

MOCK TEST PAPER – 1

FINAL COURSE: GROUP – I

PAPER – 4 : CORPORATE AND ALLIED LAWS

SUGGESTED ANSWERS/HINTS

1. (a) Section 262 of the Companies Act, 1956, provides that in the case of a public company or a private company which is a subsidiary of a public company, if the office of any director appointed by the company in general meeting is vacated before the expiry of his term of office in the normal course, the resulting casual vacancy may, subject to any regulations in the Articles of the company, be filled by the Board of directors at a meeting of the Board.

It would thus be noted that the Board of directors is empowered to fill a casual vacancy only in respect of a director appointed by the company in general meeting. If a casual vacancy arises in the office of a director appointed in the casual vacancy under section 262, there is no casual vacancy within the meaning of section 262.

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 Mr. Z as an additional director under section 260 of the Act provided the articles of association authorizes the board to do so, in which case Mr. Z will hold the office until the conclusion of the next annual general meeting.

- (b) As per section 287(2) of the Companies Act, 1956, the quorum for a Board meeting is one-third of the total strength (fraction being rounded off to one), or two directors whichever is higher. In the present case $\frac{1}{3}$ of 11 is 3.66 rounded off to 4. Though none of the three directors present in the meeting were interested in any of the items, the required quorum was not present at the outset and the meeting cannot be said to be valid.
- (c) The Central Government by virtue of powers as conferred upon it under Section 5 of the Securities Contracts (Regulation) Act, 1956, may withdraw the recognition after serving due notice on the governing Board of the Stock Exchange. Withdrawal however will not affect the validity of contracts entered into before the date of withdrawal of notification (sub-section 1).

Sub-section (2) provides that where the recognised stock exchange has not been corporatised or demutualised or it fails to submit the scheme referred to in sub-section (1) of Section 4B within the specified time therefore or the scheme has been rejected by the Securities and Exchange Board of India under sub-section (5) of Section 4B, the recognition granted to such stock exchange under Section 4, shall, notwithstanding anything to the contrary contained in this Act, stand withdrawn and

the Central Government shall publish by notification in the Official Gazette, such withdrawal of recognition.

Provided that no such withdrawal shall affect the validity of any contract entered into or made before the date of the notification, and the Securities and Exchange Board of India may, after consultation with the stock exchange, make such provisions as it deems fit in the order rejecting the scheme published in the Official Gazette under sub-section (5) of Section 4B.

- (d) Under section 224(6) of the Companies Act, 1956, the Board may fill any casual vacancy in the office of an auditor. However, where such vacancy is caused by resignation of an auditor, the vacancy shall be filled by the company in general meeting. Thus, in the present case, Parkash Carriers Limited may convene an Extra Ordinary General Meeting to appoint Mr. Albert as its auditor consequent upon the resignation by Mr. Raman.

In term of section 224(7) of the Act, 1956, Mr. Albert may be removed from office before the expiry of his term only by the Company in General Meeting after obtaining previous approval of the Central Government.

2. (a) Section 399 of the Companies Act, 1956 provides the right to apply to the Company Law Board for relief against oppression and mis-management. This right is available only when the petitioners hold the prescribed limit of shares as indicated below:

- (i) In the case of company having a share capital, not less than 100 members of the Company or not less than one tenth of the total number of its members whichever is less or any member or members holding not less than one tenth of the issued share capital of the company, provided that the applicant(s) have paid all calls and other dues on the shares.
- (ii) In the case of company not having share capital not less than one-fifth of the total number of its members.

Since the group of shareholders do not number 100 or hold 1/10th of the issued share capital or constitute 1/10th of the total number of members, they have no right to approach the CLB for relief. However, the Central Government, if it is of the view that circumstances exist which makes it just and equitable so to do, may authorize any member(s) to apply to the CLB [Section 399(4)]. So, members any approach Central Government to authorize them to approach CLB in spite of deficiency in numbers.

As regards obtaining relief from CLB, continuous losses cannot, by itself, be regarded as oppression (*Ashok Betelnut Co. P. Ltd. vs. M.K. Chandrakanth*).

Similarly, failure to declare dividends or payment of low dividends also does not amount to oppression. (*Thomas Veddon V.J. (v) Kuttanad Robber Co. Ltd.*)

Thus the shareholders may not succeed in getting any relief from CLB.

- (b) (i) Section 617 defines a Government company to mean a company in which not less than 51% of the paid up share capital is held by the Central Government, or any State Government(s) or partly by the Central Government and partly by one or more State Governments. Shareholdings of financial institutions and nationalised banks are not to be taken into account.

Therefore, AJD Ltd. is not a Government Company.

However, as per section 619B for the purpose of appointment of auditors, shareholdings of nationalised banks and other named Institutions shall be taken into account. Thus, the auditor of AJD Ltd. shall be appointed in the same manner as that of any other Government Company as per the provisions of section 619, namely by the Comptroller and Auditor General of India (C&AG).

- (ii) Section 226(3) of the Companies Act, 1956 provides for the disqualifications of an auditor. Clause (d) of the said Section states that if a person is indebted to a company for a sum exceeding Rs.1,000/- then such person is not qualified for being appointed as the auditor of that company. Section 226(4) of the said Act states that a person shall also not be qualified for appointment as auditor of a company if he is, by virtue of said Section, disqualified for appointment as auditor of any other body corporate which is that company's subsidiary or holding company or a subsidiary of that company's holding company.

In view of the above provisions of law, since ABC Ltd is a subsidiary of DGH Ltd; which is the holding company of PKM Ltd. to whom Mr. Prakash is indebted for a sum exceeding ₹ 1,000/- his appointment as the auditor of ABC Ltd. is not in order as it is violative of provisions of Section 226(3) read with Section 226(4) of the said Act.

3. (a) According to Section 258 read with section 31 of the Companies Act 1956, a public company may by an ordinary resolution, increase or reduce the number of its directors within the limits fixed by the articles and any increase in the number of its directors beyond the maximum permissible under the articles must be by a special resolution

According to section 259, in order to increase the number of directors, approval of Central government is required. However according to proviso to section 259, where such permissible maximum is 12 or less, no approval of the Central Government shall be required if the increase does not make the total number of directors more than 12. In other words, the approval of the Government would not be required for increase in the number of director's upto 12 irrespective of the provision in the Articles of Association.

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 Goodheart 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 FrontLine 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) Remuneration to Non-Executive Directors:

(i) **Guarantee Commission:** Section 309(1) of the Companies Act, 1956 provides that the remuneration payable to any director shall be inclusive of the remuneration payable for services rendered by him in any other capacity. The question is whether guarantee commission is remuneration within the meaning of section 309 of the said Act. In the case of *Suesses Textile Bearings Ltd. Vs. Union of India (1984)* it has been decided that the guarantee commission paid to the directors for giving surety against loan taken by the company from financial institutions is not a remuneration for any professional services within the meaning of section 309 and therefore approval of the Central Government is not necessary.

(ii) **Depreciation:** Section 350 of the Companies Act, 1956 specifies the manner of ascertainment of depreciation. The amount of depreciation to be deducted is the amount of depreciation as appearing in the books i.e. as shown in the profit and loss account of the relevant financial year at the rates specified in Schedule XIV of the Companies Act, 1956. Thus, the payment of commission calculated on the basis of book profits arrived at after providing for depreciation as per straight-line method is not in order.

4. (a) As per the provisions of the Companies Act, 1956 several Board Resolutions are required in course of carrying on the affairs of a limited company. But, it may sometimes so happen that a Board Meeting can not be held. To meet such eventualities, the Companies Act, 1956 contains the solution in Section 289. According to this section, the board resolution can be passed by way of circulation. It may, however, be noted that the matters listed in the provisions of Section 292 requiring passing of resolution at the board meetings only can not be passed by way of circulation.

The Chairman of ABC Ltd. is advised that the approval in the form of a Board Resolution may be obtained by way of passing the relevant resolution by circulation if the matter is not covered by Section 292 of the said Act.

Assuming that the present resolution required to be passed is not falling within the items listed in Section 292 of the said Act, the resolution can be passed by circulation.

The procedure to be adopted for the purpose of passing a resolution by circulation is as follows:-

- (i) Send the draft of the resolution in duplicate together with the necessary papers, if any, to all the directors then in India. It is to be ensured that the number of such directors is not less than the directors required to form the quorum for a Board Meeting.
 - (ii) Send that draft of the resolution in duplicate together with the necessary papers, if any, to all other directors at their usual address in India.
 - (iii) Obtain one copy of the draft resolution duly signed by the directors, whether approving the resolution or disapproving the same. It may be noted that the resolution shall be deemed to be passed by the Board if all the directors then in India or majority of all directors as are entitled to vote on the matter approve the resolution by signing one copy and returning the same to the company.
 - (iv) The resolution passed by circulation shall be placed before the next Board Meeting for confirmation.
 - (v) The resolution shall be recorded in the minutes of the next Board Meeting.
- (b) **WINDING UP (PAYMENT OF CREDITORS):** Section 530 of the Companies Act, 1956 lays down the procedure for payment of debts out of available funds with the Official Liquidator. However Section 529A of the said Act provides for overriding of the preferential payments as mentioned in Section 530. According to Section 529A of the Companies Act, 1956 notwithstanding anything contained in other provisions of this Act or any other law for the time being in force, in the winding up of a company – (1) Workmen's dues and (2) debts due to secured creditors, shall be paid in priority to all other debts. Further these debts have to be paid in full unless the assets are insufficient to meet them, in which case they shall abate in equal proportion.

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

5. (a) Section 209 (4) of the Companies Act 1956 provides that the books of account and other books and papers shall be open to inspection by any director during the business hours.

The right of inspection given by this sub-section is not so restricted that it can only be exercised personally by the director. *In Vakharia Vs Supreme General Film Exchange CO. Ltd* it was held that a director is entitled to take inspection of accounts personally or through an agent provided that there is no reasonable objection to the person chosen and the agent undertakes not to utilize the information obtained by him for any purpose other than the purpose of his principal.

As the right of inspection is a statutory right given under this sub-section, a director who is prevented from or refused inspection may enforce his right through court.

As such, Mr. Z being the director, can appoint Mr., A to inspect the Books of accounts of the company.

In case Mr. Z is the member of the company

As per the provisions of the Act the board shall from time to time determine whether and to what extent and at what times and places and under what conditions or regulation, the accounts and books of the company, or any of them, shall be open to inspection of members not being directors. No member (Not being a director) shall have any right to inspection any account or books or document of the company except as conferred by law or authorized by the board or by the company in general meeting.

In case Mr. Z is a member of the company, he shall be able to inspect the books of account only if he is given such a right by ordinary resolution of the members or if authorized by the board. But even in such case Mr. Z would have to exercise the right personally and not through a proxy i.e. he can himself inspect the books but cannot ask Mr. A to inspect the books in his behalf.

- (b) As per the SEBI (Issue of Capital and Disclosure Requirements) Regulations 2009, vide regulation 26 (d) & (e), 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
- (i) the aggregate of the proposed issue and all previous issues made in the same financial year in terms of issue size does not exceed five times its pre-issue net worth as per the audited balance sheet of the preceding financial year;
 - (ii) if it has changed its name within the last one year, at least fifty per cent. of the revenue for the preceding one full year has been earned by it from the activity indicated by the new name.

Applying the above regulations, 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 + 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 ₹ 300 crores + Previous issue in the same financial year is ₹ 20 crores, making an aggregate of ₹ 320. Since the aggregate of the issue is more than 5 times of Net Worth, i.e. more than ₹ 300 crores , the proposed offer is not within the limit, company cannot proceed ahead with in the proposed issue of ₹ 300 crores.
 2. In the second case the net worth is only ₹ 30 crores. 5 times of the net worth comes to ₹ 150 crores only. Since the aggregate of the proposed issue and the previous issue during the same financial year is ₹ 320 crores, which is exceeding the limits of ₹ 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.
6. (a) **Nomination by Life Insurance Policy Holder:** As per section 39 of the Insurance Act, 1938, the holder of a policy of life insurance on his own life may nominate a person or persons to whom the money secured by the life insurance policy shall be paid in the event of his death. Such nomination can be made either at the time of taking the policy or at any time before the maturity of the policy. Such nomination is either incorporated in the text of the policy or is stated as an endorsement on the policy document. The nomination can be cancelled or altered by the policyholder at any time before the maturity of the policy. The insurer is required to communicate to the policyholder that it has recorded the nomination, its cancellation or alteration as the case may be. In case the policyholder survives the full term of policy, the insurer shall pay the maturity amount to him only and the nomination becomes redundant. In a case where the nominee dies before the maturity of the policy and if no new nomination is made, the maturity proceeds of the policy shall be paid to the policy holder and if dies before the maturity, to the legal heirs of the policy holders.
- Minor as a nominee:** A minor can be nominated as a nominee in life insurance policy by its holder. The only other requirement as per Proviso to section 39(1) of the said Act is that the policyholder is to appoint, in the prescribed manner, an adult person to receive the money secured by the policy on behalf of the minor in the event of death of the policyholder during the minority of the nominee.
- (b) (i) A scheme of compromise or arrangement may provide for amalgamation of companies under section 394 of the Companies Act, 1956. Section 394(4)(b) defines the 'transferee' and 'transferor' companies. While the 'transferee company' does not include any company other than a company within the

meaning of the Companies Act, 1956, the transferor company includes any body corporate whether a company within the meaning of the Companies Act or not. Hence the scheme of amalgamation may provide for transfer of foreign companies to Indian companies.

- (ii) Majority in number representing three-fourths in value of members or class of members, as the case may be, present and voting either in person or by proxy, where proxies are allowed under the rules made under section 643 must approve the scheme or arrangement providing for amalgamation of companies [Section 391(2)]. Any member who though present at the meeting, does not vote for or against, but remains neutral, is not to be taken into consideration.

As the expression used is 'member', not only holders of equity shares but also preference shareholders will have to be taken into account and the value of their shares be included or, if the meeting of holders of preference shares and equity shares are ordered by the court to be held separately, the three-fourths majority of each class will have to be ascertained separately.

- (iii) The scheme may provide for the dissolution, without winding up, of any transferor company [Section 394(1)]. The Court shall not order dissolution of any transferor company unless the official liquidator has, on scrutiny of the books and papers of the company, made a report to the court that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest [Second proviso to Section 394(2)].

- 7. (a) Under provisions of section 5 of the Foreign Exchange Management Act, 1999 certain rules have been made for drawal of Foreign Exchange for Current Account transactions. As per these Rules, Foreign Exchange for some of the Current Account transactions is prohibited. As regards some other Current Account transactions, Foreign Exchange can be drawn with prior permission of the Central government or Reserve Bank of India.

- (i) Remittance out of lottery winnings, is prohibited and the same is included in First Schedule to the Foreign Exchange Management (Current Account Transactions) Rules, 2000. Hence Mr. Kale cannot withdraw Foreign Exchange for this purpose.
- (ii) Foreign Exchange meeting expenses of cultural tour can be withdrawn by any person after obtaining permission from Government of India, Ministry of Human Resources Development, (Department of Education and culture) as prescribed in Second Schedule to the Foreign Exchange Management (Current Account Transactions) Rules, 2000. Hence, in respect of item (ii), Mr. Kale can withdraw the Foreign Exchange after obtaining such permission.

In all the cases, where remittance of Foreign Exchange is allowed, either by general or specific permission, the remitter has to obtain the Foreign Exchange from an

Authorised Person as defined in Section 2(c) read with Section 10 of the Foreign Exchange Management Act, 1999.

- (b) **Consumer:** The term 'consumer' is defined in section 2(f) of Competition Act, 2002. Accordingly 'consumer' means any person who buys any goods for a consideration, which has been paid or promised or partly paid and partly promised, whether such purchase of goods is for resale or for any commercial purpose or for personal use.

Hence, it is not necessary that a person must purchase the goods for personal use in order to be considered as a 'consumer' under Competition Act, 2002. Even a person purchasing goods for resale or for any commercial purpose will also be considered as a 'consumer' within the meaning of Section 2(f) of Competition Act, 2002.

- (c) According to the provisions of section 581ZD (1) and (2) of the Companies Act, 1956, the shares of a member of a Producer Company shall not be transferable but a member of a Producer Company may after obtaining the previous approval of the Board, transfer the whole or part of his shares along with any special rights, to an active member at par value.

Based on the above provisions relating to the transfer of shares of a member in a Producer Company, Mr. Zameen has to obtain prior approval of the Board and then transfer his shares to an active member of the Producer Company at par value.

- (d) Sometimes an explanation is added to a section of an Act for the purpose of explaining the main provisions contained in that section. If there is some ambiguity in the provisions of the main section, the explanation is inserted to harmonise and clear up and ambiguity in the main section. Something may added be to or something may be excluded from the main provision by insertion of an explanation. But the explanation should not be construed to widen the ambit of the section.

For example, section 294AA of the Companies Act, 1956 gives power to the Central Government to prohibit the appointment of Sole Selling Agents of a company in certain cases. An explanation has been added to that section which states that an "appointment" includes "re-appointment". By inclusion of this explanation, the legislature has only clarified the main provisions of that section and has not widened the ambit of the powers of the Central Government.

- (e) Section 12 of Prevention of Money Laundering Act, 2002 provides for the obligations of Banking Companies, Financial Institutions and Intermediaries of securities market. Every banking company, financial institution and intermediary shall:

- (i) Maintain a record of all transactions, the nature and value of which may be prescribed, whether such transactions comprise of a single transaction or a series of transactions integrally connected to each other, and where such series of transactions take place within a month. Such records shall be

maintained for a period of ten years from the date of cessation of the transactions between the clients and the banking company or financial institution or intermediary, as the case may be:

- (ii) Furnish information of the above transactions to the Director appointed for the purpose of this Act within the prescribed time;
- (iii) Verify and maintain the records of the identity of all its clients, in the prescribed manner.

If the principal officer of a banking company or financial institution or intermediary has reason to believe that a single transaction or series of transactions integrally connected to each other have been valued below the prescribed value so as to defeat the provisions of this section, such officer shall furnish information in respect of such transactions to the Director within the prescribed time.