

PAPER – 4 : CORPORATE LAWS AND SECRETARIAL PRACTICE

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

Question 1

Answer any two of the following:

- (a) The Board of Directors of XYZ Ltd. filled up a casual vacancy caused by the death of Mr. P by appointing Mr. C as a director on 3<sup>rd</sup> April, 2009. Unfortunately Mr. C expired on 15<sup>th</sup> May, 2009 after working about 40 days as a director. The Board now wishes to fill up the casual vacancy by appointing Mrs. C in the forthcoming meeting of the Board. Advise the Board in this regard. X(5 Marks)
- (b) M/s Goyanka & Company, which is a member of a recognised stock exchange desire to buy and sell shares of Crossroads Company Limited on their own count as well as on behalf of investors. Advise M/s Goyanka & Company whether there are any restrictions for dealing in securities on their own count under the provisions of the Securities Contracts (Regulation) Act, 1956. (5 Marks)
- (c) The Mewar Rural Financial Corporation, Udaipur, established under a special statute issued 5 years bonds to public directly and not through any Stock Exchange. Decide whether the said act of the Mewar Rural Financial Corporation is in violation of the provisions of the Securities Contracts (Regulation) Act, 1956. (5 Marks)

Answer

- (a) Section 262 of the Companies Act, 1956 authorises the Board of Directors to fill up casual vacancies if the office of any director appointed by the company in general meeting is vacated before his term of office and hence the appointment of C was in order. In normal course, C could have held his office as director up to the date to which Mr. P would have held but Mr. C expired on 15<sup>th</sup> May 2009 and again a vacancy has arisen in the office of director owing to death of Mr. C who was appointed by the board to fill up the casual vacancy.

Hence the present vacancy cannot be considered as casual vacancy as stated in section 262 and therefore the board cannot fill up the same.

The board may however appoint Mrs. C as an additional director under section 260 of the Act provided the articles of association authorises the board to do so, in which case Mrs. C will hold the office until the conclusion of the next annual general meeting.

- (b) SHARE TRANSACTIONS BY MEMBERS OF STOCK EXCHANGE AS PRINCIPALS:

Members of stock exchange normally carry out transactions on behalf of investors and hence principal and agent relationship exists between them. A member can enter into transaction as principal with another member of the exchange only. If a member of stock exchange desires to enter into contract as principal with a non member then he has to get written consent from such person to act as principal. The contract note should

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indicate that he is acting as principal. (Section 15 of the Securities Contracts (Regulation) Act, 1956).

Where the member has obtained the consent of such person otherwise than in writing he shall secure written confirmation by such person or such consent within three days from the date of such contract.

However, such written consent of such person is not necessary for closing outstanding contract entered into by such person in accordance with the bye-laws, if the member discloses in the note, memorandum or agreement of sale or purchase in respect of such closing out that he is acting as principal.

Spot delivery contracts are not within the purview of section 15 of the said Act. (Section 18).

Thus M/s Goyanka & Company working as stock broker must bear in mind the above restrictions while entering into any transaction as principal with a non – member.

**(c) DIRECT ISSUE OF BONDS BY CORPORATION:**

In order to prevent undesirable transactions in securities and to promote healthy stock market, the Securities Contracts (Regulation) Act, 1956 was enacted. Stock Exchanges are recognised under the Act. Section 73 of the Companies Act, 1956 lays down that offer of shares and debentures to public for subscription shall only be made after obtaining the permission of the stock exchange.

Section 28 of the Securities Contracts (Regulation) Act, 1956 lays down that the provisions of the Act shall not apply to the Government, Reserve Bank of India, any local authority or any corporation set up by a special law or any person who has effected any transaction with or through the agency of any such authority as stated above.

As given in the question, the Mewar Rural Financial Corporation is a corporation established under a special statute enacted by competent legislature. Therefore, the said corporation need not require to seek permission of any stock Exchange for the said purpose because it is exempted from the requirement given in the legislation.

There is no violation of the provisions of the Securities Contracts (Regulation) Act, 1956 because the provisions of Section 28 of the said act are not applicable to the said corporation.

**Question 2**

Answer any two of the following:

- (a) State the kind of approval required for the following transaction under the Foreign Exchange Management Act, 1999:
- (i) L, a famous playback singer of India wants to perform a musical night in Paris for Indians residing there. Foreign exchange to the extent of US D 20,000 is required for this purpose.
  - (ii) M requires US D 5,000 to make payment related to ‘ call back services’ of telephone.

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- (iii) N wants to pursue a course in business management in New York.. He wants to draw US D 50,000 towards expenses for studying abroad.
- (iv) R wants to draw US D 20,000 to make donation to a charitable trust situated in South Korea. (7 Marks)
- (b) Mr. Raman is a software engineer of Armtex Ltd. The company sent him to Japan to develop a software programme there on deputation for 2 years. He earned a sum of US \$ 3,000 as a honorarium there. On his return to India he wants to hold this foreign currency with him. Whether Mr. Raman will be allowed to keep the foreign currency with him. (7 Marks)
- (c) The Central Government on the recommendation of selection committee appoints Mr. RKP aged 56 years as Member of the Competition Commission of India to be effective from 1<sup>st</sup> January, 2009. State with reference to the provisions of Competition Act, 2002 the term for which he will be appointed and whether he can be reappointed as such and also if he resigns after two years whether the vacancy can be filled up by the Chairman of the commission.  
  
You are further required to mention the composition of the selection committee on whose recommendation the central Government appoints chairman and other members of the Competition Commission of India. (7 Marks)

**Answer**

- (a) (i) Foreign exchange drawals for cultural tours require prior permission/approval of the Government of India irrespective of amount of foreign exchange required. Therefore, in the given case L, the singer is required to seek permission of the Government of India.
- (ii) Drawal of foreign exchange for payment related to 'call back services' of telephones is prohibited. Therefore 'M' can not draw foreign exchange.
- (iii) Release of foreign exchange for education abroad is permitted up to USD 100,000 on self declaration basis. Therefore 'N' can draw foreign exchange on self declaration basis for pursuing a course in business management in New York.
- (iv) Making donation exceeding USD 10000 per annum per beneficiary require Reserve Bank of India's prior approval. Therefore 'R' can draw USD 20000 to make donation after taking prior approval from Reserve Bank of India.
- (b) As per Section 8 of Foreign Exchange Management Act, 1999 where any amount of foreign exchange is due or has accrued to any person resident in India, such person shall take all reasonable steps to realize and repatriate to India such foreign exchange within such period and in such manner as may be specified by Reserve Bank of India.  
  
But as per section 9(e) of the said Act, this provision shall not apply to foreign exchange acquired from employment, business trade, vocation, service honorarium, gifts, inheritance or any other legitimate means up to such limit as the Reserve Bank of India may specify.

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The Reserve Bank of India has specified the following persons with the limits for possession and retention of foreign currency by a person resident in India:

Any person may possess foreign coins without any restriction to the amount.

Any person resident in India is permitted to retain in aggregate foreign currency not exceeding USD 2,000 or its equivalent in the form of currency notes/bank notes or travelers cheques acquired by him;

Any person resident in India but not permanently resident therein is permitted to hold the foreign currency without limit, if the foreign currency was acquired when he was resident outside India and was brought into India and declared to the custom authorities.

In the given case as Mr. Raman earned a sum of USD 3000 as a honorarium when he was in employment in Japan. But in view of the restrictions under FEMA and the aforesaid regulation he can retain foreign exchange up to USD 2000 only and not more than that.

- (c) Term of office of chairperson and other members are contained in Section 10 of the Competition Act, 2002.

As per this section the chairperson and every other member shall hold office as such for a term of five years from the date on which he enters upon his office and shall be eligible for re-appointment. They shall not hold office as such after attaining the age of sixty-five years. [Section 10(1)]

A vacancy caused by the resignation or removal of the chairperson or any other member by death or otherwise shall be filled by fresh appointment in accordance with the provisions of Sections 8 and 9 of the Act. [Section 10(2)]

Keeping the above provision in mind Mr. RKP can be appointed as member of the commission for a term of 5 years as he is aged 56 years on 1-1-09. He can also be reappointed but his reappointment will be only up to the age of 65 years. If Mr. RKP resigns as member after working for two years the resulting vacancy can be filled up by fresh appointment approved by the Selection Committee and the Chairman has no power to fill up the vacancy on his own.

**Selection committee for chairperson and members of commission**

The chairperson and other members of the commission shall be appointed by the Central Government from a panel of names recommended by a selection committee.

Selection committee shall consisting of –

- (a) The chief justice of India or his nominee ----- as chairperson;
- (b) The secretary in the ministry of corporate affairs ----- as member;
- (c) The secretary in the ministry of law and justice ----- as member;
- (d) Two experts of repute who have special knowledge of, and professional experience in international trade, economics, business, commerce, law, finance, accountancy,

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management, industry, public affairs or competition matters including competition law and policy as members. (Section 9)

##### Question 3

Answer any two of the following:

- (a) Point out the circumstances whereunder the following powers may be exercised by the Securities and Exchange Board of India:

- (i) Prohibiting a company from issuing or publishing any document or advertisement soliciting money from public for the issue of securities.
- (ii) Pass cease and desist order in relation to any listed company.

What remedies are available to the companies against such orders under the Securities and Exchange Board of India Act, 1992? (8 Marks)

- (b) The Balance Sheet of Get Well soon Ltd as at 31.3.2009 disclosed the following details:

- |                              |               |
|------------------------------|---------------|
| (i) Authorised share capital | Rs.400 crores |
| (ii) Paid up share capital   | Rs.150 crores |
| (iii) Reserves and surplus   | Rs.750 crores |

The company has issued in the year 2004, Fully Convertible Debentures of Rs.100 crores which are due for conversion in the year 2009. The company proposes, after conversion of Debentures to issue Bonus shares in the ratio of 1:1. Explain briefly the requirements of the Companies Act, 1956 and the Securities and Exchange Board of India (SEBI) guidelines to be followed by the company in this regard. (8 Marks)

- (c) The word “May” doesn’t mean “Shall”. Yet the word ‘May’ under certain circumstances means “Shall”. Discuss the statement in the context of interpretation of statutes and the importance of distinction between mandatory and directory provisions. (8 Marks)

##### Answer

- (a) Power of Securities Exchange Board of India (SEBI) to issue prohibition order and directions:

Under Section 11 of the SEBI Act, 1992 the basic duty of the SEBI is to protect the interests of investors in securities and regulate the securities market. Section 11A(b) specifically empowers SEBI to prohibit any company from issuing or publishing prospectus, any offer document or advertisement soliciting money from the public for the issue of securities by general or special order if such prohibition is necessary for the purpose of protection of investors interest.

According to Section 11D, SEBI can issue cease and desist order in respect of any listed company only if SEBI has reasonable grounds to believe that such a company has indulged in insider trading or market manipulation.

Aggrieved companies may appeal against orders of SEBI made under SEBI Act, 1992 rules or regulations to the Securities Appellate Tribunal (SAT) under section 15 T of the

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said Act. Such appeal should be filed within 45 days from the date on which a copy of the order of SEBI is received by the company.

If the company is aggrieved by the order of SAT, further appeal against the order of SAT can be made to the Supreme Court within 60 days from the date of communication of the order on any question of law arising out of such order.

The appeal lies only on question of law. As far as facts are concerned, decision of the SAT is final. Further Section 20A of the said Act bars jurisdiction of Civil court in respect of orders issued by the SEBI.

- (b) Chapter xv of Securities and Exchange Board of India (SEBI) (disclosure & investor protection) guidelines, 2000, contains the guidelines for issue of bonus shares, following which M/s Get well soon Ltd. can make a bonus issue in the ratio of 1:1 as follows:

1. The articles of M/s Get well Soon Ltd. must authorize it to issue the bonus shares. If there is no provision in the articles authorizing the company to issue bonus shares, firstly, the articles shall be amended by passing a special resolution.
2. Steps for determining whether any increase in authorised share capital is required.
  - (a) Paid up share capital as on 31<sup>st</sup> March, 2009 Rs.150 crores.
  - (b) Paid up capital (after conversion of Rs.100 crores fully convertible debentures, assuming that these debentures shall be converted into share capital Rs.100 crores) Rs.250 crores.
  - (c) Proposed bonus issue – 1 share for every held .
  - (d) Post bonus issue capital. Rs.500 crores.

Since the authorised share capital of the company is only Rs.400 crores, it has to take steps to increase the amount to Rs.500 crores or beyond by complying with the provisions laid down in section 94 and 97 of the companies Act,1956.

3. Sources of bonus shares.

Reserves and surplus (since free reserves built out of the genuine profits can be used for issue of bonus issue). Rs. 750 Crores

Since the source of issue of bonus shares (Rs.750 crores) is sufficient to issue bonus shares (Rs.250 crores), the proposed issue can be made.

4. Other legal requirements for issue of bonus shares are as under.
  - (a) A resolution shall be passed by the board in a duly convened board meeting.
  - (b) The bonus issue shall be made within 6 months of passing the board resolution.
  - (c) After the issue of bonus shares, the company shall file with Securities and Exchanges Board of India (SEBI) a compliance certificate duly signed by the statutory auditor of the company or a secretary in whole time practice.

The bonus issue can be made if there is no default in –

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Payment of interest or principal in respect of fixed deposits and interest on existing debentures or principal on redemption there of; and Payment of statutory dues of the employees such as contribution to provident fund, gratuity, bonus, etc.

- (c) The use of the word 'may' in a statutory provision will not by itself show that the provision is directory in nature. In some cases the legislature may use the word 'may' as a matter of pure conventional courtesy and yet intend a mandatory force. Therefore, in order to interpret the legal import of the word 'may' we have to consider various factors, e.g. the object and the scheme of the Act, the context or background against which the words have been used, the purpose and advantages of the Act sought to be achieved by use of this word and the like.

Coming to the word 'shall' the use of the word 'shall' would not of itself make a provision of the Act mandatory. It has to be construed with reference to the context in which it is used. Thus, as against the government the word 'shall' when used in a statute is to be construed as 'may' unless a contrary intention is manifest. Hence, a provision in a criminal statute that the offender shall be punished as prescribed in the statute is not necessary to be taken as against the government to direct prosecution under that provision rather under some other applicable statute.

The distinction between a provision which is mandatory and one which is directory is that when it is mandatory, it must be strictly complied with; when it is 'directory', it would be sufficient that it is substantially complied with. Non-observance of mandatory provision involves the consequences of invalidity. But non-observance of directory provisions does not entail the consequence of invalidity, whatever other consequences may occur.

No general rule can be laid down for deciding whether any particular provision in a statute is mandatory or directory. In each case the court has to consider not only the actual words used, but has to decide the legislative intent. For ascertaining the real intention of the legislature, the court may consider, amongst other things, the following:

- (i) The nature and design of the statute.
- (ii) The consequence which would flow from construing from one way or the other.
- (iii) The impact of other provisions by resorting to which the necessity of complying with the provisions in question can be avoided.
- (iv) Whether or not the statute provides any penalty if the provision in question is not complied with.
- (v) If the provision in question is not complied with, whether the consequences would be trivial or serious.
- (vi) Most important of all, whether the object of the legislation will be defeated or furthered.

Where a specific penalty is provided in a statute itself for non-compliance with the particular provision of the act, no discretion is left to the court to determine whether such provision is directory or mandatory – it has to be taken as mandatory.

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**Question 4**

(a) The following information is available from the audited Balance sheet of Makewell Ltd:

|                                          | Rs. In lakhs |
|------------------------------------------|--------------|
| Equity Share Capital                     | 60           |
| Calls outstanding                        | 01           |
| Preference Share Capital                 | 21           |
| Share application money                  | 10           |
| Securities Premium Account               | 15           |
| Capital Redemption Reserve               | 18           |
| Fixed Assets Revaluation Reserve         | 09           |
| General Reserve                          | 30           |
| Profit and Loss Account (credit balance) | 17           |
| Dividend Equalisation Reserve            | 05           |

The company proposes to acquire 3 lakh equity shares of Rs.10 each of PQR Ltd. It also intends to execute a corporate guarantee for Rs.25 lakhs in favour of Goodwill Ltd a wholly owned subsidiary company and a corporate loan of Rs.50 lakhs to ABC Ltd. State the legal requirements to be complied with to give effect to the above proposals.

(8 Marks)

(b) Sunrise Limited is a subsidiary company of Hotline Limited. The financial year of Sunrise Limited is 1<sup>st</sup> July to 30<sup>th</sup> June, whereas the financial year of Hotline Limited is from 1<sup>st</sup> April to 31<sup>st</sup> June, whereas the financial year of Hotline Limited is from 1<sup>st</sup> April to 31<sup>st</sup> march every year. To maintain uniformity and consolidation of annual accounts the Board of Directors of Hotline Limited decided that the accounting year of Sunrise Limited for the year 1<sup>st</sup> July,2007 to 30<sup>th</sup> June, 2008 be extended from present 12 months to 21 months i.e. 1<sup>st</sup> July,2007 to 31<sup>st</sup> March,2009.

Mention, in the light of the provisions of the Companies Act, 1956, the steps to be taken by the Hotline Limited in this regard.

(7 Marks)

**Answer**

(a) As per Section 372A of the Companies Act, 1956, a company cannot directly or indirectly:

1. Make any loan to any other body corporate.
2. Give any guarantee, or provide security in connection with a loan made by any other person to , or to any other person by, any body corporate; and
3. Acquire by way of subscription, purchase or otherwise the securities of any other body corporate,

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exceeding 60% of its paid up share capital and free reserve or 100% of its free reserves whichever is more.

In case the aggregate of loan and advances so far made, the amounts for which guarantee or security so far provided to or in all other bodies corporate, along with the investment, loan, guarantee or security proposed to be made or given by the board, exceeds the aforesaid limits, no investment or loans shall be made or guarantee shall be given or security shall be provided unless previously authorized by special resolution passed in the general meeting.

Here the term loan includes debentures, or any deposit of money made by one company with another company, not being a banking company, and free reserves means those reserves which, as per latest audited balance sheet of the company, are free for distribution as dividend and shall include balance to the credit of the Securities Premium Account but shall not include share application money.

Again as per section 372A (8) any guarantee made by a holding Company to its wholly owned Subsidiary is not within the perview of section 372 A.

Now in the given case the total amount of investment proposed is as under.

|                                              | Rs.              |
|----------------------------------------------|------------------|
| Investment proposed in shares of PQR Limited | 30,00,000        |
| Corporate loan to ABC Ltd.                   | <u>50,00,000</u> |
| Total                                        | <u>80,00,000</u> |

Corporate guarantee of Rs.25,00,000 in favour of wholly owned subsidiary is exempted. (u/s 372 A (8))

Paid up share capital

|                               |                  |
|-------------------------------|------------------|
| Equity share capital          | 60,00,000        |
| Less call outstanding         | <u>1,00,000</u>  |
| Balance                       | 59,00,000        |
| Add: Preference share capital | <u>21,00,000</u> |
| Paid up share capital         | <u>80,00,000</u> |

Free reserve

|                               |                  |
|-------------------------------|------------------|
| Security Premium A/c          | 15,00,000        |
| General Reserve               | 30,00,000        |
| Profit and Loss A/c           | 17,00,000        |
| Dividend equalization reserve | <u>5,00,000</u>  |
|                               | <u>67,00,000</u> |

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Share application is not included as per explanation given in the Act Capital redemption reserve and fixed assets revaluation reserve are not free for distribution as dividend and hence are not included in free reserve.

Therefore the limit for inter corporate loan and investment will be higher of the following two

60% of (80,00,000 + 67,00,000) = 88,20,000

100% of 67,00,000 = 67,00,000

Rs.88,20,000, being the higher of these two amounts, will be the limit for loan and investment.

As the investment proposed is below the limit the company can go ahead with the investment. For this purpose, the company has to convene a Board meeting whereat the above social loans and investments including corporate guarantee can be approved by means of a resolutions. As per section 372A (2) the resolutions should be passed at the meeting of the board with the consent of all the directors present at the meeting.

### (b) EXTENSION OF FINANCIAL YEAR:

Where it appears to the Central Government desirable for a holding company or a holding company's subsidiary to extend its financial year so that the subsidiary's financial year may end with that of the holding company, and for that purpose to post pone the submission of the relevant accounts to a general meeting, the central Government may on the application or with the consent of the Board of Directors of the company whose financial year is to be extended, direct that in the case that company, the submission of accounts to a general meeting, the holding of an annual general meeting or the making of an annual return, shall not be required to be submitted or made, earlier than the dates specified in the direction notwithstanding anything to the contrary in the Companies Act, 1956 or in any other Act for the time being in force.

Thus the management can extend the financial year of Sunrise Limited from 12 months to 21 months.

Following steps are required to be taken for this purpose.

1. To convene a meeting of the Board of Directors of Sunrise Limited whereat the resolution for extending the financial year is to be passed so that the year ending matches with the year ending of Hotline Ltd.
2. To make an application under Section 213 of the Companies Act, 1956 to the Central Government giving full details and specific reasons for seeking the extension in year ending.
3. To attach the following to the application:-
  - (a) A certified copy of the Last Balance Sheet and Profit & Loss Account of Hot Line Limited and Sunrise Limited.

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- (b) A certified copy of the Memorandum of Association and Articles of association of both the companies.
- (c) A certified copy of the resolution of the Board of Directors proposing the extension of the financial year.
- (d) Requisite fee payable to the Central Government under Rules.

**Question 5**

- (a) The issued, subscribed and paid-up share capital of ABC Company Limited is Rs.10 lakhs consisting of 90,000 equity shares of Rs.10 each fully paid up and 10,000 preference shares of Rs.10 each fully paid up. Out of the members of company, 400 members holding one preference share each and 50 members holding 500 equity shares applied for relief under Sections 397 and 398 of the Companies Act, 1956. As on the date of petition, the company had 600 equity shareholders and 5,000 preference shareholders.

State with details whether the above petition under Section 397 and 398 is maintainable. Will your answer be different, if preference shareholders have subsequently withdrawn their consent? (8 Marks)

- (b) Mr. Shrikant is working as Chief accountant in Black marbles Limited. The Board of Directors of the said company propose to charge him with the duty of ensuring compliance with the provisions of the Companies Act, 1956 so that books of account can be properly maintained and Balance sheet and Profit and loss Account can be prepared as per the provisions of law.

Draft a "Board Resolution" for the said purpose.

Also point out the consequences in case of default, when such a resolution is passed.

(7 Marks)

**Answer**

- (a) As per section 399 of the Companies Act, 1956, in the case of a company having a share capital, members eligible to apply for oppression and mismanagement shall be lowest of the following:

100 members; or

1/10<sup>th</sup> of the total number of members; or

Members (including equity shareholder as well as preference shareholder) holding not less than 1/10<sup>th</sup> of the issued share capital of the company.

The consent to be given by shareholder is reckoned at the beginning of the proceedings. The withdrawal of consent by shareholder during the course of proceedings does not affect the maintainability of the application.

In the question above, the shareholding pattern of the company is as follows:

Rs. 9,00,000 equity share capital held by 600 members.

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Rs. 1,00,000 preference share capital held by 5,000 members.

Rs. 10,00,000 total share capital held by 5,600 members.

The application alleging oppression and mismanagement has been made by the members as follows:

(a) Number of members making the application:

|                           |     |
|---------------------------|-----|
| - Preference shareholders | 400 |
| - Equity shareholders     | 50  |
| - Total members           | 450 |

(b) Amount of share capital held by members making the application:

|                            |                                                 |
|----------------------------|-------------------------------------------------|
| - Preference share capital | Rs. 4,000 (400 preference shares of Rs.10 each) |
| - Equity share capital     | Rs. 5,000 (500 equity shares of Rs.10 each)     |
| - Total capital            | Rs. 9,000                                       |

The application shall be valid if it has been made by the lowest of the following:

100 members

560 members (being 1/10<sup>th</sup> of 5,600)

Members holding Rs.1,00,000 share capital (being 1/10<sup>th</sup> of Rs.10,00,000)

As it is evident, the application made by 450 members meets the eligibility criteria specified u/s 399; therefore, the application is maintainable.

Such application shall remain valid despite the fact that some of the applicants have withdrawn their consent.

(b) DRAFT BOARD RESOLUTION:

“Resolved that pursuant to Sections 209 (7) and 211 (8) of the Companies Act, 1956 Mr. Shrikant, Chief Accountant of the company be and is hereby charged with the duty of seeing that the requirements of Sections 209 and 211 of the Companies Act, 1956 are duly and fully complied with.

Resolved further that Mr. Shrikant is hereby entrusted with the authority to do such acts, things and deeds as may be necessary or expedient for the purpose of compliance with the requirements of the said sections 209 and 211 of the said Act.”

Consequences in case of default

According to Section 209 (6) of the companies Act, 1956 the following persons are responsible to ensure that the company duly complies with the provisions of section 209:

1. The managing Director or manager of the company, if any;
2. All officers and other employees of the company or.

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3. If the company has no managing director, every director of the company.

Penalty for default is imprisonment up to six months or fine up to Rs.10,000/- if the persons mentioned above fail to take all reasonable steps to ensure that the provisions of Section 209 are duly complied with by the company or default has been committed by their own willful act. The punishment by way of imprisonment shall not be imposed unless the default was committed willfully [Section 209(5)].

In any penal proceedings, it shall be a defence to prove that a competent and reliable person was charged with the duty of seeing that these requirements are complied with and that he was in a position to discharge that duty. Thus, the above Board resolution makes the chief accountant responsible for compliance with the provisions of sections 209 and 211 of the Companies Act, 1956.

#### **Question 6**

- (a) As per their Articles of association the maximum number of Directors of each of the following companies is 9:
- (i) Goodheart Company Limited.
  - (ii) Frontline Trading Private Limited.
  - (iii) Hindustan Zink limited ( a Government company under section 617 of the Companies Act, 1956).

The Board of Directors of the aforesaid companies propose to increase the number of Directors to 15. Advise, whether under the provisions of the companies Act,1956, the Board of Directors can do so?  
(8 Marks)

- (b) Mr. Ramanathan is a Director of Fraudulent Ltd, Honest Ltd. and Regular Ltd. For the financial year ended on 31<sup>st</sup> March,2008 two irregularities were discovered against fraudulent Ltd. for the financial year ended on 31<sup>st</sup> March,2008 two irregularities were discovered against Fraudulent Ltd. Fraudulent Ltd. did not file its annual accounts for the year ended 31.3.2008 and failed to pay interest on loans taken from a financial institution for the last three years.

On 1<sup>st</sup> June, 2009 Mr. Ramnathan is proposed to be appointed as additional director of Goodwill Ltd, which company has sought a declaration from Mr. Ramnathan and he also submitted the declaration stating that the disqualification specified in Section 274 of the Companies Act,1956 is not attracted in his case. Decide under the provisions of the Companies Act:

- (i) Whether the declaration submitted by Mr. Ramanathan to Goodwill Ltd. is in order?
- (ii) Whether Mr. Ramnathan can continue as a Director in Honest Ltd. and Regular Ltd.?  
(7 Marks)

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Answer

**(a) INCREASE IN THE NUMBER OF DIRECTORS:**

As per Section 259 of the Companies Act, 1956, in the case of a company incorporated after 21<sup>st</sup> July, 1951, any increase in the number of its directors beyond the maximum fixed by its Articles of Association as originally adopted and registered and in the case of a company existing prior to that date, any increase in the number of directors shall not have any effect unless approved by the Central Government, and it is to become void to the extent to which it is disapproved by the Central Government. However, such approval from the Central Government is not required if the number of directors is increased to 12 or less than that.

The above mentioned provision of the Companies Act, 1956 are applicable only to public companies or private companies which are subsidiaries of public companies. Based on the above mentioned provisions, following conclusion can be drawn in respect of companies as mentioned in the question.

In the case of Good heart company Limited the Directors have to obtain the approval of the Central Government for increasing the number of Directors from 9 to 15.

In the case of Front Line Trading Private Limited (Which is a Private company) and Hindustan Zink Limited (a Government company) the provisions of section 259 of the companies Act, 1956 are not applicable and hence the directors of these companies can increase the number of directors from 9 to 15 without the approval of the Central Government, subject to fulfillment of other procedural requirements.

**(b) DISQUALIFICATION OF DIRECTOR:-**

According to section 274 (1) (g) of the Companies Act, 1956, a person who is already a Director of a public company becomes disqualified for being appointed as Director, if the concerned company has committed default on either of the two counts mentioned below:-

- (a) The concerned public company has not filed the annual accounts and annual return for any continuous three years (financial) commencing on and after 1<sup>st</sup> April, 1999 or.
- (b) The concerned public company has failed to repay its deposits or interests on due date or redeem its debentures on due date or pay dividend and such failure continues for one year or more.

Such a person is disqualified to act as a Director of any other public company for a period of five years from the date on which the public Company make default as specified above.

Here Mr. Ramanathan is a Director of Fraudulent Limited. Fraudulent Limited was regular in filing Annual returns but did not file annual accounts for only one year i.e. financial year ended 31<sup>st</sup> March, 2008. The disqualification will not apply unless the company has

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committed defaults in respect of both the matters for three consecutive financial years. Hence the provision of section 274 is not attracted.

The disqualification specified in sub-clause (b) is not applicable in matter of loans from public financial institutions. In view of this Mr. Ramnathan is eligible to be appointed as additional Director in Goodwills Limited and declaration submitted by him is in order

The disqualification if any would come in to operation only at the time of appointment or reappointment Hence Mr. Ramnathan can continue as director of Honest Ltd and Regular Ltd.

#### **Question 7**

- (a) The promoters of Balaji Producer Company Ltd; proposed to be registered under Section 581C of the Companies Act, 1956 desire to have the following information.
- (i) Can the company be registered with seven individuals?
  - (ii) What is the minimum number of directors required to be appointed?
  - (iii) The time limit within which the first annual general meeting of the company should be held after incorporation.
  - (iv) Whether the funds of the company can be given as loans to any of the directors of the company? (8 Marks)

Advise the promoters on the above said issues with relevant details.

- (b) AB Ltd. fails to raise its paid up capital up to Rs.5 Lakhs so as to comply with the provisions of the Companies (Amendment) Act, 2002. The Registrar of companies New Delhi struck off the name of the company from the Register in 2003. Mr. Mercy a creditor of the company having information that there are assets available with the company, seeks your advice on the following issues:
- (i) Can the name of the company be restored?
  - (ii) If the answer of the above question is in the affirmative, who can apply for restoration and who is the competent authority for considering the restoration of name?
  - (iii) Is there any time 'Limit for making' application for restoration and if so how many years? (7 Marks)

#### **Answer**

- (a) According to the provisions of Section 581C of the Companies Act 1956, a producer company can be formed any ten or more individuals, each of them being a producer, or any two or more producer institutions, or a combination of ten or more individuals and producer institutions, desirous of forming a producer company having its objects specified in section 581B and otherwise complying with the requirements and provisions of the Act

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Thus seven individuals cannot form a producer company.

Every producer company shall have at least 5 directors and not more than 15 directors (section 581 Q).

A producer company shall hold its first annual general meeting within a period of 90 days from the date of its incorporation.

According to section 581ZK; a producer company can grant loans and advances to any of its directors or their relatives only after obtaining the approval of the members in general meeting and also subject to the conditions if any imposed by the articles of association of the producer company.

- (b) Section 560(6) of the Companies Act, 1956 provides for restoration of a company's name previously struck off the register.

As per section 560 (6), if a company, or any member or creditor thereof, feels aggrieved by the company having been struck off the register, the court (tribunal) on an application made by the company, member or creditor before the expiry of twenty years from the publication in the official gazette of the notice aforesaid, may, if satisfied that the company was, at the time of the striking off, carrying on business or in operation or otherwise that it is just that the company be restored to the register, and the court (tribunal) may, by the order, give such directions and make such provisions as seem just for placing the company and all other persons in the same position as nearly as may be as if the name of the company had not been struck off.

Upon a certified copy of the order under sub-section (6) being delivered to the registrar for registration, the company shall be deemed to have continued in existence as if its name had not been struck off.

In view of the above the following advice may be given to Mr. Mercy.

- (i) Yes. The name of the company (AB Ltd) can be restored after following the procedure stated above.
- (ii) The application has to be made to the concerned High Court where the registered office of AB Ltd. is situated. Mr. Mercy as creditor can make the application. Such an application can be made by the company, or any member of the company also.
- (iii) Yes. There is a time limit of 20 years beyond which the power to restore the company is not possible.

**Question 8**

- (a) A Mortgage was created over the property of a public company. The loan was advanced by the son of the director. All the directors already knew this fact. Thus the director was interested in the transaction. But he has neither disclosed his interest nor abstained from voting while approving the said transaction. Later on a suit was filed for setting aside the

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mortgage on the ground that since the interested director voted on the matter, the contract was void. Advise with reasons.

- (i) Whether the contract became void due to non-disclosure of interest by the concerned director?
- (ii) Is there any ban on such a contract under the Companies Act, 1956? (8 Marks)
- (b) Decide in the light of the provisions of the companies Act, 1956 the validity and extent of powers of Board of Directors and the procedure to be complied with in the following matters:
  - (i) Delegation of power of the Managing Director of the company to invest surplus funds of the company in the shares of some companies.
  - (ii) Donation of Rs.5 lakhs to a hospital established exclusively for the benefit of employees and a donation of Rs.5 lakhs to a charitable trust registered under Section 12A and exempted under Section 80G of the Income-tax Act, 1961.
  - (iii) Donation of Rs.5 Lakhs to a political party registered with the appropriate authority. (7 Marks)

#### **Answer**

- (a) Section 299 of the Companies Act, 1956 requires the disclosure of interest by a director while section 300 prohibits an interested director to participate or vote in respect of that particular transaction at the Board meeting. Further his presence will not be counted for quorum also. But where a whole body of directors is aware of the facts relating to an interest of a director, a formal disclosure is not necessary. (Ramakrishna Rao Vs. Bangalore Race Club).

The mere voting by an interested director will not render the contract void or voidable unless with the absence of that vote, there would have been no quorum. The mere fact that voting under such situation is an offence punishable with fine under section 299(4) and 300(4) of the Act does not ipso facto render the contract void or voidable. In this case, there is no allegation of earning secret profits. Thus the action against the company will fail as the contract of mortgage is fair and in the interest of the company.

Under section 299 and 300 of the Act, there is no ban on contract in which a director is interested. The only requirement is that the interest should be disclosed, bonafide and fair. (P. Leslie & co. Vs. Vo wapshare)

Even where the interest is not disclosed the transaction is only voidable against the interested director, and not void. (Narayan Das Shreeram Somani vs Sangli Bank).

- (b) **POWERS OF BOARD OF DIRECTORS:**
  - (i) Section 292 of the Companies Act, 1956 empowers the Board of Directors to delegate to the Managing Director the power to invest in general terms. But section

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372A (2) of the said act provides that no investment shall be made, unless it is sanctioned by a resolution passed at a meeting of the Board with the consent of all the directors present. Section 372A does not provide for delegation. Hence the proposed delegation of power to the Managing Director to invest is not in order.

- (ii) Donation to a hospital run exclusively for the benefit of employees of the company is in order. The limit of 5% of average net profits during the last three financial years is applicable only to contributions to charitable and other funds not directly relating to the business of the company or the welfare of its employees. Thus, under section 293 (1) (e) of the Companies Act, 1956, the Board is empowered to make the proposed donation to the hospital.

However the donation of Rs.5 Lakhs to a charitable trust is subject to the limit laid down in section 293(1) i.e. Rs.50,000 or 5% of the average net profits of the company during the last three financial years whichever is higher.

Thus to contribute Rs.5 lakhs the average net profits for last three financial years should be Rs.100 lakhs.

- (iii) Donation of Rs.5 Lakhs to a political party can be made if the company is in existence for more than 3 years and the donation amount cannot exceed 5% of the average net profit for the preceeding three years. Further the procedure laid down in Section 293 A should also be complied with.

**Question 9**

- (a) The shareholders and creditors of Wagonbound Company Limited, in meeting convened for approval of a scheme of reconstruction of the company, passed resolutions. The scheme of reconstruction provided for the following:

- (i) Sale of vacant land and appropriation of proceeds for payment of outstanding wages, tax dues and repayment of loan.
- (ii) Unsecured creditors to forego 40% of their claims against the company and receive debentures for the balance amount.

A few share holders and creditors raised objections against the said arrangements. Advise the directors about the steps to be taken to give effect to the proposed scheme under the Companies Act, 1956. (8 Marks)

- (b) High Value Builder Ltd. is financially insolvent and is unable to pay its debts. Mr. X an unsecured creditor has to recover a sum of Rs.5 lakhs from the company. Advise Mr. X about the steps and the procedure to be followed to put the company into compulsory winding up, as an alternative for the recovery of his dues. (7 Marks)

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Answer

(a) **RECONSTRUCTION SCHEME OF COMPANY:**

The provisions contained in sections 391 to 394 of the Companies Act, 1956 are applicable to Wagonbound Company Limited as it can be considered as a company liable to be wound up within the meaning of Section 390 of the Companies Act, 1956. The proposed scheme involves a compromise or arrangement with members and creditors and it attracts section 391 of the said Act.

While the company or any creditor or member can make application to the Court/Tribunal under Section 391, it is usual for the company to make an application. On such application the Court/Tribunal may order that a meeting of creditors and/or members be called and held as per the directions of the Court/Tribunal.

The company must send notice of meeting to every creditor/member containing a statement setting forth the terms of compromise or arrangement explaining its effect. Material interest of directors, Managing Director or manager of the company in the scheme and the effect of scheme on their interest should be fully disclosed (Section 393). At the meetings convened as per directions of the Court/Tribunal majority in number representing at least  $\frac{3}{4}$  in value of creditors/members present and voting must agree to compromise or arrangement. Thereafter the company must present a petition to the Court/Tribunal for confirmation of the compromise or arrangement.

The notice of application made by the company will be served on the Central Government and the Tribunal will take into consideration representation, if any, made by the Central Government (Section 394A). The Court/Tribunal will sanction the scheme, if satisfied, after considering all relevant matters.

Copy of order issued by the Court/Tribunal must be filed with the Registrar of Companies and then only the order will come into effect. Copy of the said order must be annexed to every Memorandum of Association issued thereafter. The scheme sanctioned by the Court/Tribunal shall be binding on all members and creditors even those who were dissenting.

Note: The power under the scheme of reconstruction etc. are still with the high courts pending constitution of the National Company Law Tribunal.

- (b) Mr. X has to take the following steps to put High Value Builders Ltd. into compulsory winding up:
- (i) A petition for winding up of the company is to be filed in the High Court where the registered office of the company is located under Section 439(1) (b) read with Section 433(e) and (f) of the Companies Act, 1956. A copy of the petition should also be served on the company.

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- (ii) The petition should be filed along with an affidavit showing sufficient ground for the appointment of a provisional liquidator till an order is passed by the High Court appointing an official liquidator..
- (iii) After obtaining the winding up order from the High Court the same should be advertised within 14 days in a newspaper in English language and in the regional language of the state where the company is registered.
- (iv) A Certified copy of the winding up order passed by the court should be filed with the concerned Registrar of Companies alongwith the prescribed fees within 30 days from the date of the winding up order.
- (v) If the shares of the company are listed in a stock exchange, copy of the petition alongwith the order may be filed with the stock exchange concerned.
- (vi) The winding up proceedings will be carried out by the official liquidator till dissolution of the company.