

PAPER – 4 : CORPORATE LAWS AND SECRETARIAL PRACTICE

Question Nos. 1, 2 and 3 is compulsory.
Answer any four from the rest of the questions

Answer any two of the following:

Question 1

- (a) Mountbay company Limited decided to terminate the services of Mr. Gopal who was employed as Sales Manager. The Company, however, feels that the Sales Manager may not vacate the company's flat at Delhi. What action can be taken by the company under the Companies act, 1956 to regain possession of the flat? Is it necessary to take such action before terminating the services of Mr. Gopal? Will it make any difference, if the flat is not owned by the company, but taken on lease? (5 Marks)
- (b) The Executive Committee of a recognized stock exchange desires to transfer certain duties and functions of a clearing house to a recently set up clearing corporation, incorporated as a company under the companies Act,1956, examining the provisions of The Securities Contract (Regulation) Act, 1956. State the purposes for which such transfer of duties and functions can be made to clearing corporation.
What is the procedure to be adopted for such transfer of duties and functions? (5 Marks)
- (c) Mr. Bansal holds certain securities on 31st March, 2008, issued in his favour under the "Collective Investment Scheme." For a consideration, Mr. Bansal transferred the said securities in favour of another person. One month after the date on which the income on these securities became due, the transferee lodged the instrument of transfer. Decide in the light of the provisions of the Securities Contracts (Regulation) Act, 1956.
- (i) Whether in the given case Mr. Bansal is entitled to receive and retain the income on these securities for the financial year ended 31st March, 2008?
- (ii) What would be your answer in case the transferee lodged the instrument of transfer 10 days after the date on which the income on these securities became due? (5 Marks)

Answer

(a) ACTION AGAINST SALES MANAGER:

The company can take action under Section 630 of the Companies Act, 1956 if the sales manager refuses to vacate the premises provided by the company. According to Section 630, it is an offence if any officer or employee of a company

- (1) wrongfully obtains possession of any property of a company or
- (2) having any such property in his possession wrongfully withholds it or knowingly applies it to purposes other than those expressed or directed in the articles and authorized by the Act and such an offence is punishable with fine up to Rs. 10000/. Further the court may also order such officer or employee to deliver to the company

any such property wrongly obtained or wrongfully withheld within a time fixed by the court.

So the company can file a complaint under Section 630 as it provides speedy relief. Section 630 covers either existing as well as past officers or employees. Thus, action may also be initiated after termination of the services of Mr. Gopal.

It is not necessary that the property in question should be owned by the company. Even if the company exercises only a leasehold right, the provisions of Section 630 can be invoked.

- (b) A recognized stock exchange may, with the prior approval of the Securities Exchange Board of India, transfer the duties and functions of a clearing house to a clearing corporation, being a company incorporated under the Companies Act, 1956 for the purpose of:
 - (a) The periodical settlement of contracts and differences there under
 - (b) The delivery of, and payment for, securities;
 - (c) Any other matter incidental to, or connected with, such transfer

PROCEDURE

Every clearing corporation shall for the purpose of transfer of the duties and functions of a clearing house to clearing corporation, make byelaws and submit the same to the SEBI for approval.

The SEBI may, on being satisfied that it is in the interest of the trade and also in the public interest to transfer the duties and functions of the clearing house to a clearing corporation, grant approval to the byelaws submitted to it under sub-section (2) of Section 8A of the Securities Contracts (Regulation) Act, 1956 and approve transfer of the duties and function of a clearing house to a clearing corporation.

The provision of Sections 4 to 12 of the said act shall as far as may be apply to a clearing corporation as they apply in relation to a recognized stock exchange.

- (c) TRANSFER OF SECURITIES:

The problem as asked in the question is based on the provisions of Section 27A of the Securities contracts (Regulation) Act, 1956, wherein it shall be lawful for the holder of any securities, being units or the other instruments issued by collective investment scheme, whose name appears on the books of the scheme, issuing the said security to receive and retain any income in respect of units issued by the scheme in respect thereof for any year, notwithstanding that the said security, being units issued by the scheme, has already been transferred by him for consideration, unless the transferee who claims the income in respect of units issued by the scheme from the transferor has lodged the security and all other documents relating to the transfer which may be required by the scheme with the scheme for being registered in his name within 15 days of the date on which the income in respect of units or other instruments issued under the scheme

become due. The period of 15 day can be extended in certain contingencies as stated in explanation to Section 27A (1) of the said Act.

Thus,

- (i) the holder of the securities i.e Mr. Bansal, the transferor has right to receive or retain the income of the said securities for the financial year ended 31st March 2008, since the instrument for transfer was lodged one month after the date on which the income became due.
- (ii) the answer in the second case would differ. The holder i.e. Mr. Bansal, the transferor can not receive and retain the income since the instrument for transfer was lodged with the company within the statutory period of 15 days by the transferee. Accordingly the transferee would be entitled to receive the income on these securities.

Answer any two of the following

Question 2

- (a) Mr. Guilt an Indian National realizes that a penalty may be imposed upon him for violation of the provisions of the Foreign Exchange Management Act, 1999. He therefore desires to compound his offences. Advise Mr. Guilt about the process and procedure of compounding of the offence. (7 Marks)
- (b) Mr. Amit, a citizen of India, left India for employment in Australia on 1st June, 2007. Mr. Amit purchased a flat at New Delhi for Rs.15 lakhs in September, 2008. His brother, Mr. Sumit employed in New Delhi, also purchased a flat in the same building in September, 2008 for Rs. 15 lakhs. Mr. Sumit 's flat was financed by a loan from a housing finance company and the loan was guaranteed by Mr. Amit. Examine with reference to the provisions of Foreign Exchange Management Act, 1999, whether purchase of flat and guarantee by Mr. Amit are capital account transactions and whether these transactions are permissible. (7 Marks)
- (c) The Competition Commission of India has received a complaint that M/s. XYZ company has been abusing its dominant position in the food processing industry. Explain briefly the factors that will be considered by the commission to ascertain whether M/s. XYZ company enjoys a dominant position in the industry. (7 Marks)

Answer

- (a) Sections 15 of Foreign Exchange Management Act, 1999 (FEMA) authorizes the Reserve Bank of India and Enforcement Directorate to compound contravention on an application made by any person who has committed contravention. The process and procedure of compounding is as under:
 - An application for compounding of a contravention under the FEMA may be submitted to the compounding authority either on being advised of a contravention or either through a memorandum or suo moto on being made or becoming aware of

the contravention. The application should be as per format in the Foreign Exchange (Compounding proceeding) Rules.

- Application for compounding in prescribed form together with a copy of the memorandum wherever applicable with the prescribed fee has to be submitted with relevant facts and supporting documents to the compounding authority.
- The compounding authority may call for any information/record or any other documents relevant to the compounding proceedings.
- Where additional information/documents are called for, such information shall be submitted within thirty days or such additional period as may be given by the compounding authority from the date of the said letter. In case the contravener fails to submit additional information/document called for within the specified period, the application for compounding will be liable for rejection.
- On receipt of the application for compounding, the proceeding would be concluded and the order issued by the compounding authority within 180 days from the date of the receipt of the application for compounding.
- The sum for which contravention has been compounded shall be paid within 15 days from the date of order of compounding.
- The payment towards application fee and the sum for which contravention has been compounded shall be paid by demand draft in favour of compounding authority.

Thus Mr. Guilt will have to follow the above procedure for compounding his offences.

- (b) A “capital account transaction” means a transaction which alters the assets or liabilities, including contingent liabilities, outside India of persons resident in India or assets or liabilities in India of persons resident outside India. It also includes following transactions referred to in sub-section (3) of Section 6 of Foreign Exchange Management Act 1999:
- (a) Acquisition or transfer of immovable property in India, other than a lease not exceeding five years, by a person resident outside India;
 - (b) Giving of a guarantee or surety in respect of any debt, obligation or other liability incurred-

Thus purchase of flat at New Delhi and giving of guarantee would be considered as capital account transactions.

A capital account transaction is not permissible, unless otherwise provided in the Act, Rules or Regulations made there under, or with the general or special permission of Reserve Bank of India.

In the case referred, Mr. Amit left India for employment in Australia on 1st June 2007. Therefore, he becomes a person resident outside India from June 2007.

The purchase of flat by Mr. Amit is a capital account transaction. This is permissible in accordance with the regulation framed in this behalf i.e. The Foreign Exchange Management (Acquisition And Transfer Of Immovable Property In India) Regulation,

2000. The Foreign Exchange Management (Acquisition and Transfer of Immovable property In India) Regulation, 2000 imposes restrictions on a person resident outside India from acquiring immovable property in India provided he fulfills both the following conditions:

- (a) the person resident outside India is citizen of India and
- (b) the immovable property acquired in India is not agricultural/plantation or farmhouse.

Therefore the purchase of flat by Mr. Amit is permissible under FEMA.

Guarantee involves a long term commitment which alters the assets and liabilities of a person and therefore it is considered as a "capital account transaction" and thus restricted under FEMA. Accordingly Mr. Amit can give a guarantee to the housing finance company in respect of purchase of flat by Mr. Sumit with the permission of Reserve Bank of India.

- (c) The Competition Commission while inquiring whether the enterprise XYZ Company enjoys a dominant position or not under Section 4 of the Competition Act, 2002 will take the following factors into account:
 - (a) market share of the enterprise
 - (b) size and resources of the enterprise
 - (c) size and importance of the competitors
 - (d) economic power of the enterprise including commercial advantages over competitors.
 - (e) vertical integration of the enterprises or sale or service net work of such enterprises.
 - (f) dependence of consumers on the enterprise.
 - (g) monopoly or dominant position whether acquired as result of any statute or by virtue of being a Government company or a public sector undertaking or otherwise.
 - (h) entry barriers including barriers such as regulatory barriers, financial risk , high capital cost of entry, marketing entry barriers, technical entry barriers, economies of scale, high cost of substitutable goods or services for consumers.
 - (i) countervailing buying power.
 - (j) market structure and size of market .
 - (k) social obligations and size of market.
 - (l) relative advantage, by way of contribution to the economic development, by the enterprise enjoying a dominant position having or likely to have an appreciable adverse effect on competition.
 - (m) any other factor which the commission may consider relevant for the inquiry.

Question 3

- (a) Mr. DB is a member of RPA Ltd. He obtains an order against the company for redressal of his grievances against the company. But the company fails to redress the grievances of DB within the time fixed by the SEBI. The Board thereafter imposed penalty upon the company U/s 15C of the SEBI Act. RPL Ltd. seeks your advice whether it has any remedy against the order of SEBI. Advise. (8 Marks)
- (b) The promoters of ABC Ltd. an unlisted company decide to go for a public issue. They seek your advice in respect of the following matters:
- Whether equity shares can be reserved in a firm allotment category for promoters at a price different from the price at which shares are offered to the public.
- Circumstances in which the equity shares can be issued in denomination of Rs.2 per share.
- Need for past track record of distributable profits.
- Requirement of net tangible assets in the previous years. (8 Marks)
- (c) The analysis of the language of Section 292 and Section 372A of the Companies Act, 1956 apparently discloses a conflict because the former provision permits the Board of Directors to delegate its powers to make loans whereas the latter provision requires approval of loan by resolution passed at a board meeting with the consent of all the directors present at the said meeting. To what extent the rule of "Harmonious construction" can be applied for the purpose of interpreting these two provisions of the companies Act, 1956. (8 Marks)

Answer

- (a) Section 15C of Securities Exchange Board of India Act, 1992 lays down that if any listed company or any person who is registered as an intermediary, after having been called upon by the board in writing, to redress the grievances of investors, fails to redress such grievances within the time specified by the board, such company or intermediary shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.
- RPA limited was penalized under the provisions of above-mentioned section. Now two remedies are available to RPA limited in this matter:
- (i) Appeal to the Securities Appellate Tribunal: Section 15T of the SEBI Act, 1992 provides that any person aggrieved by an order of the Board made, on and after the commencement of the security laws (second amendment) act 1999, under this act or the rules or regulations made there under may prefer an appeal to a Securities Appellate Tribunal having jurisdiction in the matter.
- Such appeal shall be filed within a period of 45 days from the date on which a copy of the order made by the Board is received and it shall be in such form and be accompanied by such fee as may be prescribed. However the Tribunal may

entertain an appeal after the expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within the said period.

The Tribunal may, after giving the parties an opportunity of being heard, pass such orders as it thinks fit, confirming, modifying or setting aside the order appealed against.

- (ii) Appeal to the Supreme Court: Section 15Z of the SEBI Act, 1992 provides that any person aggrieved by any decision or an order of the Securities Appellate Tribunal may file an appeal to the Supreme Court within 60 days from the date of communication of the decision or an order to him on any question of law arising out of such order. The Supreme Court may, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed within a further period not exceeding 60 days.

- (b) According to SEBI (Disclosure and Investor Protection) Guidelines, 2000 any unlisted company or a listed company making a public issue of equity shares or securities convertible at a later date into equity shares may issue such securities to applicants in the firm allotment category at a price different from the price at which the net offer to the public is made, provided that the price at which the security is being offered to the applicants in firm allotment category is higher than the price at which securities are offered to public (Vide guideline No. 3.4.1)

According to guideline No. 3.7.1 the promoters of ABC Ltd. can issue equity shares in the denomination of Rs.2/- per share provided the issue price is Rs.500/- or more. In such a case the issuer company shall have a discretion to fix the face value below Rs.10/- per share subject to the condition that the face value shall in no case be less than Rs.1/- per share. If the issue price is less than Rs. 500/- per share, the face value shall be Rs.10/- per share.

The promoters of ABC Ltd. can go for public issue provided that the company has a track record of distributable profits in terms of Section 205 of the Companies Act, 1956 for atleast three (3) out of immediately preceding five (5) years. However, extraordinary items shall not be considered for calculating distributable profits in terms of Section 205 of the Companies Act, 1956.

ABC Ltd. should have net tangible assets of atleast Rs.3 crores in each of the preceding 3 full years (of 12 month each) of which not more than 50% is held in monetary assets. If more than 50% of the net tangible assets are held in monetary assets, the company has made firm commitments to deploy such excess monetary assets in its business/project.

- (c) HARMONIOUS CONSTRUCTION: Where there are in an enactment two or more provisions which can not be reconciled with each other, they should be so interpreted, wherever possible so as to give effect to all of them. This is what is known as the rule of Harmonious Construction. Importance should not be attached to a single clause in one section overlooking the provision of another section. If it is impossible to avoid inconsistency the provision which was enacted or amended later in point of time must prevail. The Rule of Harmonious Construction is applicable only when there is a real and

not merely apparent conflict between the provisions of an Act and one of them has not been subject to the other.

Every loan falling within the preview of Section 372A of the Companies Act, 1956, must be sanctioned by a resolution of the Board of Directors passed at its meeting. Every such resolution must be passed with the consent of all the directors present at the Board meets unanimously so that there is no one dissenting.

Every loan covered by Section 372A falls within the preview of Section 292(1)(e). The Section permits delegation by the Board of Directors of its powers of making loans vide proviso to Section 292(1), subject to the conditions stipulated in Section 292(3). The condition is that the resolution delegating the power must specify the total amount up to which loans may be made by the delegate, the purpose for which the loans may be made and the maximum amount of loans which may be made for each purpose in individual cases.

However by harmonious interpretation of both the provisions of Section 292 and Section 372A and in the absence of specific prohibition in Section 372A against delegation, the Board's power under Section 372A may be delegated in accordance with the provisions of Section 292 by passing unanimous resolution of the Board. Any other interpretation will make provisions of Section 292 redundant.

Question 4

- (a) The Articles of Association of Sunrise Ltd. provide that the qualification of a director shall be holding of at least 10 shares in the company. Mr. Rao has been appointed as a director in the said meeting on 1st May, 2008. Mr. Rao applied for 10 equity shares of the company on 30th July, 2008. The said shares were allotted to him on 20th August, 2008 when the Board meeting was held.

Discuss the relevant provisions of the Companies Act, 1956 in the matter of share qualification requirements and the consequences of non-compliance thereof. Also state whether Mr. Rao has complied with the requirements in this regard. (8 Marks)

- (b) Mr. Wilson was appointed in ABC Ltd. as a director and he was to retire by rotation on 1st September, 2008. On account of some unavoidable reasons the annual general meeting of the company could not be held on the said date, nor the vacancy caused by retirement could be filled up at the adjourned meeting. State the relevant provisions of the Companies Act, 1956 and decide whether Mr. Wilson shall be deemed to be retired on 1st September, 2008 when the meeting was scheduled to be held or it will become a case of deemed reappointment.. (7 Marks)

Answer

- (a) **QUALIFICATION SHARES:** The Companies Act, 1956 does not provide for any share qualification of any director but Regulation 66 of Table 'A' provides that a director must hold at least one share in the company. Usually, the articles of the company provide for holding qualification shares by a director. Where a share qualification has been prescribed in the Articles of a company which is a public company or a private company

which is a subsidiary of a public company, the provisions of Section 270 of the Companies Act, 1956 is applicable where under a director must take his qualification shares within 2 months after his appointment. Any provision in the articles of the company shall be void in so far as it requires a person to hold the qualification shares before his appointment as a director or to obtain them within a shorter time than two months after his appointment as such. The nominal value of the qualification shares shall not exceed Rs.5000/- or the nominal value of one share where it exceed Rs.5000/.

A person acting as a director without acquiring qualification shares is punishable under Section 272 of the said Act. Moreover, a director who fails to hold qualification shares is also liable to vacate his office under Section 283 of the Companies Act, 1956.

In the instant case Mr. Rao was appointed as Director of Sunrise Limited on 1st May 2008. He applied for shares of the company on 30th July 2008 which were allotted only at the Board meeting held on 20th August 2008. It can not therefore be said that he held the shares before expiry of 2 months from the date of his appointment. In view of this Mr. Rao must vacate his office as director as provided in Section 283(1)(a).

- (b) DEEMED REAPPOINTMENT OF DIRECTOR: Section 256 of the Companies Act, 1956 deals with deemed re-appointment of a retiring director. The vacancies caused by retirement of a director by rotation should be filled up at the same meeting or at an adjourned meeting. If it is not so done, the retiring director shall be deemed to have been reappointed at such adjourned meeting except in the following cases-
- (i) at any previous meeting, a resolution for his reappointment was put to vote but was lost, or
 - (ii) the retiring director has, in writing expressed his unwillingness to continue, or
 - (iii) he is not qualified or is disqualified for the said appointment, or
 - (iv) a special or ordinary resolution is necessary for his appointment or reappointment by virtue of any provisions of the Companies Act 1956, or
 - (v) it is resolved to appoint two or more directors by a single resolution, or
 - (vi) it is resolved not to fill the vacancy.

In the instant case the above mentioned exceptions are not applicable and hence Mr. Wilson cannot be deemed to be retired. He is deemed to be re-appointed as director.

Question 5

- (a) M/s X Ltd. and its two directors have received a show cause notice from the Registrar of Companies, Mumbai as to why prosecution proceedings should not be launched against them for violation of the provisions of Section 297 of the Companies Act, 1956 in not obtaining the previous approval of the Central Government in respect of a contract entered into by the company with a firm in which one of the directors of the company is interested as a partner. The company seeks your help. Advise the company the steps that should be taken to avoid prosecution proceedings, assuming that they have committed the offence. (8 Marks)

- (b) Sunrise Company Limited was merged with Moonlight Company Limited on account of amalgamation. Some workers of sunrise Company Limited refused to join as workers of Moonlight Company Limited and claimed compensation on the ground of premature termination of their services. Moonlight Company Limited resists the claim of the workers on the ground that their services have been transferred to Moonlight Company Limited in view of the order of amalgamation and merger and hence the workers must join the service of Moonlight Company Limited and cannot claim any compensation.

State the powers of the court about the matters that would be considered while sanctioning the scheme of amalgamation under the provisions of the Companies Act, 1956. Decide whether the contention of the workers is justified. (7 Marks)

Answer

- (a) To avoid prosecutions proceedings by the Registrar of Companies, Mumbai the company and its directors can file a compounding application with the Registrar of Companies as provided in Section 621A of the Companies Act, 1956.

In the said compounding applications, they have to admit the charge that the provisions of Section 297 have been violated and that the said default has been made good subsequently. For this purpose, the company should file an application for approval under Section 297 and this power of Central Government has been delegated to the Regional Directors. The power to compound the offence is with the Company Law Board if the maximum fine for the penalty exceeds Rs. 50,000 and if it is below Rs. 50,000 the power to compound is with the Regional Director. The company and its directors have to file the compounding application with the Registrar of Companies who in turn will forward the compounding applications along with his report either to the Company Law Board or to the Regional Director as the case may be. Once the compounding is done, the Regional Director after examination of the relevant factors approves the proposal and approval of the Central Government is conveyed.

- (b) While sanctioning the scheme of amalgamation, the Court under Section 394 of the Companies Act, 1956 may make provision for all or any of the following matters:
- (i) The transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of the transferor company.
 - (ii) The allotment by the transferee company of any shares, debenture etc, in that company which under the scheme are to be allotted by that company to any person.
 - (iii) The continuation of any legal proceedings by or against any transferor and transferee company.
 - (iv) The dissolution, without winding up of any transferor company.
 - (v) The provisions to be made for any persons who within such time and in such manner as the court directs, dissent from the scheme of amalgamation.
 - (vi) Such incidental matters as are necessary to secure that the amalgamation shall be fully and effectively carried out.

An order under Section 394 of the Companies Act, 1956 transferring the property, rights and liabilities of one company to another does not automatically transfer contracts of personal service which are in their nature incapable of being transferred and no contract of service is thereby created between an employee of the transferor company on the one hand and the transferee company on the other.

In *Nokes vs. Doucaster Amalgamated collieries Ltd.* (1940 (3) all 2k 549) the House of Lords clearly stated that the workers are not furniture and their services can not be transferred without their consent. Thus the contention of the workers of Sunrise Company Limited against the Moonlight Company Limited is correct and justified.

Question 6

- (a) The Board of Directors of M/s. ABC Limited and unlisted company having a paid up capital of Rs. 5 crores and preference share capital of Rs.1 crore and also 1100 small shareholders holding equity shares seeks your advice on the following:
- Is it necessary for the company to appoint a director to represent the 'Small Shareholder'?
 - In case the company decides to appoint such a Director, the procedure to be followed by the company for such appointment and the period for which such appointment can be made.
 - Can such a Director be removed by the company before the expiry of his period of appointment without the consent of the 'Small Shareholders'?

Advise explaining the relevant provisions of the Companies Act and the rules. (8 Marks)

- (b) Ashes Ltd is a company incorporated outside India. 50% of its preference share capital and 20% of its equity share capital is held by companies incorporated in India. It issued prospectus inviting subscriptions in India for its shares but did not state the country in which it is incorporated.

Examine

- Is the prospectus of the company valid?
- What is none of the shares (preference and equity) were held by Companies Incorporated in India?
- What other disclosures and required to be made by a Foreign Company? (7 Marks)

Answer

- (a) The provisions relating to small shareholders' director were inserted by the Companies Amendment Act, 2000 by inserting a proviso to Section 252(1). However this proviso will apply to a company if all the following conditions are satisfied:-
- the company is a public company.
 - the paid-up share capital of the company is five crore rupees or more,

- (iii) the numbers of shareholder is 1000 or more (a "small shareholders" means a shareholder holding shares of nominal value of twenty thousand rupees or less).

In the given case, M/s ABC Limited satisfies all the conditions specified above. Therefore, appointment of small shareholders' director can be made by M/s ABC Limited. It is not mandatory that the company shall appoint a director to represent the small shareholders. However a company may act suo-moto to elect a small shareholders' director. Further a small shareholders' director may serve a notice on the company and the company shall be bound to act on such notice.

The procedure for appointment of small shareholders' directors is as follows:

Small shareholders intending to propose a person shall leave a notice of their intention with the company at least 14 days before the meeting under the signature of at least 100 small shareholders specifying name, address, shares held and folio number and particulars of share with differential rights as to dividend and voting, if any, of the person whose name is being proposed for the post of director and of other small shareholders proposing such person as a candidate for the post of director or small shareholders.

A person whose name has been proposed for the post of small shareholders' director shall sign, and file with the company, his consent in writing to act as a director. Tenure of such small shareholders' director shall be for a maximum period of 3 years subject to meeting the requirement of provisions of Companies Act, 1956 except that he need not have to retire by rotation.

The unlisted company may appoint such small shareholders' nominee subject to above conditions if majority of small shareholders recommend his candidature for the post of director in their meeting.

As per rule 6 (viii) of the Companies (Appointment of the Small Shareholders' Director) Rules, 2001, a small shareholders director shall have to vacate the office if he is removed in pursuance of Section 284. As per Section 284 a director shall be removed by an ordinary resolution passed in the general meeting after compliance of the procedural requirement of Section 284. There is nothing in proviso to Section 252(1) or in the Companies (Appointment of the Small Shareholders' Director) Rules, 2001 which requires obtaining consent of small shareholders before removing small shareholder directors from directorship under Section 284. Therefore a small shareholders director can be removed by the company before the expiry of the term without the consent of small shareholders.

- (b) Section 591(2) of the Companies Act, 1956, provides that where not less than fifty per cent of the paid up share capital (whether equity or preference or partly equity and partly preference) of a company incorporated outside India and having an established place of business in India, is held by one or more citizens of India or by one or more bodies corporate incorporated in India, or by one or more citizens of India and one or more bodies corporate incorporated in India, whether singly or in the aggregate, such company shall comply with such of the provisions of this Act as may be prescribed with regard to the business carried on by it in India, as if it were a company incorporated in India.

- (i) As 50% of the preference share capital and 20% of the equity share capital of Ashes Ltd. is held by companies incorporated in India, it shall be treated as if it were a company incorporated in India. As such it is not necessary for Ashes Ltd. to comply with the provisions relating to foreign companies. So the prospectus of the company shall be valid.
- (ii) If none of the shares (preference and equity) were held by companies incorporated in India, Ashes Ltd. would be a foreign company within the meaning of Section 591 of the Act. Section 595 of the Act provides that every foreign company shall in every prospectus inviting subscriptions in India for its shares or debentures, state the country in which the company is incorporated. As Ashes Ltd. did not mention the name of the country in which it is incorporated, the prospectus shall not be valid.
- (iii) Section 595 of the Act provides for the following additional disclosures to be made by a foreign company:
 - (a) conspicuously exhibit on the outside of every office or place where it carries on business in India, the name of the company and the country in which it is incorporated, in letters easily legible in English characters, and also in the characters of the language or one of the languages in general use in the locality in which the office or place is situated;
 - (b) cause the name of the company and of the country in which the company is incorporated, to be stated in legible English characters in all business letters, bill heads and letter paper, and in all notices, and other official publications of the company; and
 - (c) If the liability of the members of the company is limited, cause notice of the fact-
 - to be stated in every such prospectus as aforesaid and in all business letters, bill heads, letter paper, notices, advertisements and other official publications of the company, in legible English characters; and
 - to be conspicuously exhibited on the outside of every office or place where it carries on business in India, in legible English characters and also in legible characters of the languages or one of the language in general use in the locality in which the office or place is situated.

Question 7

- (a) Supra Limited, a private company, has been converted into a public company and under the provision of the Companies Act, 1956. The company proposes to constitute an audit committee. Taking into account the provisions of the Companies Act, 1956 draft a board resolution covering the following matters:
 - (i) Member of the audit committee.
 - (ii) Chairman of the audit committee.
 - (iii) Quorum for meeting of the said committee.

(iv) Any two functions of the said committee. (8 Marks)

- (b) M/s Continuous Conflicts Ltd. is a company controlled by two family groups. The first family group has four directors namely Mr. A, Mr. B, Mr. C and Mr. D on the Board of Directors. The second group has two representatives Mr. X and Mr. Y on the board. Both the groups hold shares in the company according to their directorships viz., the first group of 4 directors hold 67% of the share capital and the second group of 2 directors hold 33% of the share capital. Because of internal family troubles, the first group, by virtue of its majority shareholding removes both Mr. X and Mr. Y as the directors of the company. Aggrieved by this action, the second group is planning to move an application before the Company Law Board. You have been approached for advice.

Advise as to the eligibility restrictions regarding filing the application and the chances of getting relief from the Company Law Board, assuming that there is no other material on record in support of oppression of the minority group. (7 Marks)

Answer

- (a) AUDIT COMMITTEE –BOARD RESOLUTION:

“Resolved that pursuant to Section 292A of the Companies Act, 1956 an Audit Committee consisting of the following Directors be and is hereby constituted.

1. Mr. ---- nominee of IDBI
2. Mr. ---- nominee of ICICI
3. Mr. ---- nominee of the SBI.
4. Mr. ---
5. Mr. ----- Managing Director.

Further resolved that the Chairman of the Audit Committee shall be elected by its members from amongst themselves.

Further resolved that the quorum for a meeting of the Audit committee shall be 1/3rd of the total number of members or two directors (other than the Managing Director) whichever is higher.

Further resolved that the Audit Committee shall have the authority to investigate into any matter that may be prescribed under Section 292A of the Companies Act, 1956 and any other matter that may be referred to it by the Board from time to time.

Further resolved that the Audit committee shall conduct discussion with the auditors periodically about internal control systems, the scope of audit including the observation of auditors.

Further resolved that the Audit Committee shall review the quarterly and annual financial statements and submit the same to the Board with its recommendations if any”.

- (b) The management of any company registered under the Companies Act, 1956 is based on the principle of majority rule and the voting power of every member depends upon the number of shares held by them. Thus one single individual holding majority shares can

overrule the view of the other member who may be more in numerical numbers but not in voting powers. However certain rights have been given to minority shareholders who complained that the affairs of the company are being conducted in a manner oppressive to any member or members. In such an event the minority shareholder can apply to the Company Law Board (now Tribunal) for relief against oppression and mismanagement.

The eligibility restriction for filling an application to the Company Law Board (now Tribunal) is contained in Section 399 of the Companies Act, 1956. According to the said Section the application to Company Law Board (now Tribunal) can be made in the case of the company having share capital, by not less than 100 members or not less than $1/10^{\text{th}}$ of the total number of members whichever is less or members holding not less than $1/10^{\text{th}}$ of the issued share capital provided the applicants have paid all calls and other dues on their respective shares. In case of a company not having share capital, the application can be filed by members holding not less than $1/5^{\text{th}}$ of the total number of members.

In the present case the majority group has removed the minority directors from the board. The election and removal of directors is the prerogative of the members and such an act cannot be perse treated as oppressive to the minority shareholder, unless there is an allegation of mismanagement to the detriment of the minority shareholders. The application under Section 397/398 requires to prove oppressive conduct to their members in their capacity as members. Thus the minority group consisting of two directors Mr. X and Mr. Y will not be able to successfully prosecute the case against the majority directors in the absence of any material or record in support of oppression and mismanagement of minority group. They have, however the right to file the petition before the Company Law Board as they fulfil the requirements laid down in Section 399.

Question 8

- (a) As per the terms of the agreement of service between NOC Ltd. and its employees, an amount equal to 12.5% of the salary shall be transferred to the recognized Provident Fund and shall be payable to the employee either on retirement or termination, as the case may be. An amount equal to 12.5% of the salary shall be contributed by the company to the recognized provident fund.

Mr. A earning Rs. 3000 p.m. has been working with the company since the last four years. Due to some personal reasons Mr. A is in need of Rs. 100,000 and wants to obtain as advance the amount standing to the credit in the fund. With reference to the provisions of the Companies Act, 1956 advice as regards the following:

- (i) When and where should the money so collected by the company be deposited?
- (ii) Can Mr. A obtain the advance from his accumulated contribution to recognized Provident Fund? (8 Marks)

- (b) Mars India Limited, a company incorporated under the Companies Act, 1956 is being wound up by the court. After realization of the assets of the company, the official liquidator has an amount of Rs. 70,00,000 at his disposal towards payment of creditors of the said company. The details of creditors are as follows:

(i) Unsecured creditors	50,00,000
(ii) Taxes and duties payable to Government	5,00,000
(iii) Dues to workers	30,00,000
(iv) Dues to secured creditors	40,00,000

The available amount with the liquidator, obviously, is not sufficient to meet the claims of all the creditors. Moreover, the company had already created a charge on all the assets of the company in favour of the secured creditors. Explain the procedure to be followed by the liquidator for payment of dues as provided in the Companies Act, 1956. (7 Marks)

Answer

- (a) Section 418 of the Companies Act, 1956 dealing with the provident fund of the employees provides that:
- (1) Where a provident fund has been constituted by a company for its employees or any class of its employees, all moneys contributed to such fund (whether by the company or by the employees) or received or accruing by way of interest or otherwise to such fund shall, within fifteen days from the date of contribution, receipt or accrual, as the case may be either-
 - (a) be deposited-
 - (i) in a post office saving bank account, or
 - (ii) in a special account to be opened by the company for the purpose in the State Bank of India or in a Scheduled Bank, or
 - (iii) Where the company itself is a Scheduled Bank, in a special account to be opened by the company for the purpose either in itself or in the State Bank of India or in any other Scheduled Bank; or
 - (b) be invested in the securities mentioned or referred to in clauses (a) to (e) of Section 20 of the Indian Trusts Act, 1882 (2 of 1882).
 - (2) Notwithstanding anything to the contrary in the rules of any provident fund to which sub-section (1) applies or in any contract between a company and its employees, no employee shall be entitled to receive, in respect of such portion of the amount to is credit in such fund as is invested in accordance with the provisions of sub-section (1), interest at a rate exceeding the rate of interest yielded by such investment.
 - (3) Nothing in sub-section (1) shall affect any rights of an employee under the rules of a provident fund to obtain advances from or to withdraw money standing to his credit in the fund, where the fund is a recognized provident fund.
 - (i) So the money collected by NOC Ltd. from its employees will have to be deposited in any of the following:
 - (a) in a post office saving bank account, or

- (b) in a special account to be opened by the company for the purpose in the State Bank of India or in a Scheduled Bank, or
- (c) be invested in securities mentioned or referred to in clauses (a) to (e) of Section 20 of the Indian Trusts Act, 1882 (2 of 1882).
- (ii) As per the provision of Section 418 (3), Mr. A can obtain advances from or withdraw money standing to his credit in the fund provided the fund is a recognized provident fund.

- (b) WINDING UP (PAYMENT OF CREDITORS): Section 530 of the Companies Act, 1956 lays down the procedure for payment of debts out of available funds with the official liquidator. However Section 529A of the said Act provides for overriding of the preferential payments as mentioned in Section 530. According to Section 529A of the Companies Act, 1956 notwithstanding anything contained in other provisions of this Act or any other law for the time being in force, in the winding up of a company –

(1) Workmen's dues and (2) debts due to secured creditors,

shall be paid in priority to all other debts. Further these debts have to be paid in full unless the assets are insufficient to meet them, in which case they shall abate in equal proportion.

In the light of the above mentioned provisions, the funds available with the official liquidator are not sufficient to meet fully the dues payable to all the creditors. Thus, tax dues to the tune of Rs. 5,00,000 payable to government authorities will not get any payment even though they are to be considered as preferential payments as per Section 530 of the Act. Thus the secured creditors will get Rs. 40,00,000 and the remaining amount of Rs. 30,00,000 shall be paid towards workers dues. The other creditors will get nothing.

Question 9

- (a) The Board of Directors of ACE Limited having a paid up share capital of Rs. 70 lakhs reappointed Bre Ltd. As sole selling agent for a period of 5 years W.E.F. 2 May, 2007. The Directors of BRE Ltd. were holding fully paid up shares of face value of Rs. 3 lakhs. In ACE Ltd. the reappointment was approved by the company in the next AGM held on 30th September, 2007 but Central Government approval was not obtained until 31st December, 2007. Give your opinion explaining the relevant provision of the Companies Act, 1956.
- (i) Is the reappointment of the sole selling agent in order?
 - (ii) Will your opinion be different if the directors of BRE Ltd. do not hold any shares in ACE Ltd?
 - (iii) If the reappointment is valid. When will the reappointment take effect from?

(6 Marks)

- (b) Mr. X is a director of several companies. He has approached the following companies in which he is a director for financial help to start his own personal business.

- (i) Expandable Industries Ltd.
- (ii) Expensive Gadgets Private Ltd.
- (iii) Easy Finance Ltd.

The first named company has agreed to grant a loan of Rs. 50 lakhs. The second company also offered another loan of Rs. 50 lakhs. The third company has agreed to provide guarantee for the repayment of a loan sanctioned to Mr. X by a Private Bank to the tune of Rs. One crore. Advise Mr. X about the legal provisions that should be complied with under the Companies Act, 1956 and the consequences if there is a non – compliance. (6 Marks)

- (c) The Board of Directors of M/s PQR Ltd. have a practical problem. The registered office of the company is situated in a classified backward area of Maharashtra. The Board wants to keep the account books of the company at its corporate office in Mumbai which is conveniently located. The Board seeks your advice about the feasibility of maintaining the accounting records at a place other than the registered office of the company. Advise. (3 Marks)

Answer

- (a) Section 294AA of the Companies Act, 1956 contains the powers of Central Government to prohibit the appointment of Sole Selling Agents in certain cases. The section further provides that no company shall appoint any individual, firm or body corporate, who or which has a substantial interest in the company, as Sole Selling Agent of that company unless such appointment has been previously approved by the Central Government (Section 294AA (2)).

Also no company having a paid up share capital of rupees fifty lakhs or more shall appoint a Sole Selling Agent except with the consent of the company accorded by a Special Resolution and the approval of the Central Government (Section 294AA(3)). Section 294AA (7) provides that if the company in general meeting disapproves the appointment referred to in sub-section (3), such appointment shall, notwithstanding anything contained in sub-section (6), cease to have effect from the date of the general meeting.

The explanation to this section provides that “appointment” includes “re-appointment “ and “substantial interest “ in relation to a body corporate, means the beneficial interest held by such body corporate or one or more of its directors or any relative of such director, whether singly or taken together, in the shares of the company , the aggregate amount paid up on which exceeds five lakhs of rupees or five per cent of the paid up share capital of the company, whichever is the lesser.

- (i) So the re- appointment of BRE Ltd. as sole selling agent is in order as general meeting approval was obtained by way of special resolution. Further, ACE Ltd. has

to obtain the approval of the Central Government as required under Section 294AA (3) and the same was also obtained by 31st December 2007.

- (ii) No, even if BRE Ltd. does not hold any shares in ACE Ltd. the appointment shall remain valid as ACE Ltd has obtained the approval of the Central Government under Section 294AA(3).
 - (iii) Effective date of reappointment is the date from which he is re appointed by the company. As such the re-appointment shall be valid from 2nd May 2007.
- (b) According to Section 295 of the Companies Act, 1956 no public company shall directly or indirectly make any loan to or give any guarantee or provide any security in connection with a loan made by any other person to a director of the company without obtaining the previous approval of the Central Government. Thus M/s. Expandable Industries Ltd, being a public company has to take approval of the Central Government before the loan amount of Rs. 50 lakhs is disbursed. However no approval of the Central Government is required in the case of Expensive Gadgets Private Ltd. being a Private Company. However, if the said Private Company is a subsidiary of a Public Company, the approval of Central Government is required. In the case of Easy Finance Ltd. the approval of Central Government is required and thereafter only the transaction can be entered into without committing violation of the provision of the Companies Act, 1956. If there is any violation, Mr. X the director will vacate his office as a director as provided in Section 283 (1) (h) of the Act. The said violations is however compoundable under Section 621A of the Act.
- (c) According to Section 209 of the Companies Act, 1956 every company shall keep the books of accounts at its registered office. However, the books of account can be kept at such other places in India as the Board of directors may decide and when the Board of directors so decide, the company shall within 7 days of the decision file with the Registrar of Companies a notice in Form No. 23AA in writing giving full address of the other place. Thus in the present case, the company can follow the above procedure and keep its accounts book at Mumbai office.