QUORUM CRISIS: WHAT A COMPANY SHOULD DO

Introduction

According to Companies Act 1994 (‘the Act’) a public company must have at least seven members and three directors, while a private company shall have at least two members and two directors.[1]

The members and the directors meet together periodically and take important business decisions. To be able to take any decision, these meetings must be attended by a minimum number of directors/members, which is called a ‘quorum’.

Quorum for the directors’ meetings and the shareholders’ meetings are usually found in the articles of a company. If there is nothing in the articles, the Act provides that in case of general meetings of a private company whose number of members does not exceed six, three members, and in case of any other company, five members personally present shall be a quorum.[2] Schedule-I to the Act also lays down that two members in case of a private company and five members in case of a public company will be the quorum.[3] For meetings of the board of directors, if the number of directors is more than three, three is the quorum.[4]

Sometimes it may so happen that the number of directors or shareholders is reduced below the quorum necessary for transaction of businesses, by reasons of death etc. Two distinct situations can be envisaged: (1) the number of directors falls below the quorum but there remains the required number of shareholders to fulfil the quorum for a general meeting (as where the quorum for both kinds of meetings is two, and there is only one director left but there remain two or more shareholders), and (2) the number of both directors and shareholders are reduced below the quorum necessary for transacting any business (as where there is only one shareholder-director left).

In the first-mentioned situation, where there are not enough directors for quorum purposes but there are enough shareholders, all that is needed is to increase the number of directors. But in the second scenario the sole shareholder-director has to find a way for bringing in new shareholders first, and then increase the number of directors.

What follows is a discussion on possible solutions for the two kinds of predicaments mentioned above. The court’s power in this regard under section 85(3) of Companies Act 1994 is also discussed. The situations in the UK and in India are also touched upon by way of comparison.

Number of directors falls below the quorum but there are sufficient shareholders

Let us suppose a company has three shareholders, two of whom are directors. One of the directors dies. Now there are two shareholders, one of whom is a director. The quorum is two for both the directors' meeting and the general meeting. So the general meeting has the necessary quorum of two but the board of directors' meeting lacks quorum.

In such a case the company has to take recourse to regulation 90 of Schedule-I to Companies Act 1994, which provides as follows:

> "90. The continuing directors may act notwithstanding any vacancy in their body; but, if and so long as their number is reduced below the number fixed by or pursuant to the regulations of the company as the necessary quorum of directors, the continuing directors may act for the purpose of increasing the number of directors to that number, or of summoning a general meeting of the company, but for no other purpose."

Thus where there aren't sufficient directors to fulfil a quorum, the remaining director or directors may act only for two purposes: to increase the number of directors, and to call a general meeting.

So the sole remaining director in our example scenario may either call a board meeting for filling in the vacancy in accordance with section 91(1)(c) and regulation 85 (co-option), or may call an extraordinary general meeting for electing a director under section 91(1)(b).

If he wants to go for co-option, he will duly issue a notice for meeting of the board of directors, with the agendum of filling in the casual vacancy in the board. The meeting will be attended by him alone. In the meeting he can co-opt the non-director shareholder as a director of the company. The board will then have achieved the necessary quorum and can function as normal. In case the new director does not have the qualification shares as specified in the articles, he may obtain them within sixty days after his appointment.[5]

However, co-option probably should not be used when there are other options available, because the general rule is that only the shareholders are competent to elect a director at a general meeting from amongst their number.[6]

Therefore, perhaps the better option would be to convene an extraordinary general meeting, with an agendum of election of directors. Election will take place in the general meeting, and there being only one contestant, the non-director shareholder will be elected unopposed.

What if the remaining director refuses to act? What if he is unwilling to call any meeting and rectify the situation? In that case the other shareholder must bring the matter to court and seek remedy under section 85(3) of the Companies Act (see below), because he, not being a director, cannot call any meeting on his own. As per our law a single director may call a meeting, but it takes two shareholders to be able to call a meeting in an emergency.[7]

So if there were two more shareholders other than the director-shareholder, the two shareholders could call a general meeting for the purpose of election of directors.[8]

Situation in other countries, e.g. in the UK and in India, is similar. In the UK the "Model Articles for Public Companies" provides that if the company has fewer than two directors (but two or more shareholders), and the director (if any) is unable or unwilling to appoint sufficient directors to make up a quorum or to call a general meeting to do so, then two or more shareholders may call a general meeting, or instruct the company secretary to do so, for the purpose of appointing one or more directors.[9] However, no provision has been made in the model articles for private companies for shareholders to convene meetings.

In India regulation 69 of Schedule I, Table F of Companies Act 2013[10] corresponds to our regulation 90 of Schedule I, and provides that the "…continuing directors or director may act for the purpose of increasing the number of directors to that fixed for the quorum, or of summoning a general meeting of the company, but for no other purpose."

There is scanty precedent on the subject of the number of directors falling below the quorum, but it has been established that the directors cannot act unless the number is first made up by the board itself or through general meeting.[11]

In *Channel Collieries Trust Ltd. v. Dover St. Margaret's and Martin Mill Light Rly*[12] the articles of the company provided that the minimum number of directors should be three and the quorum for the board's meeting should be two. The articles also gave power to the "remaining directors" to fill vacancies. The company began with three directors, then two of them resigned leaving only one director in office. When he co-opted a director from the other shareholders, it was contended that the co-option was invalid because the board had neither the minimum strength nor even the quorum provided by the articles. Rejecting this contention Lord Cozens Hardy M.R. observed as follows:

> "Sir John Jackson thus became sole director. What was his power? Under the Companies Clauses Act, 1845, as continuing director, he had power to fill up the vacancies on the board. The fact that a person exercising that power does not constitute a quorum is not really a relevant matter. The generality of the language used in Section 99 is so clear that it is impossible for us to overlook it. Any other view on that point would paralyse many a company."

The observations of Swinfen Eady L.J. are also illuminating inasmuch as our regulation 90 speaks of 'continuing *directors'*, not '*director'*:

> "I think that the context requires that the words 'remaining directors' should include the case of a remaining director. It is obvious that the number of the board may, by death or resignation or otherwise, be so reduced that it may be below the quorum, as well as that there may be vacancies occurring in the board whilst still leaving a quorum, but in either case it is necessary or proper that the vacancy should be filled up. In my opinion the necessity of the case requires that 'the remaining

> directors' should be read as including the case of a remaining director, so that if and so long as there is any remaining director he may proceed to fill up the board by appointing persons when casual vacancies occur."

In the Indian case of *A. Ananthalakshmi Ammal vs The Indian Trades And Investments Limited*[13] Madras High Court applied the above English principle and held that it was lawful for a single remaining director to co-opt another director when the strength of the board had fallen below the prescribed quorum.

Number of directors and shareholders both fall below the quorum

Here the example scenario would be where the company had two shareholders who were also directors. One of them has died, with the result that the company now has only one person as a shareholder-director. How can he increase the number of directors and shareholders?

In such a case seeking the court's directives under section 85(3) will be the best option (see below).

Let us try to find a solution that does not involve the court's intervention.

If the deceased shareholder has heirs, then the deceased's shares will be transmitted to the heirs by operation of law.[14] Alternatively, the sole member may transfer some of his own shares to any willing buyer, with a view to increasing the number of shareholders. In either case, the heirs or the transferee, as the case may be, will apply to the company for approval and registration.[15]

Now we have established that a single director may convene a meeting under regulation 90 even in the absence of quorum for board meetings, for the purpose of co-opting a director from amongst the shareholders. But can the sole director convene a board meeting for the purpose of approval and registration of any person as shareholder?

This is an open-ended question, which is in need of judicial pronouncement. Regulation 90 permits an "act" of the remaining director which is meant to increase the number of directors. If the "act" of co-option is permitted, it is submitted that the "act" of registration of a transfer/transmission should also be permitted, given that increasing the number of shareholders is the only prerequisite for an increase in the number of directors.

Besides, such transmissions or transfers are most likely to be non-contentious, given that all parties to such transactions are usually in agreement. Also, any way out conjured up by corporations that avoids burdensome litigation should be encouraged.

Once the new member or members are registered, an extraordinary general meeting may be called in the manner described in the previous section, where election of directors will take place and a new director will be chosen.

But in an attempt to increase the number of shareholders, the sole member-director cannot probably issue new shares to a person of his choice in the board meeting convened by him under the auspices of regulation 90. Increasing the subscribed capital of the company under section 155 of Companies Act by issue of further shares within the limit of the authorized capital of the company is a serious decision which should be taken by a properly constituted board of directors.

Whatever the single remaining member does, he must do it quickly, keeping in mind the provision contained in section 222 of the Companies Act. This section provides that if the number of members is reduced below the statutory minimum and the company carries on business for more than six months, the remaining members will be individually liable for the payment of the whole debts of the company contracted during the default period.

Court's power to call a meeting

In all of the above situations the option to seek the court's direction is available under section 85(3) of the Act. This provision lays down that if for any reason it becomes impracticable to call a meeting of a company in the manner prescribed by the articles or the Act, the court of its own motion or on the application of any director order a meeting of the company to be called and conducted in such manner as the court thinks fit. The court may also give such ancillary or consequential directions as it thinks expedient.

Similar provisions are retained in both the 2006 Act of the UK (section 306) and the 2013 Act of India (section 98).

The word "impracticability" is notoriously difficult to define. In the UK section 306 has been mostly used in response to quorum requirements for shareholder meetings. In India examples include: *Re Baptist Church Trust Association v. Members C.L.B*.[16] (rival groups holding meetings at separate places and appointing separate sets of office bearers), *Re Lothian Jute Mills Co. Ltd*.[17] (board of directors divided into faction), *Re Motion Pictures Association*[18] (dispute as to directorship), *Bengal and Assam Investors Ltd. v. J.K.E. Industries*[19] (impracticable from business point of view), *M.K. Srinivasan v. W.S. Subrahmanya Ayyar*[20] (usurpation of shareholders' powers by directors).

In *Bangladesh Bank vs. Sk Abul Hossain and others*[21] our Appellate Division held that before exercising the power to call a meeting under section 85(3) the court must be satisfied that it is impracticable to call a meeting in the manner in which such a meeting is to be called. Sections 81(2) and 85(3) pertain to procedural impracticability and not to any impediment imposed by operation of law. The impracticability of calling such a meeting must be determined primarily in light of the articles and the provisions of Companies Act.

In a Scottish case, *Re Edinburgh Workmen's Houses Improvement Co. Ltd*.[22] the Lord President observed: "I think the expression impracticable…to conduct the meeting of the company in a manner prescribed by the articles is sufficient to cover a case in which it is impracticable, owing to the terms of the articles and the state of the shareholding in the company, to get a quorum present."

So if it is impracticable to get a quorum present, the court can interfere, but the impracticability must be determined by reference to the terms of the articles or the Companies Act. Section 85(3) too refers to impracticability of holding a meeting "in the manner prescribed by the articles or the Act."

But our articles (Schedule-I) allows even a single director to proceed with convening meetings without going to court. Regulation 90 is sufficiently clear in providing that even if the number of directors falls below the required quorum the continuing directors may call a general meeting (if, of course, there are other shareholders). Regulation 49 also allows a single director or two members of the company to call a general meeting when quorum is lacking for absence of any other director, so that if the single director is unwilling to act the members may convene a general meeting. So calling a general meeting is not *impossible* as per the articles, at least in the first scenario mentioned above where the number of directors falls below the quorum but there are other shareholders. Could, then, section 85(3) be invoked in such a situation?

It has been held that the word "impracticable" does not mean impossible: even if it is not impossible to call a meeting, it may be impracticable from a reasonable point of view.[23] Therefore, it is arguable that when the number of directors is reduced below the necessary quorum, the court may interfere under section 85(3) and order a meeting to be held and give ancillary directions for the number to be sufficiently restored to form a quorum.

As to the second scenario mentioned above, i.e. where the number of both directors and shareholders falls below the quorum, there is no doubt that the sole surviving member-director may approach the court, and the court may convene meetings.[24] If one of two member-directors refuses to attend any meeting the court may use discretionary power to order meetings to be held with the presence of one member-director as sufficient quorum.[25]

Conclusion

In the UK private limited companies and public limited companies need only have one shareholder since the introduction of the Companies Act 2006. Any company, private or public, can be incorporated with a single member. If a company is incorporated with more than one member but subsequently the membership falls to one, there is no requirement that the number be increased: it may remain as a single member company. All it needs to do is to place a note on the register of members stating that the company now has only one member, and the date on which this became the case. If the membership of a single member company increases to more than one, a similar note is to be placed on the register. These declarations are mandatory, failing which the company and every officer in default will have committed an offence, punishable by a fine.[26] The quorum is one for single member companies, and for companies with more than one members the quorum is two, unless the articles determine otherwise.[27]

The idea sounds simple but neat. In Bangladesh, through the enactment of the new Companies (Second Amendment) Act 2020, we have now introduced the idea of "one person company". But we have followed the models of India and Pakistan and have separated the new category into a rigid compartment. If we had followed England's lead, there would have been smooth transition between different categories of companies, and reduction of number of members or directors would not have posed any difficulty. If the number of members or directors were reduced to one, the company could have stayed as a single member company and its quorum would have automatically changed to one. This would have been a simple but elegant solution to the problems discussed in this essay.

Endnotes:

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[1] See sections 5 and 90, Companies Act 1994
[2] Section 85(2)(b), ibid
[3] Regulation 52, Schedule-I, Companies Act 1994
[4] Regulation 89, Schedule-I
[5] Section 97
[6] Section 91(1)(b)
[7] See regulation 49 and 90 of Schedule-I
[8] Regulation 49, Schedule-I
[9] Article 28
[10] Corresponding to regulation 75 of Schedule I, Table A of the 1956 Act
[11] See *Re Scottish Petroleum Co*. (1883) 23 Ch. D. 413; *Re Bank of Syria*, (1900) 2 Ch. 272; *Channel Collieries Trust Ltd. v. Dover St. Margaret's and Martin Mill Light Rly*, (1914) 2 Ch. 506
[12] (1914) 2 Ch. 506
[13] AIR 1953 Mad 467
[14] See section 38(6) of the Act and regulations 22 and 23 of Schedule-I
[15] The board of directors has the power to decline to recognize the transfer/transmission or to refuse to register a new shareholder (Regulation 20 and 22, Schedule-I)
[16] (1986) 60 Com Cases 381 (Cal.)
[17] (1951) 29 Com Cases 290
[18] (1974) 44 Com Cases 298
[19] AIR 1956 Cal. 658
[20] AIR 1932 Mad 100
[21] 59 DLR (AD) 60
[22] (1935) SC 56 (Scotland) n (quoted from A. Ramaiya, *Guide to the Companies Act*, 18th ed., p. 1650)
[23] See *Dr Jayaram Chigurupati v. Ranbaxy Vidisha*, (1962) 32 Com Cases 896; *Ghyasuddin Ahmed vs. QN Faruque*, 38 DLR (AD) 296; *Bangladesh Bank vs. Sk Abul Hossain and others*, 59 DLR (AD) 60 (para 4)
[24] An English example is *Jarvis Motors (Harrow) Ltd. v. Carabott*, (1964) 1 All ER 841 (Ch D), where it was held that if there remains only one surviving member,b ` the court may order a meeting to be called.
[25] See *Re Opera Photographic Ltd*., 1989 BCLC 763; *HR Paul & Sons Ltd*. (1973) 118 Sol J 166; *Re Sticky Fingers Restaurant Ltd*., 1992 BCLC 84 (Ch D); *Pucci Dante vs. Rafeeque Ahmed*, (1999) 95 Com Cases 566

[26] See section 123, Companies Act 2006
[27] Section 318, ibid