

PAPER – 4 : CORPORATE LAWS AND SECRETARIAL PRACTICE

Answer all questions.

Question 1

- (a) A stock exchange desirous of taking over another stock exchange, seeks your advice on corporatisation. Examining the provisions of the Securities Contracts (Regulation) Act, 1956 and the meaning of the terms 'corporatisation' and 'demutualisation', advise the stock exchange about the steps to be taken to give effect to the scheme of corporatisation. (5 Marks)
- (b) Mr. Veer a newly entered investor in the field of securities business seeks your advice on the investments to be made in securities of large Companies for long term purposes. With this object in view, he wants to know the meaning of the following terms commonly used in any stock exchange.
- (i) Derivative
 - (ii) Option in securities
 - (iii) Spot delivery contract
- Advise suitably. (5 Marks)

Answer

(a) CORPORATISATION & DEMUTUALISATION OF STOCK EXCHANGES

'Corporatisation' means the succession of a recognized stock exchange, being a body of individuals or a society registered under the Societies Registration Act, 1860, by another stock exchange, being a Company incorporated for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities carried on by such individuals or society. 'Demutualisation' means the segregation of ownership and management from the trading rights of the members of a recognized stock exchange in accordance with a scheme approved by the SEBI.

Steps for Corporatisation & Demutualisation. [Section 4B-Securities Contracts (Regulations) Act, 1956]

In accordance with the provisions of the Securities Contracts (Regulation) Act, 1956, as contained in Section 4B:

1. All recognized stock exchanges referred to in Section 4A shall, within such time as may be specified by the SEBI submit a scheme for corporatisation and demutualization for its approval.
2. On receipt of the scheme, the SEBI may, after making such enquiry as may be necessary in this behalf and obtaining such further information, if any, as it may require and if it is satisfied that it would be in the interest of the trade and also in the public interest, approve the scheme with or without modification.

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3. No scheme shall be approved by the SEBI if the issue of shares for a lawful consideration or provision of trading rights in lieu of membership card of the members of a recognized stock exchange or payment of dividends to members have been proposed out of any reserves or assets of that stock exchange.
 4. Where the scheme is approved, the scheme so approved shall be published immediately by-
 - (a) The SEBI in the Official Gazette
 - (b) The recognised Stock Exchange in such two daily newspapers circulating in India, as may be specified by the SEBI, and upon such publication, notwithstanding anything to the contrary contained in this Act or any other law for the time being in force or any agreement, award, judgment, decree or other instrument for the time being in force, the scheme shall have effect and be binding on all persons and authorities including all members, creditors, depositors and employees of the recognized stock exchange and on all persons having any contract, right, power, obligation or liability with, against, over, to, or in connection with, the recognized stock exchange or its members.
 5. Where the SEBI is satisfied that it would not be in the interest of the trade and also in the public interest to approve the scheme, it may, by an order, reject the scheme and such order of rejection shall be published by it in the Official Gazette. SEBI shall give a reasonable opportunity of being heard to all the persons concerned and the recognized stock exchange concerned before passing an order rejecting the scheme.
 6. SEBI may, while approving the scheme by an order in writing, restrict -
 - (a) the voting rights of the shareholders who are stock brokers of the recognized stock exchange.
 - (b) the right of shareholders or a stock broker of the recognized stock exchange to appoint the representatives on the governing board or the stock exchange.
 7. The order made by SEBI shall be published in the Official Gazette and on the publication thereof, the order, notwithstanding anything to the contrary contained in the Companies Act, 1956, or any other law for the time being in force, have full effect.
 8. Every recognized stock exchange, in respect of which the scheme for corporatisation or demutualization has been approved shall either by fresh issue of equity shares to the public or in any other manner as may be specified by the regulations made by SEBI, ensure that at least 51% of its equity share capital is held, within 12 months from the date of publication of the order by the public other than shareholders having trading rights. The SEBI may, on sufficient cause being shown to it and in the public interest, extend the said period by another 12 months.
- (b) Mr. Veer, a new investor, desirous of entering investments business in any Stock Exchange, on different terms commonly used in any Stock Exchange as follows:

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(i) Derivative:

“Derivative” includes –

- (a) a security derived from a debt instrument, share, loan whether secured or unsecured risk instrument or contract for differences or any other form of security.
- (b) a contract, which derives its value from the prices or index of prices, of underlying securities.[Section 2 (ac) of the Securities Contracts (Regulation) Act, 1956].

(ii) Option in Securities:

“Option in Securities” means a contract for the purchase or sale of a right to buy or sell or a right to buy and sell, securities in future, and includes a teji, a mandi, a teji mandi, a galli, a put, a call or a put and call securities. [Section 2(d) of the Securities Contracts (Regulation) Act, 1956].

(iii) Spot Delivery Contract

“Spot delivery contract” means a contract which provides for:

- (i) actual delivery of securities and the payment of a price therefore either on the same day as the date of the contract or on the next day, the actual period taken for the dispatch of the securities or the remittance of money therefore through the post being excluded from the computation of the period aforesaid if the parties to the contract do not reside in the same town or locality;
- (ii) transfer of the securities by the depository from the account of a beneficial owner to the account of another beneficial owner when such securities are dealt with by a depository. [Section 2(i) of the Securities Contracts (Regulation) Act, 1956].

Question 2

- (a) (i) Mr. Ruchi resided for a period of 170 days in India during the financial year 2008-09 and thereafter went abroad. He came back to India on 1st April, 2009 as an employee of a business organization. What would be his residential status during financial year 2009-10 under the Foreign Exchange Management Act, 1999.
- (ii) Pamtop is a London based Company having several business units all over the world. It has manufacturing unit called Laptop with headquarters in Bengaluru. It has a branch in Seoul, South Korea which is controlled by the headquarters in Bengaluru. What would be the residential status under the FEMA, 1999 of Laptop in Bengaluru and that of Seoul branch? (7 Marks)
- (b) Referring to the provisions of the Foreign Exchange Management Act, 1999, examine whether V, an exporter is bound to make declaration of the following goods exported from India to United Kingdom: (7 Marks)
- (i) Exports software valuing Rs.50,000.
 - (ii) V gifts certain items of jewellery valued at Rs.20,000 to his friend in Australia.
 - (iii) V exports certain goods valuing US \$ 5,000 to Myanmar under Barter Trade Agreement.

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Answer

- (a) (i) Residential status of an individual for a particular financial year is determined with reference to his residence in India in the immediately preceding financial year. In the given problem Mr. Ruchi resided in India for less than 183 days in the financial year 2008-09. Therefore for the financial year 2009-10 he is a person resident outside India. Unless a person resides in India for more than 182 days in the preceding financial year, he can in no case be termed as a person resident in India. [Section 2(v) FEMA, 1999].

- (ii) Pamptop being a London based Company would be a person resident outside India. Section 2 (u) of the FEMA, 1999 defines 'person'. Under clause (vii) thereof 'person' would include any agency office or branch owned or controlled by such person. The term 'such person' appears to refer to person who is included in clauses (i) to (vi). Accordingly, a laptop unit in Bengaluru, being a branch of a Company, would be a 'person.'

Section 2(v) defines person 'resident in India', under clause (iii) thereof person 'resident in India', would include an office, branch or agency in India owned or controlled by a person resident outside India. Laptop unit in Bengaluru is owned or controlled by a person 'resident outside India'. Hence, it would be a person 'resident in India'.

However Seoul branch 'though not owned' is controlled by Laptop unit in Bengaluru which is a person resident in India. Hence, prima-facie, it may be possible to hold a view that the Seoul branch is also a 'person resident in India'.

- (b) In accordance with provisions of the FEMA, 1999 as contained in Section 7 read with Section 8, it imposes on an exporter to make appropriate declaration of the value of the goods being exported and he is also required to repatriate the foreign exchange due to India in respect of such exports to India in the manner within the time as may be prescribed. Under Section 8, the exporter is under an obligation to realise and repatriate to India such foreign exchange. However, if there is a delay in the receipt of export, it will not be a violation which shall be punishable. Section 8 applies to a resident who shall take all the reasonable steps, depending upon the individual case.

There are certain categories of export for which declaration need not be made. These are:

- (a) Export of goods/software not exceeding Rs.25,000 in value.
- (b) Export by way of gift not exceeding Rs.1 lac in value.
- (c) Export of goods not exceeding US \$ 1000 or its equivalent per transaction to Myanmar under Barter Trade Agreement.

Taking into consideration the above:

- (i) In the first case since the value is exceeding Rs.25,000 in value, therefore, declaration has to be completed.

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- (ii) In the second case since the value of gift of jewellery to V's friend in Australia is less than Rs.1 lac in value, the gift does not need any declaration to be completed.
- (iii) In the third case since the value is more than U.S.\$ 1,000, therefore, the declaration has to be completed.

Note : In the question, it has been stated that goods are exported from India to United Kingdom which has no relevance when subsequently, it has been stated that goods are exported to different countries such as Australia, Myanmar. There is no relevance of mentioning the name of the Country i.e. UK in the question. This perhaps might have confused the students while writing the answer

Question 3

- (a) AVD Limited was incorporated on 1st April, 2006. The Company got its shares listed at Bombay Stock Exchange on 30th September, 2007. The Company at an Extra-Ordinary General Meeting held on 31st October, 2009, decided to go for public issue of equity shares to an extent of Rs.300 crores. The net worth of the Company as per the audited Balance sheets in the financial years 2007-08 and 2008-09 was Rs.50 crores and 60 crores respectively. During the financial year 2008-09 the Company had already issued equity shares amounting to Rs.20 crores. There is no change in the name of the Company or its business activities during the financial year 2008-09. Referring to the guidelines issued by Securities and Exchange Board of India, advise the Company on the following: (8 Marks)
 - (i) Whether the Company can go ahead with the public issue of equity shares as stated above.
 - (ii) What would be your advice in case the net worth of the Company as per audited balance sheets in the financial years 2007-08 and 2008-09 was Rs.20 crores and 30 crores respectively?
 - (iii) What would be the position in case the Company in question changed its name to AJD Limited during the year 2008-09, three months before filing the offer document and the revenue due to change of business activity suggested by the new name during the financial year 2008-09 was 40% less than the total revenue for the financial year 2007-08 reckoned from the date of filing the offer document?
- (b)
 - (i) An arrangement has been made among the cotton producers that the cotton produced by them will not be sold to mills below a certain price. The arrangement is in writing but it is not intended to be enforced by legal proceeding. Examine whether the said arrangement can be considered as an agreement within the meaning of Section 2(b) of the Competition Act, 2002.
 - (ii) The orange producers of Nagpur have formed an association to control the production of oranges. Examine whether it will be considered as a cartel within the meaning of Section 2(c) of the Competition Act, 2002. (8 Marks)

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Answer

(a) PUBLIC ISSUE OF SHARES BY A LISTED COMPANY:

As per the SEBI (DIP) Guidelines 2000 a listed Company shall be eligible to make a public issue of equity shares or any other security which may be converted into or exchanged with equity shares at a later date provided that the aggregate of the proposed issue and all the previous issues made in the same financial year in terms of the size (i.e. offer through offer document + allotment + promoters' contribution through the offer document), issue size not exceed 5 times its pre-issue net worth as per the audited balance sheet of the last financial year. It is further provided that in case there is a change in the name of the issuer Company within the last 1 year (reckoned from the date of filing of the offer document), the revenue accounted for by the activity suggested by the new name is not less than 50% of its total revenue in the preceding 1 full year period).

Applying the above guidelines, the questions as asked in the problem can be answered as under:

1. There are two conditions in the guidelines as stated above viz.i) that the aggregate issue i.e. proposed + proposed + all the previous issues made in the same financial year should not exceed 5 times the net worth of the Company; ii) there is no change in the name of the issuer Company within the last 1 year. In the question the proposed issue of Rs.300 crores + Previous issue in the same financial year is Rs.20 crores, making an aggregate of Rs.320. Since the aggregate of the issue is more than 5 times of Net Worth, i.e. more than Rs.300 crores , the proposed offer is not within the limit, Company cannot proceed ahead with in the proposed issue of Rs.300 crores.
 2. In the second case the net worth is only Rs.30 crores. 5 times of the net worth comes to Rs.150 crores only. Since the aggregate of the proposed issue and the previous issue during the same financial year is Rs.320 crores, which is exceeding the limits of Rs.150 crores, as calculated above, the Company cannot proceed with the public issue of shares as proposed in the second case.
 3. In the third case the offer cannot be made since the current year revenue is less than 50% of the total revenue of the previous year.
- (b) (i) As per Section 2(b) of the Competition Act, 2002 an Agreement includes any arrangement or understanding or action in concert:-
- (i) whether or not, such arrangement, understanding or action is formal or in writing; or
 - (ii) whether or not, such arrangement, or understanding or action is intended to be enforceable by legal proceedings.

In the given case the understanding reached among the cotton producers not to sell below a certain price shall amount to an agreement as defined under Section 2(b) notwithstanding the fact that through the arrangement is in writing but not intended to be enforced by legal proceeding.

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- (ii) As per Section 2(c) of the Competition Act, 2002 the term “cartel” includes an association of producers, sellers, distributors, traders or service providers who, by agreement amongst themselves, limit, control, or attempt to control the production, distribution, sale or price of, or, trade in goods or provision of services.

The term “cartel” has an inclusive meaning. Thus an association formed to control the production of oranges is within the aforesaid definition of a cartel. Hence the association of orange producers of Nagpur will be considered as a cartel under the provisions of the Act.

Question 4

- (a) (i) Many a time a proviso is added to a Section of the enactment. Explain the function of such a proviso while carrying out the interpretation?
- (ii) Discuss the rules of interpretation of deeds and documents. (8 Marks)
- (b) PQR Limited held three board meetings till 31st December, 2008 during the financial year 2008-09. The next board meeting was due to be held on 27th March, 2009, but for want of quorum the meeting could not be held. A group of shareholders complained that the Company has violated the provisions of Section 285 of the Companies Act, 1956 in not holding the required board meeting. Further, Mr. P and Mr. Q who are the directors of the Company informed the Company their inability to attend the meeting because the notice of the meeting was not served on them. Discuss whether there is any default on the part of the Company and the consequences thereof. What will be the quorum in the given situation ? (7 Marks)

Answer

- (a) (i) The normal function of a proviso is to except something out of the enactment or to qualify something stated in the enactment which would be within its purview if the proviso were not there. The effect of the proviso is to qualify the preceding enactment which is expressed in terms which are too general. As a general rule, a proviso is added to an enactment to qualify or create an exception to what is in the enactment. Ordinarily a proviso is not interpreted as it stating a general rule.

It is a cardinal rule of interpretation that a proviso to a particular provision of a statute only embraces the field which is covered by the main provision. It carves out an exception to the provision to which it has been enacted as a proviso and not to the other. (Ram Narain Sons Ltd. Vs. Assistant Commissioner of Sales Tax., A.I.R, 1995 SC 765)

An explanation is at times appended to a Section to explain the meaning of the text of the section. An explanation may be added to include something within the Section or to exclude something from it. An explanation should normally be so read as to harmonise with and clear up any ambiguity in the main section. It should not be so construed as to widen the ambit of the section.

- (ii) The rules regarding interpretation of deeds and documents are as follows:

First and the foremost point that has to be borne in mind is that one has to find out

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what a reasonable man, who has taken care to inform himself of the surrounding circumstances of a deed or a document, and of its scope and intendments, would understand by the words used in that deed or document.

It is inexpedient to construe the terms of one deed by reference to the terms of another. Further, it is well established that the same word cannot have two different meanings in the same document, unless the context compels the adoption of such a rule.

The Golden Rule is to ascertain the intention of the parties to the instrument after considering all the words in the document/deed concerned in their ordinary natural sense. For this purpose, the relevant portions of the document have to be considered as a whole. The circumstances in which the particular words have been used have also to be taken into account. Very often, the status and training of the parties using the words have also to be taken into account as the same words may be used by a ordinary person in one sense and by a trained person or a specialist in quite another sense and a special sense. It has also to be considered that very many words are used in more than one sense. It may happen that the same word understood in one sense will give effect to all the clauses in the deed while taken in another sense might render one or more of the clauses ineffective. In such a case the word should be understood in the former and not in the latter sense.

It may also happen that there is conflict between two or more clauses of the same document. An effort must be made to resolve the conflict by interpreting the clauses so that all the clauses are given effect to. If, however, it is not possible to give effect to all of them, then it is the earlier clause that will over ride the latter one.

Similarly, if one part of the document is in conflict with another part, an attempt should always be made to read the two parts of the documents harmoniously, if possible. If that is not possible, then the earlier part will prevail over the latter one which, therefore, be disregarded.

- (b) Section 285 of the Companies Act, 1956 requires Board of Directors to meet at least once in every three months, respective of whether it is the board of a public Company or a private Company and at least four such meetings must be held in every year. However, the Central Government may, by notification in the Official Gazette, direct that these provisions will not apply in relation to any class of Companies or will apply in relation thereto subject to such exceptions, modifications or conditions as may be specified in the notification

As per Section 288 of the Act-

- (1) if a meeting of the board could not be held for want of quorum, then, unless the articles otherwise provide, the meeting shall automatically stand adjourned till the same day in the next week, at the same time and place, or if that day is a public holiday, till the next succeeding day which is not a public holiday, at the same time and place.

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- (2) The provisions of Section 285 shall not be deemed to have been contravened merely by reason of the fact that a meeting of the board which had been called in compliance with the terms of that Section could not be held for want of a quorum.
- (3) As the meeting could not be held for want of quorum, it cannot be said that PQR Ltd has violated the provisions of Section 285 of the act.

Notice of every meeting has to be served in writing on each director for the time being in India, and at his usual address in India to every other director (Section 286). Every officer of the Company whose duty is to serve the notice as aforesaid and who fails to do so shall be punishable with fine extending to Rs.1000 (Section 286).

As no notice, was served on officer of the Company who is responsible for the default shall be punishable with fine to the extent of one thousand rupees.

The Supreme Court, in case of *Parmeshwari Prasad Vs. Union of India* (1974) has held that the resolutions passed in the board meeting shall not be valid, since notice to all the Directors was not given in writing. Notice must be given to each Director in writing. Hence, even though the directors concerned knew about the meeting, the meeting shall not be valid and resolutions passed at the meeting also shall not be valid.

In relation to board meeting quorum implies fully qualified and disinterested directors who must be present at the meeting, so as to enable the board of which they are the constituents to legally transact the business thereat. According to Section 287 the quorum of board meeting is one third of the total strength of board (any fraction contained in the said one third being rounded off as one) or two directors whichever is higher. The total strength is to be derived after deducting the number of directors whose offices are vacant.

Question 5

- (a) Mr. Weldon was appointed as a director of Esquire Engineering Ltd. with effect from 1st October, 2008. Since the Company wanted to take full advantage of the wisdom and experience of Mr. Weldon, it offered him attractive remuneration payable on monthly basis and made an application to the Central Government for approval to pay such remuneration. Anticipating the approval of the Central Government, Esquire Engineering Ltd. started paying such remuneration from the date of appointment and continued to do so till 31st March, 2009. The Central Government did not fully approve the remuneration proposed by the Company and restricted the same to a lower amount. On scrutiny of accounts, the Company noticed that till 31st March, 2009 it has paid to Mr. Weldon a total sum of Rs.5.50 lakhs in excess of the remuneration sanctioned by the Central Government. Explain the relevant provisions of the Companies Act, 1956, in respect of recovery and waiver of recovery of the excess remuneration so paid. Draft a resolution for recovery/waiver of recovery of the excess remuneration paid by the Company.

(8 Marks)

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- (b) SKD an employee of M/s Moreh Ltd. met with an accident and died. The accident occurred when SKD was on Company's duty. He held one hundred Shares partly paid. Normally the Company has a first and paramount lien on the shares. The Board of Directors, however, relaxed the said provision with regard to the hundred shares held by SKD as a goodwill gesture on the part of the Company. Is the action of the Company valid? State the reasons. Also state whether the Company's lien can be extended to dividend payable on such shares. (7 Marks)

Answer

- (a) A director who is not a Managing Director or Whole Time Director can draw remuneration by way of monthly, quarterly or annual payment only if so authorized by the Central Government (Section 309). The Central Government may while sanctioning the payment of remuneration under Section 309, fix remuneration at such amount as it may deem fit (Section 637AA). If any director draws any remuneration in excess of the remuneration sanctioned by the Central Government, he shall refund such excess remuneration to the Company. Until such excess remuneration is refunded he shall hold it in trust for the Company. The Company shall not waive the recovery of any sum refundable to it unless permitted by the Central Government.

In the present case, Mr. Weldon cannot keep remuneration drawn by him which is in excess of the remuneration sanctioned by the Central Government. Accordingly he shall refund to the Company Rs.5.50 lakhs. Until such refund is made he shall hold the excess amount in trust for the Company. Further the Company cannot waive the recovery of excess remuneration.

However, if on an application made to the Central Government, the Central Government may permit, the waiver of recovery of excess remuneration. The Company can waive the recovery of excess remuneration and then Mr. Weldon shall have a right to retain the excess remuneration drawn by him. For recovery of the excess remuneration paid to Mr. Weldon, there is no need to pass any resolution. However, for waiver of recovery a resolution is required to be passed by the Company in a general meeting and approval of the Central Government is necessary.

Resolution

"Resolved that subject to the approval of the Central Government, consent of the Company be and is hereby given waiving the recovery of an amount of Rs.5.50 lakhs paid to Mr. Weldon, the director of the Company, during the period 1st October, 2008 to 31st March 2009 being in excess of the remuneration sanctioned by the Central Government vide letter no date

Resolved further that an application to be made to the Central Government and the Company Secretary be and is hereby authorized to take the necessary steps in this regard."

- (b) A Company cannot have lien on shares unless provided in the Articles of Association. Therefore provision to this effect should be in the articles. As per Regulation 9 of Table A

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of the Companies Act, 1956 the Company has first and paramount lien on every share which has not been fully paid up for all monies (whether presently payable or not) called or payable at a fixed time in respect of that share and on all shares which are not fully paid up standing registered in the name of a single person, for all moneys presently payable by him or his estate to the Company.

The Board of Directors may, however, at any time declare any share to be wholly or in part exempt from the said provision. Hence the decision of the Board of Directors of M/s Moreh Ltd to relax the provisions of lien in respect of shares held by SKD is in order and valid (Vide Regulation 9 of Table A).

Further the Company's lien is extended to all dividends payable on such shares as per regulation 9(2) of Table A to the Companies Act, 1956.

Question 6

- (a) MDV Ltd. is an infra-structure Company with paid up capital and free reserves of Rs. two crores and one crore respectively. The Board of Directors granted a loan of Rs. 50 lakhs to ABC Ltd., and also gave a guarantee to IDBI for giving a loan of Rs. one crore to RMA Co. MDV Ltd., has not given any other loan or guarantee to any one. A group of shareholders of MDV Ltd. objected to the above deals on the ground that they are violative of the provisions of the Companies Act, 1956. Applying that provisions of the said enactment relating to inter-corporate loans and investments in the given case, decide: (7 Marks)
- (i) Whether the objection raised by the shareholders is tenable?
 - (ii) Would your answer be the same in case the amount of loan granted is Rs. one crore and the guarantee given is for an amount of Rs. one and half crores?
 - (iii) What would be your answer in case MDV Ltd. is a Private Company not being the subsidiary of any Public Limited Company?
- (b) (i) The Comptroller and Auditor General of India has appointed KOL & Co. to conduct a supplementary audit of XYZ Ltd., a subsidiary of a Government Company. XYZ Ltd, however, is of the opinion that the Comptroller and Auditor General has no power to authorize such audit, it being merely a subsidiary of the Government Company. Is the argument correct? Discuss.
- (ii) CRE Ltd., a Government Company wants to appoint Parasnath & Co. as its auditors for the period 2009-10. State with reference to the provisions applicable to Government Companies, the procedure to appoint the auditors. (7 Marks)

Answer

- (a) Problem as asked in the question is based on the provisions, as contained in Section 372A (1) and (8) of the Companies Act, 1956. The Section provides for the ceiling on loans, guarantees, investments etc. Accordingly no Company shall, directly or indirectly -
- (a) make any loan to any other body corporate;

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- (b) 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
- (c) acquire, by way of subscription, purchaser or otherwise the securities of any other body corporate,

exceeding 60% of its paid-up share capital and free reserves, or 100% of its free reserves, whichever is more. Where the aggregate of the above exceeds the aforesaid limit, no investment or loan shall be made or guarantee shall be given or security shall be provided unless previously authorized by a special resolution passed in a general meeting.

Thus applying the above provisions in the given case the answers to the questions shall be as under:

1. The objection raised by the shareholders of MDV Ltd. is not tenable because Section 372A does not apply, if the investment is made by a Company of providing infrastructural facilities. Making loan by the Company in this case is in order and is valid since the provisions of Section 372A do not apply in this case [Sub-Section (8) of Section 372A].
 2. In the second case also the answer remains the same as the Company is exempted from the provisions of Section 372, being infrastructural facilities providing Company.
 3. Even in the third case the provisions of Section 372A do not apply to a private Company, unless it is a subsidiary of a Public Company. Thus in case MDV Ltd. is a Private Company not being a subsidiary of a Public Company. It can grant loans or provide guarantees without complying with the restrictions stated in Section 372A. The guarantee given by a holding Company in respect of loan made to the wholly owned subsidiary Company is valid since the provisions of Section 372A do not apply in this case also. [Sub-Section (8) Clause (d) of Section 372A].
- (b) (i) As per Section 617 of the Companies Act, 1956 Government Company means any Company in which not less than fifty-one percent of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments and includes a Company which is a subsidiary of a Government Company as thus defined.
- As such a Government Company includes subsidiary to a Government Company. So the contention of XYZ Ltd that they are mere subsidiary of the Government Company and as such is not covered by the directions of Comptroller and Auditor General of India is not correct. The Company as such cannot avoid supplementary audit by KOL& Co.
- (ii) Appointment of auditor of a Government Company is as per section 619(2) of the Companies Act, 1956. As per this Section, the auditor of a Government Company shall be appointed or reappointed by the Comptroller and Auditor General of India

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provided that the limits specified in Section 224 (1B) and (1C) of the Companies Act, 1956 shall apply in relation to the appointment or reappointment of an auditor under the said Section.

Therefore the Company cannot appoint Parsnath & Company as its auditor of the Company, unless they are appointed by Comptroller and Auditor General of India.

Procedure for appointment of auditor of a Government Company:

Under Section 619 read with Section 224(5) of the Companies Act, 1956 the first auditors of a Government Company should be appointed by the Comptroller and Auditor General of India within one month of the date of registration of the Company. Practically, there is no difference in the procedure of appointment of first auditor and the subsequent auditors as in all cases the auditor is to be appointed by the Comptroller and Auditor General of India.

The Ministry of Corporate affairs has advised that in order to obviate the delays in the appointment of auditors in Government Companies, the particulars of the Company like name, location of registered office, capital structure, period of financial year, etc; should be sent to Comptroller and Auditor General immediately on registration. In the case of public limited Government Companies, the date on which the Company become entitled to commence business and the certificate of commencement of business was granted should also preferable be furnished along with aforesaid particulars. This timely information will facilitate early appointment of auditors and will be before the statutory meeting, under Section 165 (circular no 20/30/letter no 15/17/73 e.g. date 23rd July, 1973).

For subsequent appointment of auditors again the Government Company shall write to the Comptroller and Auditor General of India immediately after the annual general meeting is held for recommending the appointment of auditor.

The statutory auditors are appointed for a period of one year and are usually re-appointed for not more than two consecutive years.

Question 7

- (a) X Ltd. had gone into liquidation and a liquidator was appointed to administer the assets and liabilities of the Company. The liquidator of the Company finds that the assets of the Company are not sufficient to meet out the liabilities. He therefore, calls on the contributories including the past members as per List B to contribute towards the assets. The past members objects to the liquidator's act on the ground that since they are no more members of the Company, they are not liable to contribute. Referring to the provisions of the Companies Act, 1956 decide:

- (i) Whether the contention of the past member is tenable and can they be exempted from the liability to contribute?
 - (ii) What would be your answer in case the members in question are the present members?
- (8 Marks)

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- (b) A group of shareholders holding more than 15% of the issued capital of M/S Defraud Ltd. have filed a petition before the Company Law Board alleging various acts of illegal, invalid and irregular transactions entered into in the name of the Company. Examine the merits of the petition in the light of the judicial pronouncements made in this regard.

(7 Marks)

Answer

- (a) In accordance with the Section 426 of the Companies Act, 1956, in the event of a Company being wound up every present and past member shall be liable to contribute to the assets of the Company to an amount sufficient -

- (a) for payment of (i) its debts and liabilities, and (ii) costs, charges and expenses of the winding up, and
- (b) for the adjustment of the rights of the contributories among themselves.

The liability of the present member i.e. as per List A shall be limited

- (i) in case of a Company limited by shares , to the amount remaining unpaid on the shares; and
- (ii) in case of a Company limited by guarantee, to the amount undertaken to be contributed by him to the assets of the Company in the event of its being wound up.

However, in the winding up of a Company limited guarantee, which has a share capital, every member of the Company shall be liable, to contribute not only the amount undertaken to be contributed by him in the event of winding up but also to contribute to the extent of any sum unpaid on any shares held by him as if the company were a company limited by shares.

Liability of Past Members : (List B)

A past member shall not be liable to contribute:

- (i) if he has ceased to be a member for 1 year or more before the commencement of the winding up;
- (ii) in respect of any debt or liability of the Company contracted after he ceased to be a member;
- (iii) if it appears to the Court that the present members will be able to satisfy the contributions required to be made by them.

The past members can be called upon only after the Court has called upon the contributories in List A to pay and their contributions are found insufficient. In the case of a Company limited by shares a past member shall not be liable to contribute more than the amount unpaid on the shares in respect of which he is liable as such member:

Thus examining the above provisions, answer to the given questions shall be:

1. The past members' contention shall be tenable only:

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- (i) When they have ceased to be a member for 1 year or more before the commencement of the winding up of the Company.
 - (ii) If the liability of the Company was contracted after he ceased to be a member.
 - (iii) If it appears to the court that the present members will be able to satisfy the contributions required to be made by them.
2. In the second case, the present members shall be liable to the extent of the amount remaining unpaid on the shares in case of a Company limited by shares. In case of a Company limited by guarantee, to the amount undertaken to be contributed by him to the assets of the Company.
- (b) A group of shareholders of M/s Defraud Ltd. must hold more than 15% of the issued share capital of the Company or satisfy other requirements under Section 399(1) of the Companies Act, 1956. Since the group holds 15% of the issued capital they are entitled to file a petition before the Company Law Board under sections 397 and 398 of the Companies Act, 1956 by alleging that the affairs of the Company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members of the Company. There are however, several judicial pronouncements according to which mere illegal, invalid or irregular acts by themselves do not constitute a ground for invoking the provisions of Section 397 unless it is proved that they are oppressive to any shareholder or prejudicial to the interest of the Company or to the public interest. [Sheth Mohanlal Ganpatram Vs Shri Savaji Jubilee Cotton and Jute Mills Company Ltd.] Thus in the present case, the petition filed by the group of shareholders will fail unless they can prove to the satisfaction of the Company Law Board that the acts complained of in the petition are oppressive and prejudicial to the interest of the Company and the public interest. And that to wind up the Company would unfairly prejudice such member or members, but that otherwise that facts would justify the making of a winding up order on the ground that it was just and equitable that the Company should be wound up.