

Lesson 02

Question - 06

As In-house Legal Counsel for GAMA Tech Ltd., you are reviewing a contractual matter. The CEO Mr. Silva recently signed an IT Equipment Procurement Agreement, valued at Rs. 200 million, on behalf of the “GAMA AI Lab” a subsidiary - a special purpose vehicle for the company’s new IT project.

However, this contract was executed One month before the subsidiary was formally incorporated. The value of IT equipment has since dropped by 10%, due to exchange rate appreciation and market competition. The main board now wishes to withdraw from the deal, arguing that contract is invalid because the subsidiary – “GAMA AI Lab” did not exist at the time of signing the contract.

The board has asked for your legal advice on the following matters;

- a. Is GAMA AI Lab legally bound by the Agreement signed Mr. Silva, CEO of GAMA Tech Ltd?
- b. What would be the legal repercussions on Mr. Silva if GAMA AI Lab does not adopt the above contract by ratification?

You must analyze the contract’s enforceability and advise the board on the legal position.

DRAFT ANSWER

Relevant Sections – Sections 23-25

- The analysis begins by examining the fundamental nature of the contract as a pre-incorporation contract, explaining to the board that such contracts are not automatically binding on a newly formed company because the entity cannot be held liable for contracts made when it did not legally exist.
- We should check whether any acts of ratification occurred after the subsidiary’s incorporation under Section 23 (2) of the Companies Act. Therefore, we should verify if the “GAMA AI Lab Pvt Ltd” board passed any resolutions accepting the contract, made any payments or took possession of IT equipment which could constitute formal or implicit ratification making the contract enforceable.

- Under Section 24 of the Companies Act, if the subsidiary does not ratify the contract, the CEO who signed as promoter would be held personally responsible for the purchase obligation based on breach of implied warranty.
- Based on this analysis, if evidence of ratification exists, the contract would be valid and fully enforceable against the subsidiary; otherwise, the company may legitimately refuse the transaction, though the CEO would remain exposed to personal liability claims from the seller.

