC may at any time change the name of such other person by giving notice to the company and the company shall intimate the same to the Registrar.
- Any such change in the name of the person shall not be deemed to be an alteration of the memorandum.
- Only a natural person who is an Indian citizen WHETHER RESIDENT IN INDIA (person who stayed in India for a period of not less than 120 days during immediately preceding financial year) OR OTHERWISE
  - shall be eligible to incorporate a OPC;
  - shall be a nominee for the sole member of a OPC.
- No person shall be eligible to incorporate more than one OPC or become nominee in more than one such company.
- No minor shall become member or nominee of the OPC or can hold share with beneficial interest.
- Such Company cannot be incorporated or converted into a company under section 8 of the Act. Though it may be converted to private or public companies in certain cases

Related Question: Naveen incorporated a "One Person Company" making his sister Navita as the nominee. Navita is leaving India permanently due to her marriage abroad. Due to this fact, she is withdrawing her consent of nomination in the said One Person Company. Taking into considerations the provisions of the Companies Act, 2013 answer the questions given below.

(a) If Navita is leaving India permanently, is it mandatory for her to withdraw her nomination in the said One Person Company?

(b) If Navita maintained the status of Resident of India after her marriage, then can she continue her nomination in the said One Person Company? [RTP May 20] [July 21- 4 Marks] CS LLM Arjun Chhabra

Answer:

Answer as per old Provision (Before Amendment)

(A) Yes, it is mandatory for Navita to withdraw her nomination in the said OPC as she is leaving India permanently as only a natural person who is an Indian citizen and resident in India shall be a nominee in OPC.

(B) Yes, Navita can continue her nomination in the said OPC, if she maintained the status of Resident of India after her marriage by staying in India for a period of not less than 182 days during the immediately preceding financial year.

Answer as per new Provision (After Amendment) – Students appearing in examinations shall write this answer in the exams if this question comes in exams.

Only a natural person who is an Indian citizen WHETHER RESIDENT IN INDIA OR OTHERWISE

- shall be eligible to incorporate a OPC;
- shall be a nominee for the sole member of a OPC.

In the light of the above provision and facts of the case:

(a) Navita is not required to withdraw her nomination because now it is not mandatory for nominee or sole member to be resident in India in order to become nominee or sole member of OPC.

(b) Navita is not required to maintain status of resident in India as per the amended provision of Companies Act, 2013. Therefore, she can continue to be nominee of OPC even after her marriage without maintaining the status of resident in India.

Related Question: Mr. A is an Indian citizen and his stay in India during immediately preceding financial year is for 115 days. He appoints Mr. B as his nominee who is a foreign citizen but has stayed in India for 130 days during immediately preceding financial year.

(i) Is Mr. A eligible to be incorporated as a One Person Company (OPC). If yes, can he give the name of Mr. B in the memorandum of Association as his nominee to become the member after Mr. A's incapacity to become a member.

(ii) If Mr. A has contravened any of the provisions of the Act, what are the consequences? [RTP Nov 21]

Answer:

Institute's Answer in RTP Nov 21

As per the provisions of the Companies Act, 2013, only a natural person who is an Indian citizen and resident in India (person who stayed in India for a period of not less than 120 days during immediately preceding financial year) –

- Shall be eligible to incorporate an OPC
- Shall be a nominee for the sole member.

(i) In the given case, though Mr. A is an Indian citizen, his stay in India during the immediately preceding previous year is only 115 days which is below the requirement of 120 days. Hence Mr. A is not eligible to incorporate an OPC.

Also, even though Mr. B's name is mentioned in the memorandum of Association as nominee and his stay in India during the immediately preceding financial year is more than 120 days, he is a foreign citizen and not an Indian citizen. Hence B's name cannot be given as nominee in the memorandum.

(ii) Since Mr. A is not eligible to incorporate a One Person Company (OPC), he will be contravening the provisions, if he incorporates one. He shall be punishable with fine which may extent to ten thousand rupees and with a further fine which may extent to One thousand rupees every day after the first during which such contravention occurs.

CS LLM Arjun Chhabra's Answer:

Students appearing in examinations shall write this answer in the exams if this question comes in exams.

As per the provisions of the Companies Act, 2013, Only a natural person who is an Indian citizen WHETHER RESIDENT IN INDIA (person who stayed in India for a period of not less than 120 days during immediately preceding financial year) OR OTHERWISE

- shall be eligible to incorporate a OPC;
- shall be a nominee for the sole member of a OPC.

(i) In the given case, Mr. A being a natural person and Indian citizen is eligible to incorporate OPC even though he is not resident in India during immediately preceding financial year because now it is not mandatory for nominee or sole member to be resident in India in order to become nominee or sole member of OPC.

Mr. A cannot give the name of Mr. B in the memorandum of Association as his nominee to become the member after Mr. A's incapacity to become a member because Mr. B is a foreign citizen and not an Indian citizen. Hence B's name cannot be given as nominee in the memorandum.

(ii) If Mr. A has contravened any of the provisions of the Act, following are the consequences:

- He shall be punishable with fine which may extent to ten thousand rupees and
- with a further fine which may extent to One thousand rupees every day after the first during which such contravention occurs.

Related Question: Mr. R is an Indian citizen, and his stay in India during the immediately preceding financial year is for 130 days. He appoints Mr. S, a foreign citizen, as his nominee, who has stayed in India for 125 days during the immediately preceding financial year. Is Mr. R eligible to be incorporated as a One-Person Company (OPC)? If yes, can he give the name of Mr. S in the Memorandum of Association as his nominee? Justify your answers with relevant provisions of the Companies Act, 2013. [May 22 - 3 Marks]

Answer:

Institute's Answer

In the given case, Mr. R is an Indian citizen and his stay in India during the immediately preceding financial year is 130 days which is above the requirement of 120 days. Hence, Mr. R is eligible to incorporate an OPC.

Also, even though Mr. S's name is mentioned in the Memorandum of Association as nominee and his stay in India during the immediately preceding financial year is more than 120 days, he is a foreign citizen and not an Indian citizen. Hence, S's name cannot be given as nominee in the memorandum.

CS LLM Arjun Chhabra's Answer:

Students appearing in examinations shall write this answer in the exams if this question comes in exams.

Provision: Same as above

In the given case, Mr. R being an Indian citizen is eligible to incorporate an OPC irrespective of the fact whether he is resident in India (a person who has stayed in India for a period of not less than one hundred and twenty days during the immediately preceding financial year) or not because from 1st April 2021 i.e after Companies (Incorporation) Second Amendment Rules,2021:

Only a natural person who is an Indian citizen whether resident in India or otherwise
(a) shall be eligible to incorporate a One Person Company;
(b) shall be a nominee for the sole member of a One Person Company.

Mr. R cannot give the name of Mr. S in the memorandum of Association as his nominee to become the member after Mr. R's incapacity to become a member because Mr. S is a foreign citizen and not an Indian citizen. Hence B's name cannot be given as nominee in the memorandum.

Related Question: Rohan incorporated a "One Person Company". The memorandum of OPC indicates the name of his brother Vinod as the nominee of OPC. However, Vinod is starting his new business in abroad and needs to leave India permanently. Due to this fact, Vinod is withdrawing his consent of nomination in the said One Person Company. Taking into considerations the provisions of the Companies Act, 2013 answer the questions given below:-

I. If is it mandatory for Vinod to withdraw his nomination in the said OPC

II. Can Rohan make his 17-year-old son as a nominee in such a case. [MTP May 22 – 4 Marks]

Answer: Institute's Answer in MTP May 22

(A) Yes, it is mandatory for Vinod to withdraw his nomination in the said OPC as he is leaving India permanently as only a natural person who is an Indian citizen and resident in India or otherwise and has stayed in India for a period of not less than 120 days during the immediately preceding financial year shall be a nominee in OPC.

Since Vinod will not satisfy this condition, so he needs to withdraw his nomination.

(B) No, Rohan cannot make his 17 year old son as a nominee of his OPC as no minor shall become member or nominee of the OPC or can hold beneficial interest.

CS LLM Arjun Chhabra's Answer:

Students appearing in examinations shall write this answer in the exams if this question comes in exams.

As per the provisions of the Companies Act, 2013, Only a natural person who is an Indian citizen WHETHER RESIDENT IN INDIA (person who stayed in India for a period of not less than 120 days during immediately preceding financial year) OR OTHERWISE

- shall be eligible to incorporate a OPC;
- shall be a nominee for the sole member of a OPC.

In the light of the above provision and facts of the case:

(a) Vinod is not required to withdraw his nomination because now it is not mandatory for nominee or sole member to be resident in India in order to become nominee or sole member of OPC.

Vinod is not required to maintain status of resident in India as per the amended provision of Companies Act, 2013. Therefore he can continue to be nominee of OPC even after her marriage without maintaining the status of resident in India.

(b) No, Rohan cannot make his 17-year-old son as a nominee of his OPC as no minor shall become member or nominee of the OPC or can hold beneficial interest.

Related Question: Mr. Anil formed a One Person Company (OPC) on 16 April, 2018 for manufacturing electric cars. The turnover of the OPC for the financial year ended 31 March, 2019 was about Rs. 2.25 crores. His friend Sunil wanted to invest in his One Person Company (OPC), so they decided to convert it voluntarily into a private limited company. Can Anil do so, as per the provisions of the Companies Act, 2013? [Nov 22 - 4 Marks]

Answer:

Section 2(62) of the Companies Act, 2013 defines one person company as a company which has only one person as a member. However, a private company shall have minimum 2 members without any restriction on the share capital or turnover. If OPC is converted into private company Mr. Anil and Mr. Sunil both can be the members of the company and investment from Mr. Sunil can be accepted.

A One Person Company can voluntarily convert itself into a private company by following the compliances given under the Companies Act, 2013.

In the instant case, OPC formed by Mr. Anil can be voluntarily converted into a private company by following the compliances given under the Companies Act, 2013. Here, the information given relating to turnover for the financial year ended 31st March, 2019 is immaterial.

Formation of Companies with Charitable Objects, etc. – Section 8

Question 9

What do you mean by "Companies with charitable purpose" (section 8) under the Companies Act, 2013? Mention the conditions of the issue and revocation of the licence of such company by the government. [May 19, 6 Marks]

Related Question: State whether a non-profit organization be registered as a company under the Companies Act, 2013? If so, what procedure does it have to adopt? [RTP May 18] [RTP May 19] [MTP Nov 22 – 6 Marks] CS LLM Arjun Chhabra

Answer:

Formation of companies with charitable purpose etc. (Section 8 company):

Section 8 of the Companies Act, 2013 deals with the formation of companies which are formed to

- promote the charitable objects of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment etc.

Such company intends to apply its profit in

- promoting its objects and
- prohibiting the payment of any dividend to its members.

Examples of section 8 companies are FICCI, ASSOCHAM, National Sports Club of India, CII etc.

Power of Central government to issue the license–

(i) Section 8 allows the Central Government to register such person or association of persons as a company with limited liability without the addition of words 'Limited' or 'Private limited' to its name, by issuing licence on such conditions as it deems fit.

(ii) The registrar shall on application register such person or association of persons as a company under this section.

(iii) On registration the company shall enjoy same privileges and obligations as of a limited company.

Revocation of license: The Central Government may by order revoke the licence of the company where the company contravenes any of the requirements or the conditions of this sections subject to which a licence is issued or where the affairs of the company are conducted fraudulently, or violative of the objects of the company or prejudicial to public interest, and on revocation the Registrar shall put 'Limited' or 'Private Limited' against the company's name in the register. But before such revocation, the Central Government must give it a written notice of its intention to revoke the licence and opportunity to be heard in the matter.

Related Question: What are the significant points of Section 8 Company which are not applicable for other companies? Briefly explain with reference to provisions of the Companies Act, 2013. [Dec-20, 6 Marks]

Answer:

Section 8 Company- Significant points

- Formed for the promotion of commerce, art, science, religion, charity, protection environment, sports, etc.
- Requirement of minimum share capital does not apply.
- Uses its profits for the promotion of the objective for which formed.
- Does not declare dividend to members.
- Operates under a special licence from Central Government.
- Need not use the word Ltd./ Pvt. Ltd. in its name and adopt a more suitable name such as club, chambers of commerce etc.
- Licence revoked if conditions contravened.
- On revocation, Central Government may direct it to
  - Converts its status and change its name
  - Wind – up
  - Amalgamate with another company having similar object.
- Can call its general meeting by giving a clear 14 days' notice instead of 21 days.
- Requirement of minimum number of directors, independent directors etc. does not apply.
- Need not constitute Nomination and Remuneration Committee and Shareholders Relationship Committee.
- A partnership firm can be a member of Section 8 company.

Related Question: A company registered under section 8 of the Companies Act, 2013, earned huge profit during the financial year ended on 31st March, 2018 due to some favorable policies declared by the Government of India and implemented by the company. Considering the development, some members of the company wanted the company to distribute dividends to the members of the company. They approached you to advise them about the maximum amount of dividend that can be declared by the company as per the provisions of the Companies Act, 2013. Examine the

relevant provisions of the Companies Act, 2013 and advise the members accordingly. [Nov 18, 4 Marks] [MTP Oct 19, 4 Marks] CS LLM Arjun Chhabra

Answer: Provision same as above

Hence, a company that is registered under section 8 of the Companies Act, 2013, is prohibited from the payment of any dividend to its members.

In the present case, the company in question is a section 8 company and hence it cannot declare dividend. Thus, the contention of members is incorrect.

Related Question: A, B and C has decided to set up a new club with name of ABC club having objects to promote welfare of Christian society. They planned to do charitable work or social activity for promoting the art work of economically weaker section of Christian society. The company obtained the status of section 8 company and started operating from 1st April, 2017 onwards.

However, on 30th September 2019, it was observed that ABC club was violating the objects of its objective clause due to which it was granted the status of section 8 Company under the Companies Act 2013.

Discuss what powers can be exercised by the central government against ABC club, in such a case?

Answer:

Section 8 of the Companies Act, 2013 deals with the formation of companies which are formed to promote the charitable objects of commerce, art, science, education, sports etc. Such company intends to apply its profit in promoting its objects. Section 8 companies are registered by the Registrar only when a license is issued by the Central Government to them.

Since ABC Club was a Section 8 company and it was observed on 30 th September, 2019 that it had started violating the objects of its objective clause. Hence in such a situation the following powers can be exercised by the Central Government:

(i) The Central Government may by order revoke the licence of the company where the company contravenes any of the requirements or the conditions of this sections subject to which a licence is issued or where the affairs of the company are conducted fraudulently, or violative of the objects of the company or prejudicial to public interest, and on revocation the Registrar shall put 'Limited' or 'Private Limited' against the company's name in the register. But before such revocation, the Central Government must give it a written notice of its intention to revoke the licence and opportunity to be heard in the matter.

(ii) Where a licence is revoked, the Central Government may, by order, if it is satisfied that it is essential in the public interest, direct that the company be wound up under this Act or amalgamated with another company registered under this section. However, no such order shall be made unless the company is given a reasonable opportunity of being heard.

(iii) Where a licence is revoked and where the Central Government is satisfied that it is essential in the public interest that the company registered under this section should be amalgamated with another company registered under this section and having similar objects, then, notwithstanding anything to the contrary contained in this Act, the Central Government may, by order, provide for such amalgamation to form a single company with such constitution, properties, powers, rights, interest, authorities and privileges and with such liabilities, duties and obligations as may be specified in the order.

Related Question: A Company registered under Section 8 of the Companies Act, 2013, has been consistently making profits for the past 5 years after a major change in the management structure. Few members contented that they are entitled to receive dividends. Can the company distribute dividend? If yes, what is the maximum percentage of dividend that can be distributed as per provisions of the Companies Act, 2013? Also, to discuss this along with other regular matters, the company kept a general meeting by giving only 14 days' notice. Is this valid? [RTP Nov 22]

Answer:

A company registered under Section 8 of the Companies Act, 2013 is prohibited from the payment of any dividends to its members.

Hence in the given case, the contention of the members to distribute dividend from the profits earned is wrong.

Also, Section 8 company is allowed to call a general meeting by giving 14 days instead of 21 days.

Classification of Capital

Question 10

What do you mean by the term capital? Describe its classification in the domain of Company Law. [Dec 21 – 6 Marks]

Answer:

The term capital has a variety of meanings. In relation to a company limited by shares, the word capital means share capital, i.e., the capital or figure in terms of so many rupees divided into shares of a fixed amount.

In other words, the contributions of persons to the common stock of the company form the capital of the company. The proportion of the capital to which each member is entitled is his share. A share is not a sum of money; it is rather an interest measured by a sum of money and made up of various rights contained in the contract.

In the domain of Company Law, the term 'capital' is used in the following senses:

1) "Authorised capital" or "Nominal capital": It means the Capital as is authorized by the MOA of a Company to be the maximum amount of Share Capital of the Company. [Sec.2(8)]

It is also known as registered capital of company upon which it pays the stamp duty.

It is usually fixed at the amount, which, it is estimated, the company will need, including the working capital and reserve capital, if any.

2) Issued capital: It means such Capital as the Company issues from time to time for subscription. [Sec.2(50)]. Issued Capital also includes Shares allotted for consideration other than cash.

It is that part of authorised capital which is offered by the company for subscription.

3) Subscribed capital: It means that part of the capital, which is for the time being subscribed by the members of a company.

It is the nominal amount of shares taken up by the public. Where any notice, advertisement or other social communication or any business letter, billhead or letter paper of a company states the authorised capital, the subscribed and paid-up capital must also be stated in equally conspicuous characters.

Default in this regard will make the company and every officer who is in default liable to pay the penalty extending ₹10,000 and ₹5,000, respectively.

4) Called-up capital: It means the capital that has been called for payment. It is the total amount called upon the shares issued.

5) Paid-up capital: Paid-up capital is the total amount paid or credited as paid up on shares issued. It is equal to called up capital less calls in arrears.

Related Question: Explain the kinds of share capital as per the Companies Act, 2013. Also explain when the capital shall be deemed to be preference capital. **(Dec 23 - 6 Marks)**

Answer:

Kinds of share capital: Section 43 of the Companies Act, 2013 provides the kinds of share capital. According to the said provision, the share capital of a company limited by shares shall be of two kinds, namely: —

1. "Equity share capital", with reference to any company limited by shares, means all share capital which is not preference share capital;

Equity share capital— can be

(i) with voting rights; or

(ii) with differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed;

2. "Preference share capital", with reference to any company limited by shares, means that part of the issued share capital of the company which carries or would carry a preferential right with respect to—

(a) payment of dividend, either as a fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income-tax; and

(b) repayment, in the case of a winding up or repayment of capital, of the amount of the share

capital paid-up or deemed to have been paid-up, whether or not, there is a preferential right to the payment of any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company;

Capital shall be deemed to be preference capital, despite that it is entitled to either or both of the following rights, namely: —

(a) that in **respect of dividends,** in addition to the preferential rights to the amounts specified as above, it has a right to participate, whether fully or to a limited extent, with capital not entitled to the preferential right aforesaid;

(b) that in **respect of capital,** in addition to the preferential right to the repayment, on a winding up, of the amounts specified above, it has a right to participate, whether fully or to a limited extent, with capital not entitled to that preferential right in any surplus which may remain after the entire capital has been repaid.

Memorandum of Association

Question 11

"The Memorandum of Association is a charter of a company". Discuss. Also explain in brief the contents of Memorandum of Association. [Nov 19, 6 Marks] [MTP Oct 21 - 6 Marks] CS LLM Arjun Chhabra

Answer:

The Memorandum of Association of company is in fact its charter; it defines its constitution and the scope of the powers of the company with which it has been established under the Act. It is the very foundation on which the whole edifice of the company is built.

Object of registering a memorandum of association:

- It contains the object for which the company is formed and therefore identifies the possible scope of its operations beyond which its actions cannot go.
- It enables shareholders, creditors and all those who deal with company to know what its powers are and what activities it can engage in.
  A memorandum is a public document under Section 399 of the Companies Act, 2013. Consequently, every person entering into a contract with the company is presumed to have the knowledge of the conditions contained therein.
- The shareholders must know the purposes for which his money can be used by the company and what risks he is taking in making the investment.

A company cannot depart from the provisions contained in the memorandum however imperative may be the necessity for the departure. It cannot enter into a contract or engage in any trade or business, which is beyond the power confessed on it by the memorandum. If it does so, it would be *ultra vires* the company and void.

Contents of the memorandum: The memorandum of a company shall state—

(a) the name of the company (Name Clause) with the last word "Limited" in the case of public

limited company, or the last words "Private Limited" in the case of a private limited company. This clause is not applicable on the companies formed under section 8 of the Act.

(b) the State in which the registered office of the company (Registered Office clause) is to be situated;

(c) the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof (Object clause);

(d) the liability of members of the company (Liability clause), whether limited or unlimited

(e) the amount of authorized capital (Capital Clause) divided into share of fixed amounts and the number of shares with the subscribers to the memorandum have agreed to take, indicated opposite their names, which shall not be less than one share. A company not having share capital need not have this clause.

(f) the desire of the subscribers to be formed into a company. The Memorandum shall conclude with the association clause. Every subscriber to the Memorandum shall take at least one share, and shall write against his name, the number of shares taken by him. (Association Clause)

Doctrine Of Constructive Notice [Negative Doctrine]

Applicability of doctrine

This doctrine operates in favour of the company, i.e. it creates a presumption in favour of the company. It operates against the persons dealing with the company.

Effect of the doctrine

Once registered the memorandum and articles become public documents (Sec. 399) Therefore, every person dealing with the company is presumed to have read the memorandum and articles. Further, it is presumed that he has understood the provisions of memorandum and articles correctly, i.e. in the right sense [T.R. Pratt (Bombay) Ltd. v E.D. Sassoon & Co. Ltd.]

- Thus, it is required of every person to apprise himself with the requirements of the memorandum and articles, before entering into any contract with a company.
- The doctrine prevents any person dealing with the company from alleging that he did not know the provisions contained in the articles or memorandum.
- If a person enters into a contract with the company in contravention of the provisions of the memorandum and articles, he cannot enforce such a contract.

Example: Kotla Venakataswamy v C Rammurthi

- The articles of a company required that all the documents and deeds of the company shall be signed by MD, the secretary and a working director of the company.
- A mortgage deed was signed by the secretary and a working director only.
- It was held that the mortgage deed was invalid even though the plaintiff had acted in good faith and money was utilised for the benefit of the company.

Doctrine Of Ultra Vires

Question 12

Briefly explain the doctrine of "ultravires" under the Companies Act, 2013. What are the consequences of ultravires acts of the company? [RTP Nov 18] [MTP Oct 18, 6 Marks] [RTP May 20] [MTP Nov 21 – 6 Marks]

Answer:

Meaning and effect of the doctrine

• Ultra means 'beyond' or 'in excess of' and vires means 'powers'. Thus, ultra vires means an act or transaction beyond or in excess of the powers of the company.

• An act or transaction shall be ultra vires if -

- it is not permitted or authorised by the Companies Act, 2013; and
- it falls outside the object clause of memorandum.

Ashbury Railway Carriage & Iron Company Ltd. v Richie

Extract of object clause. The object clause of an industrial company contained the following objects besides some other objects:

(a) To make, sell or lend on hire, railway carriages and wagons.

(b) To carry on the business of mechanical engineers and general contractors.

(c) To purchase, lease, work and sell mine, minerals, land and buildings.

Nature of contract made by company: The company entered into a contract with Richie, for the financing of a construction of a railway line in Belgium.

Decision of the Court: The Court held that the word 'general contractors' had to be given a restricted meaning.

- Only such contracts could be covered in the term 'general contractors' as are in some way related or connected with mechanical engineering.
- Therefore, the company could not finance the construction of a railway line by alleging that such a business falls under the business of general contractors.

Effects of ultra vires transactions:

1. The transaction is void ab initio: An act which is ultra vires the company is void and is of no legal effect.

   Neither the company nor the other contracting party derives any right under an ultra vires contract.

   Even ratification of an ultra vires contract by the whole body of shareholders does not make an ultra vires contract valid or enforceable.

2. No ratification or estoppel: An ultra vires contract cannot become valid by estoppel or ratification.
3. Injunction against the company: Any member may obtain an injunction order from the Court, i.e. an order of the Court restraining the company from proceeding with the ultra vires contract.

4. Personal liability of directors: If funds of the company are misapplied or wasted by entering into ultra vires transactions, the directors shall be personally liable to the company for breach of trust.

Effects of acts ultra vires the directors or articles:

- Acts ultra vires the directors or articles means those acts which are beyond the powers of the directors or powers given under the articles.
- Such acts are not altogether void and inoperative. Such acts may be ratified by the members.

Related Question: Ravi Private Limited has borrowed Rs. 5 crores from Mudra Finance Ltd. This debt is ultra vires to the company. Examine, whether the company is liable to pay this debt? State the remedy if any available to Mudra Finance Ltd.? [May 18, 4 Marks] CS LLM Arjun Chhabra

Answer:

Meaning and effect of the doctrine

• Ultra means 'beyond' or 'in excess of' and vires means 'powers'. Thus, ultra vires means an act or transaction beyond or in excess of the powers of the company.

• An act or transaction shall be ultra vires if -

- it is not permitted or authorised by the Companies Act, 2013; and
- it falls outside the object clause of memorandum.

The transaction is void ab initio:

An act which is ultra vires the company is void and is of no legal effect.

Neither the company nor the other contracting party derives any right under an ultra vires contract.

So is being the act void in nature, there being no existence of the contract between the Ravi Private Ltd. and Mudra Finance Ltd. Therefore, the company Ravi Private Ltd. is liable to pay this debt amount upto the limit prescribed in the memorandum.

Remedy available to the Mudra Finance Ltd.: The impact of the doctrine of ultra vires is that a company can neither be sued on an ultra vires transaction, nor can it sue on it. Since the memorandum is a "public document", it is open to public inspection. Therefore, a company which deals with the other, is deemed to know about the powers of the company.

So, Mudra Finance Ltd. can claim for the amount within the expressed limit prescribed in its memorandum.

Related Question: AK Private Limited has borrowed 36 crores from BK Finance Limited. However, as per the memorandum of AK Private Limited, the maximum borrowing power of the company is ₹30 crores. Examine whether AK Private Limited is liable to pay this debt? State the remedy, if any, available to BK Finance Limited. [Dec 21, 4 Marks] CS LLM Arjun Chhabra

Answer: Provision same as above

So, BK Finance Limited can claim for the amount within the expressed limit prescribed in its memorandum. i.e., ₹30 crores only.

Related Question: The Object Clause of Memorandum of Association of ABC Pvt. Ltd. authorized the company to carry on the business of trading in Fruits and Vegetables. The Directors of the company in recently concluded Board Meeting decided and accordingly, the company ordered for fish for the purpose of trading. FSH Limited supplied fish to ABC Pvt. Ltd. worth Rs. 36 Lakhs. The members of the company convened an extraordinary general meeting and negated the proposal of the Board of Directors on the ground of ultra vires acts. FSH Limited being aggrieved of the said decision of ABC Pvt Ltd. seeks your advice. Advise them. [MTP Aug 18, 4 Marks] [May 22 – 6 Marks]

Answer: Provision same as answer no.11 above

Therefore, the resolution passed by the Board of Director ABC Pvt. Limited for an ultra vires transaction is invalid. As a result of this, the transaction entered into the supply of fish with FSH Limited is not legal and is void.

Related Question: ABC Limited was into sale and purchase of iron rods. This was the main object of the company mentioned in the Memorandum of Association. The company entered into a contract with Mr. John for some finance related work. Later on, the company repudiated the contract as being ultra vires.

With reference to the same, briefly explain the doctrine of "ultravires" under the Companies Act, 2013. What are the consequences of ultravires acts of the company? [RTP May 22 - 6 Marks] [RTP June 23]

Answer:

An act which is ultra vires the company being void, cannot be ratified even by the unanimous consent of all the shareholders of the company.

Hence in the given case, ABC Limited cannot enter into a contract outside the purview of its object clause of memorandum of association as it becomes ultra vires and thus null and void.

Expected Questions based on Doctrine of Ultra Vires

Related/Expected Question: The objects clause of the Memorandum of Association of the XYZ (Pvt.) Ltd., New Delhi, authorized to do trading in mangoes. The company, however, entered into partnership with Mr. A and traded in mangoes and incurred liabilities to Mr. A. The Company, subsequently, refused to admit the liability to 'A' on the ground of 'ultra vires' the Company'.

Advice whether stand of the company is legally valid and if so, gives reasons in support of your answer.

Answer:

- The company is not liable to A.
- Since the partnership agreement for trading in mangoes is an ultra vires contract, and an ultra vires contract is void ab initio, and is not binding on the company or the other party;
- Since such power can be legally exercised by the company only if the object clause of memorandum expressly authorises the company to enter into partnership.

Doctrine Of Indoor Management [Positive Doctrine]

Question 13

Explain clearly the doctrine of 'Indoor Management' as applicable in cases of companies registered under the Companies Act, 2013. Explain the circumstances in which an outsider dealing with the company cannot claim any relief on the ground of 'Indoor Management'. [RTP Nov 20] [Jan 21- 6 Marks]

Related Question: State the limitations of the doctrine of indoor management under the Companies Act, 2013. [May 18, 3 Marks] CS LLM Arjun Chhabra

Answer

Purpose of doctrine

The doctrine of indoor management operates in favour of the outsiders, i.e. this doctrine creates a presumption in favour of the outsiders.

Meaning of the doctrine

- As per this doctrine, outsiders dealing with the company are not required to enquire into the internal management of the company.
- Outsiders dealing with the company are entitled to assume that as far as internal proceedings of the company are concerned, everything has been done regularly. It is a presumption and therefore rebuttable.
- Thus, the doctrine protects an innocent outsider from any irregularity present in the working of the company (provided he had actual knowledge of the memorandum and articles, and he complied with the requirements contained in the memorandum and articles).

Effect of the doctrine

If a contract is entered into on behalf of the company by any director or officer of the company, it is enforceable against the company, if provisions contained in the memorandum and articles have been complied with, even though while entering into such a contract, some internal irregularity had arisen of which the outsider was unaware.

Royal British Bank v Turquand

Facts of the case

- Mr Turquand was the official manager (liquidator) of the insolvent Railway Company.
- The company had given a bond for £2,000 to the Royal British Bank, which secured the company's drawings on its current account.
- The bond was under the company's seal, signed by two directors and the secretary.
- When the company was sued, it alleged that under its registered deed of settlement (the articles of association), directors only had the power to borrow up to an amount authorised by a company resolution.
- A resolution had been passed but did not specify how much the directors could borrow.

Judgment

- Bank was deemed to be aware that the directors could borrow only up to the amount resolutions allowed.
- Articles of association were registered, so there was constructive notice.
- But the bank could not be deemed to know which ordinary resolutions passed, because these were not registrable.
- The bond was valid because there was no requirement to look into the company's internal workings.
- This is the indoor management rule, that the company's indoor affairs are the company's problem.

Exceptions to the doctrine of indoor management

1. Knowledge of irregularity: Where the persons dealing with the company have knowledge of an internal irregularity, obviously the presumption that every internal proceeding has been conducted regularly shall stand rebutted, i.e. they cannot assume that everything has been done regularly. Therefore, the benefit of doctrine of indoor management shall not be available in such a case.

Howard v Patent Ivory manufacturing Company

- The directors of a company could borrow upto £1,000 without the sanction of members in GM.
- The consent of the shareholders was required to borrow in excess of £1,000.
- The directors themselves lent £3,500 to the company.
- It was held that the directors had the notice of the internal irregularity and therefore the company was liable to them only for £1,000.

2. Negligence - Suspicious circumstances: If there are suspicious grounds surrounding a transaction, but the person dealing with the company fails to make reasonable inquiry, the benefit of doctrine of indoor management will not be available.

Anand Bihari Lal v Dinshaw & company

- An accountant of the company entered into a contract on behalf of the company with a third party to sell the property of the company.
- It was held that the third party could not assume that the accountant was authorised by the company to sell the property of the company.
- Therefore, the third party could not enforce such a contract against the company even though the third party had acted bonafide.

3. Forgery: Ruben v Great Fingall Consolidated Company

- A share certificate was issued under the common seal of the company.
- The secretary of the company had signed on the share certificate.
- However, the signatures of two directors were also required on it, which were forged by the secretary.
- The holder of the share certificate contended that he was not aware of the fact of forgery, it was not possible for him to determine whether the signatures were genuine or forged and therefore,

the certificate issued to him should be held as valid.

- The Court held that in case of forgery, there is not a defect in consent, but absence of consent, and therefore the certificate issued by way of forgery is void. Thus, the certificate was held to be invalid.

Related Question: Sound Syndicate Ltd., a public company, its articles of association empowers the managing agents to borrow both short and long term loans on behalf of the company, Mr. Liddle, the director of the company, approached Easy Finance Ltd., a non-banking finance company for a loan of Rs. 25,00,000 in name of the company.
The Lender agreed and provided the above said loan. Later on, Sound Syndicate Ltd. refused to repay the money borrowed on the pretext that no resolution authorizing such loan have been actually passed by the company and the lender should have enquired about the same prior providing such loan hence company not liable to pay such loan.
Analyse the above situation in terms of the provisions of Doctrine of Indoor Management under the Companies Act, 2013 and examine whether the contention of Sound Syndicate Ltd. is correct or not? [May 19, 4 Marks] [MTP Oct 20 – 6 Marks] (May 22 - 4 Marks)

Answer: Provision same as above as given in answer no 12 – till meaning of doctrine
Easy Finance Ltd. being external to the company, need not enquire whether the necessary resolution was passed properly. Even if the company claims that no resolution authorizing the loan was passed, the company is bound to pay the loan to Easy Finance Ltd.

Related Question: The Articles of Association of XYZ Ltd. provides that Board of Directors has authority to issue bonds provided such issue is authorized by the shareholders by a necessary resolution in the general meeting of the company. The company was in dire need of funds and therefore, it issued the bonds to Mr. X without passing any such resolution in general meeting. Can Mr. X recover the money from the company? Decide referring the relevant provisions of the Companies Act, 2013. [RTP May 18] CS LLM Arjun Chhabra

Answer: Provision same as above
Here in this case Mr. X can recover the money from the company considering that all required formalities for the passing of the resolution have been duly complied.

Related Question: Mr. X had purchased some goods from M/s ABC Limited on credit. A credit period of one month was allowed to Mr. X. Before the due date Mr. X went to the company and wanted to repay the amount due from him. He found only Mr. Z there, who was the factory supervisor of the company. Mr. Z told Mr. X that the accountant and the cashier were on leave, he is in-charge of receiving money and he may pay the amount to him. Mr. Z issued a money receipt under his signature. After two months M/s ABC Limited issued a notice to Mr. X for non-payment of the dues within the stipulated period. Mr. X informed the company that he had already cleared the dues and he is no more responsible for the same. He also contended that Mr. Z is an employee of the company to whom he had made the payment and being an outsider, he trusted the words of Mr. Z as duty distribution is a job of the internal management of the company.

Analyse the situation and decide whether Mr. X is free from his liability. [Nov 18, 3 Marks] [MTP March 19, 4 Marks] [MTP Oct 19, 3 Marks] CS LLM Arjun Chhabra

Answer: Provision same as above as given in answer no 12 – till effect of doctrine

Mr. X has made payment to Mr. Z and he (Mr. Z) gave receipt of the same to Mr. X. Thus, it will be rightful on part of Mr. X to assume that Mr. Z was also authorised to receive money on behalf of the company.

Hence, Mr. X will be free from liability for payment of goods purchased from M/s ABC Limited, as he has paid amount due to an employee of the company.

Related Question: Mr. R, a manufacturer of toys approached MNO Private Limited for supply of raw material worth Rs. 1,50,000/-. Mr. R was offered a credit period of one month. Mr. R went to the company prior to the due date and met Mr. C, an employee at the billing counter, who convinced the former that the payment can be made to him as the billing -cashier is on leave.

Mr. R paid the money and was issued a signed and sealed receipt by Mr. C. After the lapse of due date, Mr. R received a recovery notice from the company for the payment of Rs. 1,50,000/-.

Mr. R informed the company that he has already paid the above amount and being an outsider had genuine reasons to trust Mr. C who claimed to be an employee and had issued him a receipt.

The Company filed a suit against Mr. R for non-payment of dues. Discuss the fate of the suit and the liability of Mr. R towards company as on current date in consonance with the provision of the Companies Act 2013? Would your answer be different if a receipt under the company seal was not issued by Mr. C after receiving payment? [Nov 22 - 4 Marks]

Answer: Provision same as above as given in answer no 12 – till effect of doctrine + reference of case law

(i) In the instant case, Mr. R is not liable to pay the amount of ` 1,50,000 to MNO Private Limited as he had genuine reasons to trust Mr. C, an employee of the company who had issued him a signed and sealed receipt.

(ii) Liability of Mr. R in case no receipt is issued by Mr. C: Exceptions to doctrine of indoor management: Suspicion of irregularity is an exception to the doctrine of indoor management. The doctrine of indoor management, in no way, rewards those who behave negligently. It is the duty of the outsider to make necessary enquiry, if the transaction is not in the ordinary course of business.

(iii) If a receipt under the company seal was not issued by Mr. C after receiving payment, Mr. R is liable to pay the said amount as this will be deemed to be a negligence on the part of Mr. R and it is his duty to make the necessary enquiry to check that whether Mr. C is eligible to take the payment or not.

Related Question: Articles of Association of XYZ Private Limited provides that Board of Directors can take the loan upto Rs. 50,00,000 for company by passing the Board Resolution. In the case where the loan amount is in excess of the said limit, Special Resolution is required to be passed in general meeting. Due to urgent need of funds, Board of Directors applied for loan in a reputed bank for Rs. 60,00,000 without passing the Special Resolution in the general meeting. Board of Directors gave an undertaking to bank that Special Resolution has been passed for such loan. The bank on believing on such undertaking lend the money. On demanding the repayment of loan, company denied the payment as the act was ultra vires to company. Advise. [RTP May 22 - 4 Marks] [RTP June 23]

Answer: Provision same as above as given in answer no 12 – till effect of doctrine + reference of case law.

In the instant case, Articles of Association of XYZ Private Limited have taken loan from reputed bank for Rs. 60,00,000 by passing Board Resolution while Special Resolution was necessary for such amount. Board of Directors gave an undertaking to bank that Special Resolution has been passed for such loan. The bank on believing on such undertaking lends the money.

On the basis of provisions of doctrine of Indoor Management, the bank can claim the amount of his loan from the company. The bank can believe on the undertaking given by board and no need to enquire further.

Features of Company

Question 14

When a company is registered, it is clothed with a legal personality. Explain. [RTP May 18]

Answer:

When a company is registered, it is clothed with a legal personality. It comes to have almost the same rights and powers as a human being. Its existence is distinct and separate from that of its members. A company can own property, have bank account, raise loans, incur liabilities and enter into contracts.

a) It is at law, a person different altogether from the subscribers to the memorandum of association. Its personality is distinct and separate from the personality of those who compose it.

b) Even members can contract with company, acquire right against it or incur liability to it. For the debts of the company, only its creditors can sue it and not its members.

A company is capable of owning, enjoying and disposing of property in its own name. Although the capital and assets are contributed by the shareholders, the company becomes the owner of its capital and assets. The shareholders are not the private or joint owners of the company's property.

Question 15 Mr. Sunny sold his business of cotton production to a cotton production company CPL Private Limited in which he held all the shares except one which was held by his wife. He is also the creditor in the company for a certain amount. He also got the insurance of the stock of

cotton of CPL Private Limited but in his own name not in the name of company. After one month, all the stocks of the cotton of CPL Private Limited were destroyed by fire. Mr. Sunny filed the claim for such loss with the Insurance company. State with reasons that whether the insurance company is liable to pay the claim? [MTP Nov 22 - 3 Marks]

Answer:

According to the decision taken in case of Salomon v/s Salomon & Co. Ltd., a company has separate legal entity. A company is different from its members. Further, according to the decision taken in case of Macaura v/s Northern Assurance Co. Ltd., a member or creditor does not have any insurable interest in the property of company. Members or creditors of the company cannot claim ownership in the property of company.

On the basis of above provisions and facts, it can be said Mr. Sunny and CPL Private Limited are separate entities. Mr. Sunny cannot have any insurable interest in the property of CPL Private Limited neither as member nor as creditor. Hence, the insurance company is not liable to pay to Mr. Sunny for the claim for the loss of stock by fire.

Question 16

ABC Pvt. Ltd., 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, 2013 whether existence of the company has also come to the end? [RTP Nov 18]

Answer:

Death of all members of a Private Limited Company, Under the Companies Act, 2013: The most distinguishing feature of a company is its being a separate entity from the shareholders and promoters who form it. This lends stability and perpetuity to the company form of business organization. In short, a company is brought into existence by a process of law and can be terminated or wound up or brought to an end only by a process of law. Its life is not impacted by 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 by allowing the constitution and identity of shareholders to change.

In the present case, ABC Pvt. Ltd. does not cease to exist even by the death of all its shareholders. The legal process will be for the successors of the deceased shareholders to get the shares registered in their names by way of the process which is called "transmission of shares". The company will cease to exist only when it is wound up by a due process of law.

Related Question: Five persons are the only members of a private company Flower Fans Limited. All of them go in a boat on a pleasure trip into an open sea. The boat capsizes and all the 5 die being drowned.

(a) Is the private company Flower Fans Limited no longer in existence?
(b) Further is it correct to say that a company being an artificial person cannot own property and cannot sue or be sued? Explain with reference to the provisions of Companies Act, 2013. [MTP Oct 21 – 3 Marks] [RTP Nov 18] [RTP June 23]

Answer:

(a) Perpetual Succession – A company on incorporation becomes a separate legal entity. It is an artificial legal person and have perpetual succession which means even if all the members of a company die, the company still continues to exist. It has permanent existence.

In the instant case, five persons who were the only members of private company and they have died being drowned in the sea. The existence of a company is independent of the lives of its members. It has a perpetual succession. In this problem, the company will continue as a legal entity. The company's existence is in no way affected by the death of all its members.

(b) The statement given is incorrect. A company is an artificial person as it is created by a process other than natural birth. It is legal or judicial as it is created by law. It is a person since it is clothed with all the rights of an individual. Further, the company being a separate legal entity can own property, have banking account, raise loans, incur liabilities and enter into contracts. Even members can contract with company, acquire right against it or incur liability to it. It can sue and be sued in its own name. It can do everything which any natural person can do except be sent to jail, take an oath, marry or practice a learned profession. Hence, it is a legal person in its own sense.

Related Question: M and N holding 70% and 30% of the shares in the company. Both died in an accident. Answer with reference to the provisions of the Companies Act, 2013, what will be the legal effect on the company as both the members have died? (June 24 - 3 Marks)

Answer: Refer above provision.

Related Question: A private limited company must have a minimum of two members, while a public limited company must have at least seven members. [MTP Oct 21 – 3 Marks] [RTP Nov 18]

Answer:

Correct: Section 3 of the Companies Act, 2013 deals with the basic requirement with respect to the constitution of the company. In the case of a public company, any 7 or more persons can form a company for any lawful purpose by subscribing their names to memorandum and complying with the requirements of this Act in respect of registration. In exactly the same way, 2 or more persons can form a private company.

Related Question: Affixing of Common seal on company's documents is compulsory. [MTP March 18, 3 Marks] [MTP Oct 18, 3 Marks] [MTP April 19, 3 Marks] CS LLM Arjun Chhabra

Answer:

Incorrect: The common seal is a seal used by a corporation as the symbol of its incorporation. The Companies (Amendment) Act, 2015 has made the common seal optional by omitting the words "and a common seal" from Section 9 so as to provide an alternative mode of authorization for companies who opt not to have a common seal. This amendment provides that the documents which need to be authenticated by a common seal will be required to be so done, only if the company opts to have a common seal. In case a company does not have a common seal, the authorization shall be made by two directors or by a director and the Company Secretary, wherever the company has appointed a Company Secretary.

Concept of Separate Legal Entity

Question 17

Mr. Raj formed a company with a capital of Rs. 50,000. He sold his business to another company for Rs. 40,000. For the payment of sale, he accepted shares worth Rs. 30,000 (3000 shares of Rs. 10 each). The balance 10,000 was considered as loan and Mr. Raj secured the amount by issue of debentures. His wife and three daughters took one share each. Owing to strike the company was wound up. The assets of the company were valued at Rs. 6000. The debts due to unsecured creditors were Rs. 8000.

Mr. Raj retained the entire sum of Rs. 6000 as part payment of loan. To this, the other creditors objected. Their contention was that a man could not own any money to himself, and the entire sum of Rs. 6000 should be paid to them.

Examine the rights of Mr. Raj and other creditors. Who will succeed? [RTP May 22 - 3 Marks]

Answer:

Separate Legal Entity: Corporate Veil refers to a legal concept whereby the company is identified separately from the members of the company.

The term Corporate Veil refers to the concept that members of a company are shielded from liability connected to the company's actions. If the company incurs any debts or contravenes any laws, the corporate veil concept implies that members should not be liable for those errors.
In other words, they enjoy corporate insulation.

Thus, the shareholders are protected from the acts of the company. The leading case law of Saloman Vs Saloman and Company Limited, laid the foundation of concept of corporate veil or independent corporate personality. A company is a person distinct and separate from its members.

Based on the above discussion and provisions, Mr. Raj was entitled to the assets of the company as he was a secured creditor of the company and the contention of the creditors that Mr. Raj and the company are one and same person is wrong.

Lifting of Corporate Veil

Question 18

There are cases where company law disregards the principle of corporate personality or the principle that the company is a legal entity distinct from its shareholders or members. Elucidate. [Nov 18, 6 Marks] [June 23 , 6 Marks]

Answer:

Corporate Veil refers to a legal concept whereby the company is identified separately from the members of the company.

However, this veil can be lifted which means looking behind the company as a legal person, i.e., disregarding the corporate entity and paying regard, instead, to the realities behind the legal facade. Where the Courts ignore the company, and concern themselves directly with the members or managers, the corporate veil may be said to have been lifted. Only in appropriate circumstances, the Courts are willing to lift the corporate veil and that too, when questions of control are involved rather than merely a question of ownership.

Lifting of Corporate Veil

The following are the cases where company law disregards the principle of corporate personality or the principle that the company is a legal entity distinct and separate from its shareholders or members:

- Trading with enemy: If the public interest is likely to be in jeopardy, the Court may be willing to crack the corporate shell
- Where corporate entity is used to evade or circumvent tax, the corporate veil may be lifted
- Where companies form other companies as their subsidiaries to act as their agent
- Company is formed to circumvent welfare of employees
- Where the device of incorporation is adopted for some illegal or improper purpose: Where the device of incorporation is adopted for some illegal or improper purpose, *e.g.,* to defeat or circumvent law, to defraud creditors or to avoid legal obligations.

Related Question: A, an assessee, had large income in the form of dividend and interest. In order to reduce his tax liability, he formed four private limited company and transferred his investments to them in exchange of their shares. The income earned by the companies was taken back by him as pretended loan. Can A be regarded as separate from the private limited company he formed? [Nov19, 3 Marks]

Related Question: Krishna, an assessee, was a wealthy man earning huge income by way of dividend and interest. He formed three Private Companies and agreed with each to hold a bloc of investment as an agent for them. The dividend and interest income received by the companies was handed back to Krishna as a pretended loan. This way, Krishna divided his income into three parts in a bid to reduce his tax liability.

Decide, for what purpose the three companies were established? Whether the legal personality of all the three companies may be disregarded. [March 18, 4 Marks] [MTP October 18, 4 Marks] [MTP March 19, 6 Marks] [MTP April 19, 4 Marks] [RTP May 19] CS LLM Arjun Chhabra

CS LLM Arjun Chhabra
(Law Maven)
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Answer:

1. The House of Lords in *Salomon Vs Salomon & Co. Ltd.* laid down that a company is a person distinct and separate from its members, and therefore, has an independent separate legal existence from its members who have constituted the company.
2. But under certain circumstances the separate entity of the company may be ignored by the courts. When that happens, the courts ignore the corporate entity of the company and look behind the corporate veil and hold the persons in control of the management of its affairs liable for the acts of the company.
3. Where a company is incorporated and formed by certain persons only for the purpose of evading taxes, the courts have discretion to disregard the corporate entity and tax the income in the hands of the appropriate assesse.
4. In *Dinshaw Maneckjee Petit* case it was held that the company was not a genuine company at all but merely the assessee himself disguised that the legal entity of a limited company. The assessee earned huge income by way of dividends and interest. So, he opened some companies and purchased their shares in exchange of his income by way of dividend and interest. This income was transferred back to assessee by way of loan. The court decided that the private companies were a sham and the corporate veil was lifted to decide the real owner of the income.
5. In the instant case, the four private limited companies were formed by A, the assesse, purely and simply as a means of avoiding tax and the companies were nothing more than the façade of the assesse himself. Therefore, the whole idea of Mr. A was simply to split his income into four parts with a view to evade tax. No other business was done by the company.
6. Hence, A cannot be regarded as separate from the private limited companies he formed.

Related Question: A transport company wanted to obtain licences for its vehicles but could not obtain licences if applied in its own name. It, therefore, formed a subsidiary company and the application for licence was made in the name of the subsidiary company. The vehicles were to be transferred to the subsidiary company. Will the parent and the subsidiary company be treated as separate commercial units? Explain in the light of the provisions of the Companies Act, 2013. [RTP Nov 22]

Answer:

If the subsidiary is formed to act as agent of the Principal Company, it may be deemed to have lost its individuality in favour of its principal. The veil of Corporate Personality is lifted and the principal will be held liable for the acts of subsidiary company.

The facts of the case are similar to the case of Merchandise Transport Limited vs. British Transport Commission (1982), wherein a transport company wanted to obtain licences for its vehicles but could not do so, if applied in its own name. It, therefore, formed a subsidiary company, and the application for the licence was made in the name of the subsidiary. The vehicles were to be transferred to the subsidiary company. Held, the parent and the subsidiary were held to be one commercial unit and the application for licences was rejected.

Hence, in this case the parent and the subsidiary company shall not be treated as separate commercial units.

Related Question: Mr. Dhruv was appointed as an employee in Sunmoon Timber Private Limited on the condition that if he was to leave his employment, he will not solicit customers of the company. After some time, he was fired from company. He set up his own business under proprietorship and undercut Sunmoon Timber Private Limited's prices. On the legal advice from his legal consultant and to refrain from the provisions of breach of contract, he formed a new company under the name Seven Stars Timbers Private Limited. In this company, his wife and a friend of Mr. Dhruv were the sole shareholders and directors. They took over Dhruv's business and continued it. Sunmoon Timber Private Limited files a suit against Seven Stars Timbers Private Limited for violation of contract. Seven Stars Timbers Private Limited argued that the contract was entered between Mr. Dhruv and Sunmoon Timber Private Limited and as company has separate legal entity, Seven Stars Timbers Private Limited has not violated the terms of agreement. Explain with reasons, whether separate legal entity between Mr. Dhruv and Seven Stars Timbers Private Limited will be disregarded? [RTP Nov 21]

Answer:

It was decided by the court in the case of Gilford Motor Co. Vs. Horne, that if the company is formed simply as a mere device to evade legal obligations, though this is only in limited and discrete circumstances, courts can pierce the corporate veil. In other words, if the company is mere sham or cloak, the separate legal entity can be disregarded.

On considering the decision taken in Gilford Motor Co. Vs. Horne and facts of the problem given, it is very much clear that Seven Stars Timbers Private Limited was formed just to evade legal obligations of the agreement between Mr. Dhruv and Sunmoon Timber Private Limited. Hence, Seven Stars Timbers Private Limited is just a sham or cloak and separate legal entity between Mr. Dhruv and Seven Stars Timbers Private Limited should be disregarded.

Related Question: An employee Mr. Karan signed a contract with his employer company ABC Limited that he will not solicit the customers after leaving the employment from the company. But after Mr. Karan left ABC Limited, he started up his own company PQR Limited and he started soliciting the customers of ABC Limited for his own business purposes.

ABC Limited filed a case against Mr. Karan for breach of the employment contract and for soliciting their customers for own business. Mr. Karan contended that there is corporate veil between him, and his company and he should not be personally held liable for this.

In this context, the company ABC Limited seek your advice as to the meaning of corporate veil and when the veil can be lifted to make the owners liable for the acts done by a company? [RTP May 22]

Answer:

Based on the above provisions and leading case law of Gilford Motor Co. Vs Horne, the company PQR Limited was created to avoid the legal obligation arising out of the contract, therefore that employee Mr. Karan and the company PQR Limited created by him should be treated as one and thus veil between the company and that person shall be lifted. Karan has formed the only for fraud/improper conduct or to defeat the law. Hence, he shall be personally held liable for the acts of the company.

Miscellaneous

Question 19

FAREB Limited was incorporated by acquisition of FAREB & Co., a partnership firm, which was earlier involved in many illegal activities. The promoters furnished some false information and also suppressed some material facts at the time of incorporation of the company. Some members of the public (not being directors or promoters of the company) approached the National Company Law Tribunal (NCLT) against the incorporation status of FAREB Limited. NCLT is about to pass the order by directing that the liability of the members of the company shall be unlimited.

Given the above, advice on whether the above order will be legal and mention the precaution to be taken by NCLT before passing order in respect of the above as per the provisions of the Companies Act, 2013. [MTP Aug 18, 3 Marks] CS LLM Arjun Chhabra

Answer:

As per section 7(7) of the Companies Act, 2013, where a company has been got incorporated by furnishing false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company or by any fraudulent action, the Tribunal may, on an application made to it, on being satisfied that the situation so warrants, direct that liability of the members shall be unlimited.

Hence, the order of NCLT will be legal.

Precautions: Before making any order, —

a) the company shall be given a reasonable opportunity of being heard in the matter; and
b) the Tribunal shall take into consideration the transactions entered into by the company, including the obligations, if any, contracted or payment of any liability.

Question 20

Explain the concept of "Dormant Company" as envisaged in the Companies Act, 2013. [RTP May 18]

Answer:

Dormant Company (Section 455 of the Companies Act, 2013)

Where a company is formed and registered under this Act for a future project or to hold an asset or intellectual property and has no significant accounting transaction, such a company or an inactive company may make an application to the Registrar in such manner as may be prescribed for obtaining the status of dormant company.

"Inactive company" means a company which has not been carrying on any business or operation, or has not made any significant accounting transaction during the last two financial years, or has not filed financial statements and annual returns during the last two financial years.

"Significant accounting transaction" means any transaction other than –

a. payment of fees by a company to the Registrar;
b. payments made by it to fulfil the requirements of this Act or any other law;
c. allotment of shares to fulfil the requirements of this Act; and
d. Payments for maintenance of its office and records.

Related Question: MTK Private Limited is a company registered under the Companies Act, 2013 on 5th January, 2021. The company has not started its business till now. On 7th April, 2023, a notice has been received from ROC for non-filing of FORM No-INC-20A. Identify under which category MTK Private Limited company is classified. Explain the definition of the category of the company in detail. **(Dec 23 - 3 Marks)**

Answer:

"Inactive company" – Provision same as above

In the instant case, MTK Private Limited was registered on 5th January, 2021 and has not started its business till now. On 7th April, 2023, a notice has been received from ROC for non-filing of Form No. INC-20A. Since the Company has not started its business and a period of more than two years have already elapsed, it will be treated as an inactive company.