

Borrowing Powers of Company – Provisions, Exemptions & Case laws under Companies Act, 2013

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This article is an analysis of the provisions, exemptions & compliances for private companies and public companies under section 179 and section 180 of the Cos. Act, 2013. The focus of the article is primarily on borrowing powers of the company. There is also a discussion on the prominent case laws relating to the subject.

Introduction

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Borrowing limits under section 180(1)(c) of the Act

1. Section 180 of the Companies Act, 2013 ('Act') relates to 'restrictions on powers of board of directors'. It states that the board of directors of a company shall exercise certain powers (as prescribed in section 180 of the Act and the Rules made there under) only with the consent of the company by a special resolution. Pursuant to clause (c) of sub-section (1) of section 180 of the Act, the board of directors of the company can borrow money, provided the money to be borrowed, together with the money already borrowed by the company does not exceed aggregate of its paid-up share capital, free reserves and securities premium. Prior to the Companies (Amendment) Act, 2017¹, the company could borrow only up to paid-up share and free reserves. The borrowing limits have been enhanced.

The threshold limit prescribed under clause (c) of sub-section (1) of section 180 of the Act shall not include temporary loans obtained from the company's bankers in the ordinary course of business. There are 3 issues in identifying the exception: (i) What are temporary loans? (ii) Who are company's bankers? (iii) What is the meaning of temporary loan obtained in the ordinary course of business? Out of the 3 issues, 'temporary loan' is defined in the Act², it means loans repayable on demand or within 6 months from the date of the loan such as short-term, cash credit arrangements, the discounting of bills and the issue of other short-term loans of a seasonal character. However, 'temporary loan' does not include loans raised for the purpose of financial expenditure of a capital nature. Such loans are to be excluded from 'temporary loans', even if they are for the period less than 6 months.

The acceptance by a banking company, in the ordinary course of its business, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise, shall not be deemed to be borrowings of monies by the banking company within the meaning of clause (c) of sub-section (1) of section 180 of the Act³.

MCA provided clarity on transition issues - from compliance under Companies Act, 1956 to compliance under Companies Act, 2013

2. The MCA received many representations regarding various difficulties arising out of implementation of section 180 of the Companies Act, 2013 with reference to borrowings and/or creation of security, on the basis of ordinary resolution. MCA stated that the resolution passed under section 293 of the Companies Act, 1956 prior to September 12, 2013 with reference to borrowings (subject to the limits prescribed) and/or creation of security on assets of the company would be regarded as sufficient compliance of the requirements of section 180 of the Companies Act, 2013 for a period of 1 year from the date of notification of section 180 of the Act (i.e., September 12, 2013).

Applicability & exemptions from the compliance of section 180 of the Act:

- (i) **Private companies:** The provisions of section 180 of the Act are not applicable to private companies⁴. Such exemption is applicable even in cases where the private companies do not have an express provisions w.r.t. their exemptions in their articles of association;
- (ii) **Public companies:** The provisions of section 180 of the Act are entirely applicable to unlisted and listed companies. The provisions are also applicable to private companies that are subsidiaries of public companies;
- (iii) **Certain class of unlisted public companies,⁵ i.e., Specified IFSC public company:** Unlisted public company which is licensed to operate by the RBI or the SEBI or IRDAI from International Financial Services Centre located in an approved multi-services Special Economic Zone⁶ shall comply with provisions of section 180 of the Act, unless the articles of the company provide otherwise.

Borrowing powers under section 179(3)(d) of the Act

4. Section 179 of the Act relates to 'powers of the board of directors'. The board of directors of a company shall be entitled to exercise all such powers, and to do all such acts and things, as the company is authorised to exercise and do. The board of directors of a company (whether a private company or public company) shall exercise certain powers on behalf of the company by means of resolutions passed at meetings of the Board, i.e., such decision cannot be taken by the board of directors by passing a Circular Resolution under the provisions of the Act. Clause (d) of sub-section (3) of section 179 of the Act states that the board can borrow monies only with the approval of the board of directors at its meeting.

5. Exemptions from the compliance of section 179(3)(d) of the Act:

- (i) **In case of a Specified IFSC private company:** In case of a Specified IFSC private company, the board of directors of the company can exercise the powers (prescribed in sub-section (3) of section 179 of the Act) by means of resolutions passed at the meetings of the board of directors or through resolutions passed by circulation⁷;
- (ii) **In case of a Specified IFSC public company:** In case of a Specified

IFSC public company, the Board can exercise powers (prescribed in sub-section (3) of section 179 of the Act) by means of resolutions passed at the meetings of the Board or through resolutions passed by circulation⁸;

- (iii) *Companies incorporated under Section 8 of the Act*: In case of companies incorporated under section 8 of the Companies Act, 2013/Section 25 of the Companies Act, 1956, the matters referred to in clauses (d), (e) and (f) of sub-section (3) may be decided by the Board by circulation instead of at a meeting.

Delegation of authority by the board of directors to borrow money

6. The board of directors of the company may, by a resolution passed at a meeting, delegate the powers to borrow monies (invest funds of the company and grant loans or give guarantee or provide security in respect of loans) to any of the following:

- (i) Any committee of directors,
- (ii) Managing Director,
- (iii) Manager, or
- (iv) Any other principal officer of the company
- (v) In the case of a branch office of the company, the principal officer of the branch office.

The board of directors may specify any condition w.r.t. the borrowing of money. Such conditions could be approval matrix in a company, amount of money to be borrowed, etc⁹.

Following activity shall not be deemed to be borrowing of monies or loans by banking company ¹⁰

6.1 Acceptance by a banking company in the ordinary course of its business of deposits of money from the public repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise, or the placing of monies on deposit by a banking company with another banking company on such conditions as the Board may prescribe, shall not be deemed to be a borrowing of monies or, as the case may be, a making of loans by a banking company within the meaning of section 179 of the Act.

The provisions of clause (d) of sub-section (3) of section 179 of the Act shall not apply to borrowings by¹¹:

- (i) Banking company from other banking companies, or
- (ii) Banking company from Reserve Bank of India, or
- (iii) Banking company from the State Bank of India, or
- (iv) Banking company from other banks established by or under any Act.

In respect of dealings between a company and its bankers, the exercise by the company of the power specified in clause (d) of sub-section (3) of section 179 of the Act shall mean the arrangement made by the company with its bankers for the borrowing of money by way of overdraft or cash credit or otherwise

and not the actual day-to-day operation on overdraft, cash credit or other accounts by means of which the arrangement so made is actually availed of¹².

7. Analysis of a few important case laws relating to borrowing by the company

- (i) **Powers of directors where agent's unauthorised act has been ratified, whether it binds company?:** Under the articles of association of company, the power to borrow is vested only in the directors. In an emergency, the managing agent contracted for an overdraft from a bank. The amount of overdraft was shown in two subsequent balance sheets, which had been signed by the directors at the board meetings. The question was whether the act of the agent had been ratified by the directors so as to be binding on the company. The Allahabad High Court *Dehra-Dun-Mussoorie Electric Tramway Co. Ltd. v. Jagminder Das* [1931] 1 Comp. Cas. 227 held that, though the managing agent exceeded yet his powers in obtaining the loan to meet an emergency, yet his action was never repudiated, but, on the contrary, was clearly ratified by the board of directors. Therefore, the company could not escape liability on the ground that their managing agent had no authority to raise the loan;
- (ii) **Company's liability where money is borrowed, but there is a complete prohibition on the delegation on the board's power to borrow:** The articles of association of company prohibited the delegation of the board's power to borrow. At the same time, the managing agent was given very extensive power to conduct and manage the business and affairs of the company and 'to enter into all contracts and to do all other things usual, necessary or desirable in the management of the affairs of the company'. The company had ordered machinery and stores from England which had arrived and had to be paid for without delay. Money was, therefore, urgently required and the managing agent contracted for an overdraft with a bank. It was not disputed that the money had been utilised at once for the purposes of the company. The question was whether the agreement for overdraft bound the company? The Allahabad High Court *Dehra-Dun-Mussoorie* case (*supra*) held that under sections 188 and 189 of the Indian Contract Act an agent has very extensive powers in an emergency to do such acts as are necessary for the purpose of protecting his principal from loss and for carrying on the business. In the instant case, under the articles of association also the managing agent was given extensive powers to do any anything necessary in the management of the affairs of the company. In the circumstances of this case the managing agent might well be regarded as being faced with an emergency and, thus, authorised under the ordinary rules of agency to obtain temporary accommodation from the bank for the purpose of protecting the interests of the company. It was not denied that the loan was necessary and that the money was at once utilised for the purposes of the company. Although the managing agent had no general power to borrow money on behalf of the company, nevertheless he was authorised to incur a temporary loan in the interests of the company in an emergency such as arose in the present case. Therefore, the company was liable for overdraft;
- (iii) **Can shareholders ratify the acts of directors which are intra vires company, though they may not be intra vires board of directors?** A company had only two shareholders. Its

share capital was Rs. 99,000, and it borrowed Rs. 3.97 lakhs on the strength of a promissory note executed by the two shareholders. The articles of the company provided that the Regulations in Table A of the First Schedule of the 1913 Act would be applicable to it, so far as they related to a private company and in so far as they were not excluded or modified by the articles of the company. There was no specific power given to directors to borrow nor was there a limitation in the articles on their power to borrow. The question was whether the company was bound by the promissory note. The Madras High Court *Sri Balasaraswathi Ltd. v. A Parameswara Aiyar* [1956] 26 Comp. Cas. 298 held that regulation 73 of Table A of Schedule I of the 1913 Act presumes that the directors have power to borrow on behalf of the company subject to the limitation that borrowing in excess of the issued capital should be only with the consent of the shareholders. The usual presumption is that the directors of the company would be entitled to borrow subject to the restrictions placed on the borrowing powers in the memorandum and articles of association. The memorandum and articles of association did not say that the directors should not borrow at all on behalf of the company. No specific power to borrow was, in the circumstances, necessary. The directors could borrow on behalf of the company up to the issued share capital of Rs. 99,000, as contemplated in regulation 73 in Table A of Schedule I and even above that amount with the assent of the shareholders. A company is bound in a matter *intra vires* the company by the unanimous agreement of all its incorporators, and that if all the individual incorporators in fact assent to a transaction that is *intra vires* the company, though *ultra vires* the board, it is not necessary that they should hold a meeting in one room or one place to express that assent simultaneously;

- (iv) ***Prima-facie liability for offence under section 138 of Negotiable Instruments Act, 1881:*** A complaint under section 138 of the 1881 Act was filed against the petitioner-company and its directors, and an order issuing process against the accused directors was passed under section 138. The non-bailable warrants came to be issued against the accused directors of the petitioner-company. That issuance of process was challenged before the Court. The Bombay High Court observed¹³ that by virtue of the fact that the petitioner-company and its directors could avail of financial assistance from the respondent-company and their power to borrow monies otherwise than on debentures, solely rested with the board of directors of the company (as provided under section 292 of the Companies Act, 1956¹⁴). The High Court held that the accused before the Trial Court were, *prima facie* liable to be proceeded against and punished for having committed offence under section 138 of the Negotiable Instruments Act.

Conclusion

8. Borrowings, whether short-term or long-term, are important sources of raising finance by the company. Depending on the lender, terms and conditions involved, the cost of raising money by borrowing may be less. The time and documentation involved in entering into a borrowing transaction is also less. The other provisions of the Companies Act are also applicable (creation of charge and maintaining registers under the provisions). Compliances relating to external commercial borrowings are also relevant where an Indian company has borrowed from 'recognized lenders' (as

prescribed in FEMA and RBI Guidelines). Interestingly, as per the Companies Act and SEBI's Listing Regulation, the Audit Committee has no role to play in approving/reviewing/monitoring the borrowings of the company, unless such transaction is with a related party.

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1. With effect from February 9, 2018.
 2. Explanation to clause (c) of sub-section (1) of section 180 of the Companies Act, 2013.
 3. Proviso to clause (c) of sub-section (1) of section 180 of the Act.
 4. MCA Notification No. GSR 464(E) [F.NO.1/1/2014-CL-V], Dated June 5, 2015
 5. MCA Notification No. GSR 8(E) [F.NO.3/1/2015-CL.I], dated January 4, 2017
 6. Set-up under the Special Economic Zones Act, 2005 read with the Special Economic Zones Rules, 2006
 7. MCA Notification No. GSR 9(E) [F.NO.3/1/2015-CL.I (PART-1)], dated January 4, 2017.
 8. MCA Notification No. GSR 8(E) [F.NO.3/1/2015-CL.I], dated January 4, 2017
 9. First Proviso to sub-section (3) of section 179 of the Act.
 10. Second Proviso to sub-section (3) of section 179 of the Act.
 11. Explanation I to sub-section (3) of section 179 of the Act.
 12. Explanation II to sub-section (3) of section 179 of the Act.
 13. *Orient Syntex Ltd. v. Besant Capital Tech Ltd.* [2001] 104 COMP CASE 669 (Bombay).
 14. Corresponding to section 179 of Companies Act, 2013.