CHAPTER 2

Incorporation of Company and Matters Incidental Thereto

LDR Questions

Q. 8	Q. 12	Q. 15	Q. 16	Q. 18	Q. 20	Q. 23	Q. 27

ICAI Module Descriptive Questions

Section 5 Entrenchment Clause

1. Yadav dairy products Private limited has registered its articles along with memorandum at the time of registration of company in December, 2019. Now directors of the company are of the view that provisions of articles regarding forfeiture of shares should not be changed except by a resolution of 90% majority. While as per section 14 of the Companies Act, 2013 articles may be changed by passing a special resolution only. One of the directors said that they cannot make a provision against the Companies Act. You are required to advise the company on this matter.

Solution:

As per section 5 of the Companies Act, 2013 the article may contain provisions for entrenchment to the effect that specified provisions of the articles may be altered only if more restrictive conditions than a special resolution, are met.

The provisions for entrenchment shall only be made either on formation of a company, or by an amendment in the articles agreed to by all the members of the company in the case of a private company and by a special resolution in the case of a public company.

Where the articles contain provisions for entrenchment, whether made on formation or by amendment, the company shall give notice to the Registrar of such provisions in prescribed manner.

In the present case, Yadav dairy products Private Limited is a private company and wants to protect provisions of articles regarding forfeiture of shares. It means it wants to make entrenchment of articles, which is allowed. But the company will have to pass a resolution taking permission of all the members and it should also give notice to ROC regarding entrenchment of articles.

Section 8 Company

2. A group of individuals intend to form a club namely 'Budding Pilots Flying Club' as limited liability company to impart class room teaching and aircraft flight training to trainee pilots. It was decided to form a limited liability company for charitable purpose under Section 8 of the Companies Act, 2013 for a period of ten years and thereafter the club will be dissolved and the surplus of assets over the liabilities, if any, will be distributed amongst the members as a usual procedure allowed under the Companies Act.

Examine the feasibility of the proposal and advise the promoters considering the provisions of the Companies Act, 2013.

Solution:

According to section 8(1) of the Companies Act, 2013, where it is proved to the satisfaction of the Central Government that a person or an association of persons proposed to be registered under this Act as a limited company—

(a) has in its objects the promotion of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object;

(b) intends to apply its profits, if any, or other income in promoting its objects; and

(c) intends to prohibit the payment of any dividend to its members; the Central Government may, by issue of licence, allow that person or association of persons to be registered as a limited liability company.

In the instant case, the decision of the group of individuals to form a limited liability company for charitable purpose under section 8 for a period of ten years and thereafter to dissolve the club and to distribute the surplus of assets over the liabilities, if any, amongst the members will not hold good, since there is a restriction as pointed out in point (b) above regarding application of its profits or other income only in promoting its objects.

Further, there is restriction in the application of the surplus assets of such a company in the event of winding up or dissolution of the company as provided in sub-section (9) of Section 8 of the Companies Act, 2013. Therefore, the proposal is not feasible.

Section 8

3. Alfa school started imparting education on 1st April, 2010, with the sole objective of providing education to children of weaker society either free of cost or at a very nominal fee depending upon the financial condition of their parents. However, on 30th March 2024, it came to the knowledge of the Central Government that the said school was operating by violating the objects of its objective clause due to which it was granted the status of a section 8 company under the Companies Act, 2013. Describe what powers can be exercised by the Central Government against the Alfa School, in such a case?

Solution:

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 a 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, Alfa School was a Section 8 company and 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 section 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.

Section 13 Procedure to Alter Object Clause

4. XY Ltd. has its registered office at Mumbai in the State of Maharashtra. For better administrative conveniences the company wants to shift its registered office from Mumbai to Pune (within the State of Maharashtra, but from Mumbai ROC to Pune ROC). What formalities the company has to comply with under the provisions of the Companies Act, 2013 for shifting its registered office as stated above? Explain.

Solution:

The Companies Act, 2013 under section 13 provides for the process of altering the Memorandum of a company. Since the location or Registered Office clause in the Memorandum only names the state in which its registered office is situated, a change in address from Mumbai to Pune, does not result in the alteration of the Memorandum and hence the provisions of section 13 (and its sub sections) do not apply in this case.

However, under section 12 (5) of the Act which deals with the registered office of company, the change in registered office from one town or city to another in the same state, must be approved by a special resolution of the company.

Further, registered office is shifted from one ROC to another, therefore company will have to seek approval of Regional director.

Section 13

5. Anushka security equipments limited is a manufacturer of CCTV cameras. It has raised ₹100 crore through public issue of its equity shares for starting one more unit of CCTV camera manufacturing. It has utilized 10 crore rupees and then it realized that its existing business has no potential for expansion because the government has reduced customs duty on import of CCTV cameras. Hence imported cameras from China are cheaper than its own manufacturing. Now it wants to utilize the remaining amount in the mobile app development business by adding a new object in its memorandum of association.

Does the Companies Act allow such change of object? If not, then what advise will you give to the company. If yes, then give steps to be followed.

Solution:

According to section 13 of the Companies Act, 2013 a company, which has raised money from public through prospectus and still has any unutilised amount out of the money so raised, shall not change its objects for which it raised the money through prospectus unless a special resolution is passed by the company and—

(i) the details in respect of such resolution shall also be published in the newspapers (one in English and one in vernacular language) which is in circulation at the place where the registered office of the company is situated and shall also be placed on the website of the company, if any, indicating therein the justification for such change;

(ii) the dissenting shareholders shall be given an opportunity to exit by the promoters and shareholders having control in accordance with SEBI regulations.

Company will have to file copy of special resolution with ROC and he will certify the registration within a period of thirty days. Alteration will be effective only after this certificate by ROC.

Looking at the above provision we can say that company can add the object of mobile app development in its memorandum and divert public money into that business. But for that it will have to comply with above requirements.

Section 13

6. The object clause of the Memorandum of Vivek Industries Limited., empowers it to carry on real-estate business and any other business that is allied to it. Due to a downward trend in real-estate business, the management of the company has decided to take up the business of Food processing activity. The company wants to alter its Memorandum, so as to include the Food Processing Business in its objects clause. Examine whether the company can make such change as per the provisions of the Companies Act, 2013?

Solution:

Alteration of Objects Clause of Memorandum

The Companies Act, 2013 has made alteration of the memorandum simpler and more flexible. Under section 13(1) of the Act, a company may, by a special resolution after complying with the procedure specified in this section, alter the provisions of its Memorandum.

In the case of alteration to the objects clause, section 13(6) requires the filing of the Special Resolution by the company with the Registrar. Section 13 (9) states that the Registrar shall register any alteration to the Memorandum with respect to the objects of the company and certify the registration within a period of thirty days from the date of filing of the special resolution by the company.

Section 13 (10) further stipulates that no alteration in the Memorandum shall take effect unless it has been registered with the Registrar as above.

Hence, the Companies Act, 2013 permits any alteration to the objects clause with ease. Vivek Industries Limited can make the required changes in the object clause of its Memorandum of Association.

Doctrine of Indoor Management

7. The persons (not being members) dealing with the company are always protected by the doctrine of indoor management. Explain. Also, explain when the doctrine of Constructive Notice will apply.

Solution:

Doctrine of Indoor Management

According to this doctrine, persons dealing with the company need not inquire whether internal proceedings relating to the contract are followed correctly, once they are satisfied that the transaction is in accordance with the memorandum and articles of association.

Stakeholders need not enquire whether the necessary meeting was convened and held properly or whether necessary resolution was passed properly. They are entitled to take it for granted that the company had gone through all these proceedings in a regular manner.

The doctrine helps to protect external members from the company and states that the people are entitled to presume that internal proceedings are as per documents submitted with the Registrar of Companies.

The doctrine of indoor management is opposite to the doctrine of constructive notice. Whereas the doctrine of constructive notice protects a company against outsiders, the doctrine of indoor management protects outsiders against the actions of a company.

This doctrine also is a safeguard against the possibility of abusing the doctrine of constructive notice.

Exceptions to Doctrine of Indoor Management (Applicability of doctrine of constructive notice)

(i) Knowledge of irregularity: In case an 'outsider' has actual knowledge of irregularity within the company, the benefit under the rule of indoor management would no longer be available. In fact, he/she may well be considered part of the irregularity.

(ii) Negligence: If with a minimum of effort, the irregularities within a company could be discovered, the benefit of the rule of indoor management would not apply.

The protection of the rule is also not available where the circumstances surrounding the contract are so suspicious as to invite inquiry, and the outsider dealing with the company does not make proper inquiry.

(iii) Forgery: The rule does not apply where a person relies upon a document that turns out to be forged since nothing can validate forgery. A company can never be held bound for forgeries committed by its officers.

Section 16 Company incorporated by furnishing false or incorrect information

8. Manglu and friends got registered a company in the name of Taxmann advisory private limited. Taxmann is a registered trademark. After 5 years when the owner of the trademark came to know about the same, it filed an application with relevant authority. Can the company be compelled to change its name by the owner of the trademark? Can the owner of a registered trademark request the company and then company changes its name at its discretion?

Solution:

According to section 16 of the Companies Act, 2013 if a company is registered by a name which, —

- in the opinion of the Central Government, is identical with the name by which a company had been previously registered, it may direct the company to change its name. Then the company shall by passing an ordinary resolution change its name within 3 months.
- is identical with a registered trade mark and owner of that trade mark apply to the Central Government within three years of incorporation of registration of the company, it may direct the company to change its name. Then the company shall change its name by passing an ordinary resolution within 6 months.

Company shall give notice to ROC along with the order of Central Government within 15 days of change. In case of default company and defaulting officer are punishable.

In the given case, owner of registered trade-mark is filing objection after 5 years of registration of company with a wrong name. While it should have filed the same within 3 years. Therefore, the company cannot be compelled to change its name.

As per section 13, company can anytime change its name by passing a special resolution and taking approval of Central Government. Therefore, if owner of registered trademark request the company for change of its name and the company accepts the same then it can change its name voluntarily by following the provisions of section 13.

Section 19 Subsidiary Not to Hold Shares in Holding

9. Explain in the light of the provisions of the Companies Act, 2013, the circumstances under which a subsidiary company can become a member of its holding company.

Solution:

In accordance with the provisions of Section 19 of the Companies Act, 2013, a subsidiary company cannot either by itself or through its nominees hold any shares in its holding company and no holding company shall allot or transfer its shares to any subsidiary companies. Any such allotment or transfer of shares in a company to its subsidiary is void. The section however does not apply where:

(1) the subsidiary company holds shares in its holding company as the legal representative of a deceased member of the holding company,

(2) the subsidiary company holds such shares as a trustee, or

(3) the subsidiary company was a shareholder in the holding company even before it became its subsidiary.

Section 19

10. Shri Laxmi Electricals Ltd. (S) is a company in which Hanuman power suppliers Limited (H) is holding 60% of its paid up share capital. One of the shareholder of H made a charitable trust and donated his 10% shares in H and ₹50 crore to the trust. He appointed S as the trustee. All the assets of the trust are held in the name of S. Can a subsidiary hold shares in its holding company in this way?

Solution:

According to section 19 of the Companies Act, 2013 a company shall not hold any shares in its holding company either by itself or through its nominees.

Also, holding company shall not allot or transfer its shares to any of its subsidiary companies and any such allotment or transfer of shares of a company to its subsidiary company shall be void.

Following are the exceptions to the above rule;

(a) Where the subsidiary company holds such shares as the legal representative of a deceased member of the holding company; or

(b) Where the subsidiary company holds such shares as a trustee; or

(c) Where the subsidiary company is a shareholder even before it became a subsidiary company of the holding company, but in this case, it will not have a right to vote in the meeting of holding company.

In the given case, one of the shareholders of holding company has transferred his shares in the holding company to a trust where the shares will be held by subsidiary company. It means now subsidiary will hold shares in the holding company. But it will hold shares in the capacity of a trustee. Therefore, we can conclude that in the given situation S can hold shares in H.

Section 20 Service of Documents

11. Explain the provisions of the Companies Act, 2013 relating to the 'Service of Documents' on a company and the members of the company.

Solution:

Under section 20 of the Companies Act, 2013 a document may be served on a company or an officer thereof by sending it to the company or the officer at the registered office of the company by registered post or by speed post or by courier service or by leaving it at its registered office or by means of such electronic or other mode as may be prescribed. However, in case where securities are held with a depository, the records of the beneficial ownership may be served by such depository on the company by means of electronic or other mode.

Under section 20 (2), save as provided in the Act or the rule thereunder for filing of documents with the registrar in electronic mode, a document may be served on Registrar or any member by sending it to him by post or by registered post or by speed post or by courier or by delivering at his office or address, or by such electronic or other mode as may be prescribed. However, a member may request for delivery of any document through a particular mode, for which he shall pay such fees as may be determined by the company in its annual general meeting.

Section 22 Execution of Bills of Exchange

12. Parag Constructions Limited is a leading infrastructure company. One of the directors of the company Mr. Parag has been signing all construction contracts on behalf of the company for many years. All the parties who ever deal with the company know Mr. Parag very well. The company has got a very important construction contract from a renowned software company. Parag constructions will do construction for this site in partnership with a local contractor Firozbhai.

Mr. Parag signed a partnership deed with Firozbhai on behalf of the company because he has an implied authority. Later in a dispute the company denied to accept liability as a partner. Can the company deny its liability as a partner?

Solution:

As per section 22 of the Companies Act, 2013 a company may authorise any person as its attorney to execute deeds on its behalf in any place either in or outside India. But common seal should be affixed on his authority letter or the authority letter should be signed by two directors of the company or it should be signed by one director and secretary. This authority may be either general for any deeds or it may be for any specific deed.

A deed signed by such an attorney on behalf of the company and under his seal shall bind the company as if it were made under its common seal.

In the present case company has not neither given any written authority not affixed common seal of the authority letter.

It means that Mr. Parag is not legally entitled to execute deeds on behalf of the company. Therefore, deeds executed by him are not binding on the company. Therefore, company can deny its liability as a partner.

RTP, MTP and PYQ Descriptive Questions

Section 2(69) - PROMOTER

13. Mr. Abhi is a Chartered Accountant and MBA by profession, has been appointed as an Executive Director on the Board of XYZ Limited. His job profile includes advising the Board of Directors of the company on various compliance matters, strategies, business plans, and risk matters relating to the company. Keeping in view of above position whether Mr. Abhi can be classified as the Promoter of XYZ Limited? Please examine the same under the provisions of the Companies Act, 2013. **(RTP May 2022) (5 Marks) (MTP Dec 24)**

Solution:

Law: As per section 2(69) of companies Act,2013

(i) Promoter means a person

(a) who has been named as such in a Prospectus; or

(b) is identified by the Company in the Annual Return;

(c) who has control over the affairs of the company directly or indirectly,

(d) in accordance with whose advice, directions or instructions; the BOD of a company is accustomed to Act.

(ii) However, a person acting merely in a professional capacity shall not be regarded as promoter under point (d).

Conclusion: In present case, As the job profile of Mr. Kaushal is only limited to advise the Board of Directors on various compliance matters, strategies, business plans and risk matters relating to business of the company and that to only in a professional capacity, he will not be classified as a Promoter of XYZ Limited.

Section 3A Members Severally Liable in Certain Cases

14. Red Limited was incorporated on 1st April, 2014 is facing severe effects of depression of the economy. Owing to its bad financial status most of the members have started withdrawing their holding from the company. The company had 250 members on 10th January, 2019. By 15th January, 2019, 244 members had withdrawn their holding. No new member has invested in the company after 15th February till date. Now, Mr. A, an existing member has approached you to advise him regarding his liabilities in such a situation. **(RTP NOV 2019)**

Solution:

Law: As per section 3A of the Companies Act, 2013, If at any time the number of members of a company is reduced below 2/7, {in the case of a private company, below 2, and in the case of a public company, below 7}, and the company carries on business for more than 6 months while the number of members is so reduced, Every person who is a member of the company during the time that it so carries on business after those 6 months and is cognizant of the fact that it is carrying on business with less than 2/7 members, shall be severally liable (personally liable) for the payment of the whole debts of the company contracted during that time

Conclusion: In present case, since 244 out of 250 members has withdrawn membership is restricted to 6 i.e less than 7 if the membership remains less than 7 till 6 months from 10th January, every contract entered by company after that will make personally liable to A and all existing members who knew about such reduction.

Section 5 Entrenchment Clause

15. Mr. Shyamlal is a B. Tech in computer science. He has promoted an IT start up and got it registered as a Private Limited Company. Initially, only he and his family members are holding all the shares in the company. While drafting the Articles of Association of the company, it has been included that Mr. Shyamlal will remain as a director of the company for lifetime.

Mr. Mehra, a close friend of Mr. Shyamlal has warned him (Mr. Shyamlal) that in future if 75% or more shares in the company are held by non- family members then by passing a Special Resolution, the relevant articles can be amended and Mr. Shyamlal may be removed from the post of director.

Mr. Shyamlal has approached you to advise him for protecting his position as a director for lifetime. Give your answer as per the provisions of the Companies Act, 2013. **(6 Marks) (MTP May 21)**

Solution:

Law: As per the provisions of section 5 of the Companies Act, 2013,

(i) Usually, an article of association may be altered by passing a special resolution but entrenchment makes it one difficult to change it. So, entrenchment means making something more protective.

(ii) As per the provisions of sub-section (4) of section 5 of the Companies Act, 2013, the provisions of entrenchment shall only be made either on formation of a company, or by an amendment in the Articles of Association as agreed to by all the members of the company in the case of a private company and by a special resolution in case of a public company.

Conclusion: In the said situation, the IT startup company is a private company. Therefore, Mr. Shyamlal can get the articles altered which is agreed to by all the members whereby the amended article will say that he can be removed from the post of director only if, say, 95% votes are cast in favour of the resolution and give notice of the same to the Registrar.

Section 7 Incorporation of a Company

16. ABC Pvt. Ltd., a company that has been operational for two years, was incorporated with the submission of false information and suppression of material facts. The company's founders, Mr. X and Ms. Y, provided incorrect financial statements and concealed significant liabilities during the incorporation process. This misrepresentation was recently uncovered during an internal audit initiated by the company's new CFO, Mr. Z.Upon discovering these fraudulent actions, Mr. Z has filed an application with the National Company Law Tribunal (NCLT). Explain the provisions of the Companies Act, 2013 in respect where a company has been incorporated by furnishing false or incorrect information. **(RTP sep 24)**

Solution:

company incorporated by furnishing false or incorrect information

According to 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—

(a) pass such orders, as it may think fit, for regulation of the management of the company including changes, if any, in its memorandum and articles, in public interest or in the interest of the company and its members and creditors; or

(b) direct that liability of the members shall be unlimited; or

(c) direct removal of the name of the company from the register of companies; or

(d) pass an order for the winding up of the company; or

(e) pass such other orders as it may deem fit. However, before making any order under this sub-section, -

(i) the company shall be given a reasonable opportunity of being heard in the matter; and

(ii) the Tribunal shall take into consideration the transactions entered into by the company, including the obligations, if any, contracted or payment of any liability.

Entrenchment Clause

17. The Articles of Association of a Company may contain provisions for entrenchment under Section 5 of the Companies Act, 2013. What is meant by entrenchment provisions in this context? Also State the relevant provisions of the said Act dealing with entrenchment provisions. **(3 Marks) (Nov 2020) (MTP Oct. 22)**

Solution:

Entrenchment Clause

1. Usually an AOA may be altered by passing special resolution but entrenchment makes it more difficult to change it. So entrenchment means making something more protective.

2. The AOA may contain the provisions for entrenchment, i.e. certain specified provisions of the articles can be altered only by complying with such conditions or procedures as are more restrictive than those as are applicable in case of a SR.
3. The provisions for entrenchment may be made at the time of formation of the company; or by an amendment of articles,
   (a) In case of a private company, with the consent of all the members;
   (b) In case of a public company, by passing Special Resolution.
4. Where the articles contains the provisions for entrenchment, the company shall give notice of such provisions to the Registrar:
   (i) In Form No. INC-2 & SPICe+ INC-32, as the case may be, at the time of incorporation of the company;
   (ii) In Form No. MGT-14, within 30 days from the date of entrenchment of the articles in case of existing companies.

Section 10 MOA/AOA Doesn't Bind Outsider

18. The Articles of a Public Company clearly stated that Mr. A will be the solicitor of the company. The company in its general meeting of the shareholders resolved unanimously to appoint B in place of A as the solicitor of the company by altering the articles of association. Examine whether the company can do so? State the reasons clearly. Does it make any difference if A also member of the company **(RTP May 2015) (RTP May 2016) (MAY 2013)**

Solution:

Law:

(i) According to Section 10(1) of the Companies Act, 2013, the memorandum and articles shall, when registered, bind the company and the members thereof to the same extent as if they respectively had been signed by the company and by each member

(ii) MoA and AoA binds
   (a) Company to members
   (b) Members to company
   (c) Members Interse

(iii) The Memorandum and Articles do not bind either the company or the members to any third party.

(iv) Further, under Section 14 (1) subject to the provisions of this Act and to the conditions contained in the Memorandum, a company may, by a special resolution, alter its Articles.

Ref Case: Eley v Positive Life Insurance Co

Conclusion: In the present case,

(i) Since section 10 do not bind outsiders so A can be terminated, the company has altered the Articles by a unanimous resolution of the members passed at a general meeting. Hence, the alteration is valid and after registration of the altered Articles, the appointment of B will stand and A will be terminated.

(ii) No it doesn't make any difference if he is also member of company as being solicitor is not right attached with membership

Doctrine of Ultra Vires

19. The object clause of the Memorandum of Association of Miranda Private Ltd, Kolkata authorized it to do trading in fruits and vegetables. The company, however, entered into a Partnership with Mr. Karan and traded in steel and incurred liabilities to Mr. Karan. The company, subsequently, refused to admit the liability to Karan on the ground that the deal was 'Ultra Vires' the company. Examine the validity of the company's refusal to admit the liability to Karan. Give reasons in support of your answer. **(RTP Nov 2016)**

Solution:

Law: As per Doctrine of Ultra Vires, the acts beyond the powers of a company/Memorandum/ object clause are ultra vires and void and cannot be ratified even though every member of the company may give his consent [Ashbury Railway Carriage Company Vs Richee]

Conclusion: Miranda Pvt. Ltd is authorized to trade directly on fruits and vegetables. It has no power to enter into a partnership for iron and steel with Mr. Karan. Such act cannot be treated as being within either the 'express' or 'implied' powers of the company. Mr. Karan who entered into partnership is deemed to be aware of the lack of powers of Miranda Pvt. Ltd. In the light of the above, Mr. Karan cannot enforce the agreement or liability against Miranda Pvt. Ltd under the Companies Act, 2013. Mr. Karan should be advised accordingly.

Doctrine of Indoor Management

20. The Doctrine of Indoor Management always protects the persons (outsiders) dealing with a company." Explain the above statement. Also, state the exceptions to the above rule **(MAY 2015) (NOV 2018) (MTP Sep 22)**

Solution:

Doctrine of Indoor Management

(i) As per this doctrine, outsiders dealing with the company are not required to enquire into the internal management of the company.

(ii) 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.

(iii) If not, company is in fault and cannot deny liability on said ground

(iv) Thus, the doctrine protects an innocent outsider from any irregularity present in the working of the company

Exceptions to Doctrine of Indoor Management

Relief on the ground of 'indoor management' cannot be claimed by an outsider dealing with the company in the following circumstances:

1. Knowledge of irregularity - In case this 'outsider' has actual knowledge of irregularity within the company, the benefit under the rule of indoor management would no longer be available. In fact, he/she may well be considered part of the irregularity.
2. Negligence: If with a minimum of effort, the irregularities within a company could be discovered, the benefit of the rule of indoor management would not apply. The protection of the rule is also not available where the circumstances surrounding the contract are so suspicious as to invite inquiry, and the outsider dealing with the company does not make proper inquiry.
3. Forgery: The rule does not apply where a person relies upon a document that turns out to be forged since nothing can validate forgery. A company can never be held bound for forgeries committed by its officers.

4. Where the question is in regard to the very existence of an agency.
5. Where a pre-condition is required to be fulfilled before company itself can exercise a particular power. In other words, the act done is not merely ultra vires the directors/officers but ultra vires the company itself.

Doctrine of Indoor Management

21. The role of doctrine of 'Indoor management' is opposed to that of the role of 'Constructive notice'. Comment on this statement with reference to the Companies Act, 2013.

(6 Marks) (MTP Nov. 23)

Solution:

Yes doctrine of 'Indoor management' is opposed to that of the role of 'Constructive notice' because of following reasons

(i) It protects outsiders from company whereas 'Constructive notice protects company from outsiders.

(ii) In Constructive notice outsider is at fault whereas in indoor management company is at fault

(iii) In Constructive notice outsider is presumed to have knowledge of Moa and AoA whereas in indoor management he is presumed that all internal proceeding are done regularly

(iv) Constructive notice makes contract void whereas Indoor management makes contract valid

Doctrine of Indoor Management

22. The directors of Smart Computers limited borrowed a sum of money from Mr. Tridev. The company's articles provided that the directors may borrow on bonds such sums as may, from time to time, be authorized by resolution passed at a general meeting of the company. The shareholders claimed that there had been no such resolution authorizing the loan, and therefore, it was taken without their authority and the company is not bound to repay the loan to Tridev. In the light of the contention of shareholders, decide whether the company is bound to pay the loan.

(MTP MAY 2020) (NOV 2016)

Solution:

Law: Doctrine of Indoor Management: According to this doctrine, persons dealing with the company need not enquire whether internal proceedings relating to the contract are followed correctly, once they are satisfied that the transaction is in accordance with the memorandum and articles of association.

Ref Case: Royal British Bank vs Turquand.

Conclusion: In the given question, Mr. Tridev being a person external to the company, need not enquire whether the necessary meeting was convened and held properly or whether necessary resolution was passed properly. Even if the shareholders claim that no resolution authorizing the loan was passed, the company is bound to pay the loan to Mr. Tridev.

Doctrine of Indoor Management

23. The Secretary of a company issued a share certificate to 'A' under the company's seal with his own signature and the signature of a Director forged by him. 'A' borrowed money from 'B' on the strength of this certificate. 'B' wanted to realize the security and requested the company to register him as a holder of the shares. Explain whether 'B' will succeed in getting the share registered in his name.

(RTP Nov 2013)

Solution:

Law: As per doctrine of Indoor Management which says that persons dealing with the company are entitled to assume that the acts of the directors or the officers of the company are validly performed, if they are within the scope of their apparent authority. The rule of Indoor Management is not applicable if the transaction involves forgery. A company can never be held bound for forgeries committed by its officers.

Ref case: Ruben vs Great Fingall consolidated company.

Conclusion: In the stated problem, the doctrine of indoor management can apply only in case of irregularities which might otherwise affect the transaction, but it cannot apply to forgery which must be regarded as nullity. Hence, 'B' will not succeed in getting the share registered in his name.

Doctrine of Indoor Management

24. Under the Articles of Association of ABC Ltd. Company, directors had power to borrow up to ₹10,000 without the consent of the general meeting. The Directors themselves lent ₹35,000 to the company without such consent and took debentures of the Company. Decide under the provisions of the Companies Act, 2013, whether the company is liable? If so, what is the extent of liability of the company in this case? **(MTP MAY 2013)**

Solution:

Law: As per exception to doctrine of Indoor management, where a person dealing with a company has actual or constructive notice of the irregularity as regards internal management, he cannot claim the benefit under the rule of indoor management and such contract will not be enforceable on the company.

Ref case: Howard vs Patent Ivory Manufacturing Company

Conclusion: In this case, the directors of a company could borrow any amount up to ₹10,000/- without the resolution of the company in a general meeting. But for any amount beyond

₹10,000/- they had to obtain the consent of the shareholders in a general meeting. The directors themselves lent ₹35,000/- to the company without such consent and took debentures. The directors had the notice of the internal irregularity and hence the company was liable to them only for ₹10,000/-.

Section 13 Procedure to alter Object clause

25. Rishi Pharmacy Ltd. decided to take up the business of food processing because of the downward trend in pharmacy business. There is no provision in the object clause of the Memorandum of Association to enable the company to carry on such business.

State whether its object clause can be amended? Mention briefly the procedure to be adopted for change in the object clause. **(MAY 2016)**

Solution:

Procedure to alter Object Clause

Company can pursue only that object which is mentioned in object clause of memorandum. Any contract not supported by object clause of MOA is void ab initio Following are procedure to alter object clause of MOA

(i) A company may alter its object clause by passing SR.

(ii) If a company has raised money from the public by issue of a prospectus, and any part of it remains unutilized with the company, then the company shall alter its objects for which it raised the money through prospectus if following conditions are satisfied:

(a) the company has published the prescribed details and justification for such alteration in 2 -newspapers (one English newspaper and one newspaper in vernacular language) circulating at the place where the registered office of the company is situated;

(b) the prescribed details and justification for such change have been placed on the website of the company, if any, and

(c) the dissenting shareholders have been given an exit opportunity by the promoters and shareholders having control in accordansce with the regulations to be specified by SEBI

(iii) The company shall file a copy of SR with the Registrar within 30 days.

(iv) The Registrar shall register the alteration and issue a certificate of registration within 30 days of receipt of the SR.

Section 14 Procedure to alter AOA

26. The Board of Directors of Sindhu Limited wants to make some changes and to alter some Clauses of the Articles of Association which are to be urgently carried out, which include the increase in Authorized Capital of the company, issue of shares, increase in borrowing limits and increase in the number of directors. Discuss about the provisions of the Companies Act, 2013 to be followed for alteration of Articles of Association. **(RTP NOV 2018)**

Solution:

Alteration of Articles of Association

Section 14 of the Companies Act, 2013, vests companies with power to alter its articles. The law with respect to alteration of articles is as follows:

(i) A company may alter its articles by a special resolution, subject to the provisions of this Act and the conditions contained in its memorandum.

(ii) Every alteration of the articles and a copy of the order of the Central Government approving the alteration, shall be filed with the Registrar, together with a printed copy of the altered articles, within a period of fifteen days in Form No. INC 27

Section 19 Subsidiary Not to Hold Shares in Holding

27. As at 31st March, 2018, the paid up share capital of S Ltd. is ₹1,00,00,000 divided into 10,00,000 equity shares of ₹10 each. Of this, H Ltd. is holding 6,00,000 equity shares and 4,00,000 equity shares are held by others. Simultaneously, S Ltd. is holding 5% equity shares of H Ltd. out of which 1% shares are held as a legal representative of a deceased member of H Ltd. On the basis of the given information, examine and answer the following queries with reference to the provisions of the Companies Act, 2013: **(MAY 2019)**

(i) Can S Ltd. make further investment in equity shares of H Ltd. during 2018-19?

(ii) Can S Ltd. exercise voting rights at Annual general meeting of H Ltd.?

(iii) Can H Ltd. allot or transfer some of its shares to S Ltd.?

Solution:

Law:

(i) Section 2(87) provides that a company shall be deemed to be a subsidiary of another, if any of the following conditions are satisfied:

(a) That other controls the composition of its board of directors;

(b) That other exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies; or through its Subsidiaries

(ii) As per section 19 of the Companies Act, 2013

(a) A subsidiary company shall not hold any shares in its holding company either itself or through its nominee.

(b) A holding company shall not allot or transfer its shares to any of its subsidiary companies and if so done, it shall be void.

Section 19 is not applicable to a case:

(a) where the subsidiary company holds such shares as the legal representative of a deceased member of the holding company; or

(b) where the subsidiary company holds such shares as a trustee; or

(c) where the subsidiary company is a shareholder even before it became a subsidiary company of the holding company:

However, the subsidiary company to whom section 19 does not apply, shall have a right to vote at a meeting of the holding company only in case (a) or (b) mentioned above.

Conclusion: In the instant case,

(i) As per the provisions of sub-section (1) of Section 19 of the Companies Act, 2013, no company shall, either by itself or through its nominees, hold any shares in its holding company. Therefore, S Ltd. cannot make further investment in equity shares of H Ltd. during 2018-19.

(ii) As per second proviso to Section 19, a subsidiary company shall have a right to vote at a meeting of the holding company only in respect of the shares held by it as a legal representative or as a trustee. Therefore, S Ltd. can exercise voting rights at the Annual General Meeting of H Ltd. only in respect of 1% shares held as a legal representative of a deceased member of H Ltd.

(iii) Section 19 also provides that no holding company shall allot or transfer its shares to any of its subsidiary companies and any such allotment or transfer of shares of a company to its subsidiary company shall be void. Therefore, H Ltd. cannot allot or transfer some of its shares to S Ltd.

Section 19

28. Octagon Limited is holding 58% of the paid up share capital of Pentagon Limited. Vijay, one of the shareholders of Octagon Limited, holding 10% shares of the company, has made a charitable trust. He donated his 10% shareholding in Octagon Limited and ₹20 crore to the trust. He appointed Pentagon Limited as the trustee. All the assets of the trust are held in the name of Pentagon Limited. As per the provisions of the Companies Act, 2013, decide whether Pentagon Limited can hold shares of Octagon Limited. **(6 Marks) (MTP Sep. 22) (5 Marks) (MTP Aug 24)**

Solution:

Law: Hint – similar to above question

Conclusion: In the given case, one of the shareholders of holding company (Octagon Limited) has transferred his shares in the holding company to a trust where the shares will be held by subsidiary company (Pentagon Limited). It means now subsidiary will hold shares in the holding company. But it will hold shares in the capacity of a trustee. Therefore, we can conclude that in the given situation Pentagon Limited can hold shares in Octagon Limited.

Section 19

29. ABC Limited issued equity shares worth 1,00,000 (10,000 shares of 10 each) on 1st April, 2023 which has been fully subscribed, whereby XYZ Limited holds 3,500 equity shares and PQR Limited holds 2,500 equity shares. Prior to the issue of equity shares, ABC Limited already hold 20% of

the equity shares of MNP Limited. Further, XYZ Limited holds 10% of MNP Limited's equity shares as a trustee. MNP Limited controls the composition of the Board of Directors of XYZ Limited and PQR Limited on 01.07.2023. Examine with reference to the relevant provisions of the Companies Act, 2013 — **(Nov 23) 5 Marks**

(i) Whether ABC Limited is a subsidiary of MNP Limited ?

(ii) Whether ABC Limited and XYZ Limited have the right to vote on the Annual General Meeting of MNP Limited held on 30th September, 2023?

Solution:

Law: Similar to above question

Conclusion: In present case ,

(i) since MNP Limited controls the composition of the Board of Directors of XYZ Limited and PQR Limited they are subsidiaries of MNP ltd and since XYZ Limited holds 3,500 equity shares and PQR Limited holds 2,500 equity shares i.e subsidiaries of MNP holds more than half of its voting rights(6000 out of 10000 shares) in ABC ltd , ABC ltd is subsidiary of MNP ltd

(ii) ABC ltd has no voting rights in MNP ltd as it held shares before becoming subsidiary but XYZ Limited have the right to vote on the Annual General Meeting of MNP Limited as it held shares as a trustee

Section 19

30. S Ltd acquired 10% paid up share capital of H Ltd on 15th March 2017. H Ltd acquired 55% paid up share capital of S Ltd on 10th March 2018. H Ltd. on 25th September, 2020 decided to issue bonus shares in the ratio of 1:1 to the existing shareholders. **(Nov 2020)**

Accordingly, bonus shares were allotted to S Ltd.

Examine under the provisions of the Companies Act, 2013 and decide

(i) the validity of holding of shares by S Ltd. in H Ltd.

(ii) allotment of Bonus shares by H Ltd. to S Ltd.

Solution:

Law: As per Section 19 of the Companies Act, 2013, no company shall, hold any shares in its holding company and no holding company shall allot or transfer its shares to any of its subsidiary companies and any such allotment or transfer of shares of a company to its subsidiary company shall be void.

However, this shall not apply where the subsidiary company is a shareholder even before it became a subsidiary company of the holding company.

Conclusion: In the given case, H Ltd. has acquired 55% paid up share capital of S Ltd. on 10th March 2018. Whereas, S Ltd. has been holding 10% paid up share capital of H Ltd. since 15th March, 2017. The said instance as asked in the question falls under the exception stated above.

Therefore –

(i) Holding of shares by S Ltd. in H Ltd. is valid in view of the proviso (c) to sub-section of section 19 of the Act, which states that the restrictions of provisions of section 19(1) will not be applicable where the subsidiary company is a shareholder even before it became a subsidiary company of the holding company.

(ii) Allotment of bonus shares by H Ltd. to S Ltd. is also valid in view of the above proviso.

Section 19

31. New Ltd. is a company in which Old Ltd. is holding 65% of its paid up share capital. One of the shareholder of Old Ltd. made a charitable trust and donated his 10% shares in Old Ltd. and ₹50 crore to the trust. He appoints New Ltd. as the trustee. All the assets of the trust are held in the name of New Ltd. Can a subsidiary hold shares in its holding company in this way?

(MTP Sept 24)

Solution:

Law: According to section 19 of the Companies Act, 2013 a company shall not hold any shares in its holding company either by itself or through its nominees. Also, holding company shall not allot or transfer its shares to any of its subsidiary companies and any such allotment or transfer of shares of a company to its subsidiary company shall be void.

Following are the exceptions to the above rule:

(a) where the subsidiary company holds such shares as the legal representative of a deceased member of the holding company; or

(b) where the subsidiary company holds such shares as a trustee; or

(c) where the subsidiary company is a shareholder even before it became a subsidiary company of the holding company but in this case it will not have a right to vote in the meeting of holding company.

Conclusion: In the given case one of the shareholders of holding company has transferred his shares in the holding company to a trust where the shares will be held by subsidiary company. It means now subsidiary will hold shares in the holding company. But it will hold shares in the capacity of a trustee. Therefore, we can conclude that in the given situation New Ltd. can hold shares in Old Ltd.