

MOCK TEST PAPER – 2

FINAL COURSE: GROUP – I

PAPER – 4 : CORPORATE AND ALLIED LAWS

SUGGESTED ANSWERS/HINTS

1. (a) False. The accounts must be audited. Section 218 of the Companies Act, 1956 clarifies that copy of balance sheet cannot be issued, circulated or published without the annexures and attachments. The attachments and annexures are – Profit and Loss account, balance sheet of subsidiary, auditor's report and Report of Board of directors. Thus, a balance sheet without auditor's report or without report of Board of directors cannot be issued, circulated or published. It, therefore, follows that unaudited accounts cannot be sent to members or unaudited accounts cannot be filed with the Registrar of Companies.

- (b) Section 263 (1) of the Companies Act 1956 requires that the appointment of every director shall be voted on individually. Thus, two or more directors cannot be appointed by a single resolution. However, an exception has been carried out where under if a resolution has been first passed to the effect that all the directors shall be appointed by a single resolution without any vote being against it.

Any resolution, as per section 263(2), in contravention of the aforesaid provisions shall be void whether or not objection was taken at the time of its being so moved.

The aforesaid provision, however apply to a public company or a private company which is subsidiary of a public company. Hence, the appointments so made are void. However, if XYZ Ltd. was a private limited company, then the condition of provision of section 263(1)(2) were not applicable as regards the condition of single resolution was concerned.

- (c) In order to prevent undesirable transactions in securities and to promote healthy stock market, the Securities Contracts (Regulation) Act, 1956 was enacted and all the Stock Exchanges in the country are registered under this Act. Section 73 of the Companies Act, 1956 states that offer of shares or debentures to public for subscription shall be made only after the permission of a Stock exchange.

Section 28(1) of the Securities Contracts (Regulation) Act, 1956 states that the provisions of this Act shall not apply to the Government, the Reserve Bank of India, any local authority, or 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 earlier.

As stated in the question, Industrial Finance Corporation of India is a corporation set up under the Industrial Finance Corporation Act, 1948. i.e. under a special statute enacted by the Parliament. Therefore, this Corporation does not need any

permission from a Stock Exchange to issue any Bond or other securities. Accordingly, it has not violated the provisions of the Securities Contracts (Regulation) Act, 1956. The nature and tenure of the Bonds are immaterial.

- (d) As per Rule 2 of the Companies (Declaration of Dividend out of Reserves) Rules, 1975, dividend may be declared by a company for any year out of the accumulated profits earned by it in previous years and transferred by it to the reserves subject to certain conditions. One of the conditions is that the rate of dividend declared shall not exceed the average of the rates at which dividend was declared by it in the 5 years immediately preceding that year or 10% of its paid-up capital which ever is less. As the proposed dividend exceeds 10%, it is necessary to seek the approval of the Central Government as required under section 205A(3) and only after obtaining the approval of the Central Government, the company may declare dividend at rate of 20% for year 2011-12, even if the other conditions relating to the amount that can be drawn from the reserves and minimum balance in the reserve are fulfilled. However, the credit balance, if any, carried in the profit and loss account will be available for declaration of dividend without any restriction. Hence, in such a case dividend may be declared at the rate of 20% for 2011-12, without approval of the Central Government.

- 2 (a) (i) Compromise or Arrangement: The scheme must be approved by a resolution passed with the special majority stipulated in section 391(2) of the Companies Act, 1956, namely a majority in number representing three-fourths in value of the creditors, or members, or class of members, as the case may be, present and voting either in person or, by proxy.

The majority is dual, in number and in value. A simple majority of those voting is sufficient. Whereas the 'three-fourths' requirement relates to value. The three-fourths value is to be computed with reference to paid-up capital held by members present and voting at the meeting.

In this case, out of 700 members, 400 members attended the meeting, but only 310 members voted at the meeting. As 160 members voted in favour of the scheme the requirement relating to majority in number (i.e. 156) is satisfied. 310 members who participated in the meeting held 12,40,000, three-fourth of which works out to 9,30,000 while 160 members who voted for the scheme held 10,00,000 shares. As both the requirements are fulfilled, the scheme is approved by the requisite majority. (It is presumed that all the shares are fully paid-up).

- (ii) Preference shareholders: The term 'member' includes preference shareholders also. Further, preference shareholders are a class of members and their rights may be affected differently in the proposed scheme of arrangement. Hence their approval is also required.

If the Court directs separate meeting of preference shareholders and equity

shareholders, then the scheme should be approved by requisite majority in both such meetings held as per directions of the Court.

- (b) (i) Section 224(5) of the Companies Act, 1956 lays down that the first auditor of a company shall be appointed by the Board of Directors within one month of the date of registration of the company.

If the Board of directors fails to exercise its power, the company in general meeting may appoint the first Auditor or Auditors.

Subsequently Auditor or Auditors of a company are appointed every year by the shareholders in annual general meeting by passing an ordinary resolution.

- (ii) Section 225 of the Companies Act, 1956 prescribes certain procedure for removal of auditors. The Board shall be advised as follows:

(i) Special Notice shall be required for a Resolution at an annual general meeting appointing as auditor a person other than a retiring auditor or providing expressly that a relating auditor shall not be reappointed.

(ii) On receipt of notice of such a resolution the company shall forthwith send a copy thereof to the retiring auditor.

(iii) Where notice is given of such a resolution and the retiring auditor makes with respect thereto representations in writing to the company (not exceeding a reasonable length) and request their notification to members of the company, the company shall, unless the representations are received by it too late for it to do so:

(a) in any notice of the resolution given to members of the company, state the fact of the representations having been made; and

(b) send a copy of the representations to every member of the company to whom notice of the meeting is sent, whether before or after the receipt of the representations by the company;

If a copy of the representations is not sent as aforesaid because they were received too late or because of the company's default, the auditor may (without prejudice to his right to be heard orally) require that the representations shall be read out at the meeting unless Central Government directs otherwise.

However, a resolution for removal of an auditor (before the expiry of his term) can be passed in the general meeting only after obtaining the prior approval of the Central Government in this behalf. [Section 224(7)].

The first auditors appointed by Board can be removed by the company at a general meeting. [Proviso (a) to section 224 (5)]. The provisions in respect of removal as contained in section 225 (2) & (3) are applicable for

removal of first auditors also. [Section 225 (4)]. However, in case of removal of first auditor appointed by the Board of directors, only an ordinary resolution is sufficient to remove the auditor and Central Government's approval is not required.

3. (a) ACE Forgings Ltd. is not a wholly owned subsidiary of ACE Automobiles Ltd. and hence investment in such a subsidiary company is not covered by exemption under section 372A(8)(e) of the Companies Act, 1956. As the aggregate of the loans and investments so far made by ACE Automobiles Ltd. exceeds 60% of the paid-up share capital and free reserves it is necessary for the company to follow the following procedure:
- (i) pass a resolution of the Board of directors at a meeting of the Board approved by all the directors present at the meeting [Section 372A(2)]. The notice of special resolution must indicate clearly the specific limits, the particulars of the body corporate in which the investment is proposed to be made, the purpose of the investment, specific source of binding and such other details [proviso 3 to section 372(d)].
 - (ii) pass a special resolution in the General Meeting [Proviso to section 372A(1)].
 - (iii) obtain prior approval of ICICI Ltd. since ACE Automobiles Ltd., has obtained the term loan from ICICI Ltd. which is a public financial institution as per section 4A of the Companies Act, 1956 and therefore, the provisions of the Proviso to section 372A(2) are also attracted.
 - (iv) enter the prescribed particulars of the investment in a register within seven days of making the investment [Section 372A(5)].
 - (v) comply with the guidelines, if any, prescribed by the Central Government under section 372A(7).

In case the company has not repaid the matured public deposits, then the section 372A(4) disallows the company to make any inter-company investment till such default is subsisting. Therefore, in such a situation, the company must make good the default before it can give effect to the proposed additional investment in the subsidiary company.

- (b) (i) In terms of the provisions of section 265 of the Companies Act, 1956, the Articles of Association of a company may provide for the appointment of not less than two thirds of the total number of directors of a public company, or a private company which is subsidiary of a public company, according to the principle of proportional representation. The appointment of such directors is made for a period of three years. The directors so appointed cannot be removed from their office before the expiry of the tenure of their appointment. [Section 284].

This is so because the concept of proportional representation has been

introduced in the Act to enable different groups among shareholders to have their representatives on the Board. The above concept will lose its merit if any Director appointed on the basis of this principle can be removed by an ordinary resolution under section 284 in a general meeting.

- (ii) The requirements as to the disclosure of interest of directors as contained in section 299 of the Companies Act, 1956, do not apply to any contract or arrangement between two companies where any of the directors of one company or two or more of them together holds or hold not more than 2 per cent of the paid up share capital in the other company.

In the facts given in the question, though the value of equity shares held by a director of 'Y' Company in 'Z' company has been given, it is not clear as to whether the holding of the directors is less than or more than 2% as prescribed in section 299(6) of the Act. In case the holding is more than 2%, the director is liable for not disclosing his interest. If, however, the holding is less than 2%, he is not liable.

- 4. (a) (i) The provisions in regard to quorum for a Board meeting are contained in section 287 of the Companies Act, 1956. It is provided therein that the quorum for a Board meeting shall be one-third of the total number of directors of a company (any fraction contained in that one-third shall be rounded off as one) or two directors, whichever is higher. It is further provided that where at any time the number of interested directors exceeds or is equal to two thirds of the total strength, the number of disinterested directors present at the meeting being not less than two shall form the quorum. The company is, however, free to fix a higher quorum for the Board meeting.

Viewed in the context of the above provisions, the company has fixed the quorum for a Board meeting at 3. In this case, out of five directors present at the meeting, the number of interested directors is three. As such, the remaining two directors who are not interested do not constitute a quorum and hence the meeting cannot be validly convened. Therefore, the allotment of shares at the aforesaid meeting is not valid.

The proviso to section 287(2) cannot also be availed of as the interested directors, who are three, are not equal to or more than two-thirds of the total strength of directors. The figure representing two-thirds will be 4 by rounding off fraction, if any. Hence, it can be assumed that the allotment made at the Board meeting will not be valid.

- (ii) As per section 288, of the Companies Act, 1956, if a meeting of the Board could not be held for want of quorum, then unless the Articles provide otherwise, the meeting shall automatically stand adjourned to, the same day in the next week, at the same time and place or that day is a public holiday till the next succeeding day which is not a public holiday.

Sub section (2) of section 288 further provides that the provisions of section 285 shall not be deemed to have been contravened merely by reason of the fact that meeting of the board which has been called in compliance with the terms of that section, could not be held for want of quorum.

- (b) (i) The official liquidator can invoke the provisions contained in Section 531 of the Companies Act, 1956 to recover the sale of assets of the company. According to Section 531, any transfer of property, movable or immovable made within 6 months before the commencement of winding up will be deemed to be a fraudulent preference and hence invalid in the eyes of laws. Since in the present case, the sale of immovable property took place on 10th May, 2012 and the company went into liquidation on 15th October, 2012 i.e., within 6 months before the winding up of the company and since the sale has resulted in a loss of ` 50 lakhs to the company. The official liquidator will be able to succeed in proving the case under Section 531 by way of fraudulent preference as the property was sold to a private company in which the son of the ex-managing was interested.
 - (ii) According to Section 534 of the Companies Act, any floating charge created within 12 months of the commencement of the winding up will be treated as invalid unless it is proved that the company immediately after the creation of charge was solvent. In the present case, it may be difficult for the Bank, the charge holder to prove that the company was solvent after the creation of the floating charge. The charge holder i.e., the Bank is however, entitled to recover from the company. The amount advanced along with 5% interest. Further, preferential debts under Section 530 will have priority over debts secured by a floating charge. The official liquidator may thus prove that the floating charge created by the company is invalid.
5. (a) Under section 397 of the Companies Act, 1956, on an application by any member of a company, the Company Law Board (CLB) is of the opinion that –
- (i) the company's affairs are being conducted in a manner which is prejudicial to public interest or in a manner oppressive to any member(s); and
 - (ii) to wind up the company would unfairly prejudice such member(s), but that otherwise the facts justify winding up of the company on just and equitable ground.

The CLB may, with a view to bringing to an end the matters complained of, make such order as it thinks fit.

As per section 399, a member holding 10% shares is entitled to file such a petition.

In the present case, C was holding 33% shares in the company which is nothing but a quasi partnership and was participating in the management. By

further allotment of shares in a clandestine manner and without the consent of C, his shareholding was reduced to 10% while the shareholding of his brothers stood at 90%. This is a serious act of oppression of C, a minority shareholder. On similar facts, it was held by Supreme Court in Dale & Carrington Inv't. Private Ltd. Vs. P.K. Prathpan, (2004) 122 Comp cases 175(SC) that assuming meetings of board of directors did take place, the manner in which the shares were issued in favour of R without informing other shareholders about it and without offering them to any other shareholder, was totally mala fide and the sole object of R in this was to gain control of the company by becoming a majority shareholder. This was clearly an act of oppression on the part of R. The only relief that has to be granted in the present case was to undo the advantage gained by R through his manipulation and fraud. The allotment of all the additional shares in favour of R had to be set aside.

Section 397 protects the rights of shareholders and not as a director. It has, however, been held by CLB in a number of cases that in a family company like the present one, removal of the promoter-director is also an act of oppression.

In the facts and circumstances of this case, C is advised to file a petition under section 397 of the Act. Being a 10% shareholder he is entitled to file the petition before the Principal Bench of CLB at New Delhi. He may seek the following reliefs:

- (i) the alleged allotment of further shares be declared null and void and set aside;
 - (ii) the alleged removal of the petitioner, C be declared as null and void and set aside;
 - (iii) The Board of directors be re-constituted with the petitioner and his two brothers and an independent person, as the Chairman of the Board of directors to be appointed by the CLB with casting vote;
 - (iv) the petitioner may be appointed as Managing director of the company having substantial powers of management.
- (b) (i) The minimum contribution that should be made by the promoters should be in accordance with the Regulation 32 (1) of the SEBI (ICDR) Regulations, 2009. According to the said regulations the promoters of the issuer shall contribute in the public issue in case of an initial public offer, not less than twenty per cent of the post issue capital. In the above case, pre-issued capital is ` 3 crores and proposed issue is ` 9 crores (90,000 equity shares of ` 10 each). Of the total post issue capital ie. ` 12 crores (` 3 crores + ` 9 crores), the promoters have to contribute minimum of ` 2.4 crores (20% of ` 12 crores). For the purpose of promoters' contribution, the following securities shall be considered as ineligible as per Regulation 33 (i) (b)

Specified securities acquired by promoters during the preceding one year at a price lower than the price at which specified securities are being offered to public in the initial public offer: Provided that nothing contained in this clause shall apply: if promoters pay to the issuer, the difference between the price at which specified securities are offered in the initial public offer and the price at which the specified securities had been acquired.

In the above case, shares acquired by the promoters on 1st January, 2012 shall not be taken into account for the computation of promoter's contribution, as the allotment was made in the preceding one year. However, shares acquired during the 1st January, 2008 shall be taken into account for promoter's contribution. Further, it is to be noted that there is a difference in price (shares which were earlier acquired at ` 10 each as on 1<sup>st</sup> January, 2008 and the issue price in July, 2012 (` 15 per share). In view of the proviso in the said Regulation, the difference in price ` 15 including premium of ` 5 per share for issue in July, 2012 and acquisition @ ` 10 per share = ` 5 per share for 10 lakh equity shares (` 50 lakhs) acquired in 1<sup>st</sup> January, 2012 need to be brought in by the promoters. In view of the proviso to the said Regulation, the acquisition of shares in July, 2012 of 10 lakh shares will also be taken into consideration for calculating promoters' contribution. Of the total ` 2.4 crores issue of shares, if ` 2 crores issue already acquired by the promoters are taken into account, then the promoters are eligible to subscribe only for the balance of 4 lakh shares (ie. 2.4 crores – 2 crores = 0.4 crores or 4 lakh equity shares).

- (ii) Lock-in of specified securities held by promoters: As per regulation 36 of the SEBI (ICDR) Regulations, 2009, in a public issue, the specified securities held by promoters shall be locked-in for the period stipulated hereunder:
- (a) minimum promoters' contribution shall be locked-in for a period of three years from the date of commencement of commercial production or date of allotment in the public issue, whichever is later;
 - (b) promoters' holding in excess of minimum promoters' contribution shall be locked-in for a period of one year, provided that excess promoters' contribution as provided in proviso to clause (b) of regulation 34 shall not be subject to lock-in.

Explanation: For the purposes of this clause, the expression "date of commencement of commercial production" means the last date of the month in which commercial production in a manufacturing company is expected to commence as stated in the offer document.

Accordingly, in the above case, promoters are required to hold the shares for a lock-in-period of 3 years. However, any excess of minimum promoter's

contribution shall be locked in for a period of 1 year.

6. (a) Power of Reserve Bank of India to inspect banks (Section 35 of the Banking Regulation Act, 1949): RBI is empowered to conduct inspection of any bank and to give them direction as it deems fit. All banks are bound to comply with such directions. Every directors or other officer of the bank shall produce all such books, documents as required by the inspector. The inspector may examine on oath any director or other officers.

RBI shall supply the bank a copy of such report of the inspection. RBI submits report to Central Government and the latter, on scrutiny, if is of the opinion that the affairs of the bank are being conducted detrimental to the interest of its depositors, it may, after giving an opportunity of being heard, to the bank, may order in writing prohibiting the bank from receiving fresh deposits, direct the RBI to apply section 38 for winding up of the bank.

Power of RBI to appoint Directors (Section 36AB of the Banking Regulation Act, 1949): RBI is empowered to appoint additional Directors for the banking company with effect from the date to be specified in the order, in the interest of the bank or that of depositors. Such additional directors shall hold office for a period not exceeding three years or such further periods not exceeding three years at a time.

- (b) Documents to be furnished by foreign companies carrying on business in India: As per Section 592 of the Companies Act, 1956 a foreign company has to furnish the following documents to the Registrar of Companies within 30 days of the establishment of the place of business in India for registration.

- (i) Certified copy of charter, statute or memorandum and articles of the company or other instruments deferring the constitution of the company. If it is not in English Language, its certified translation should be submitted.
- (ii) Full address of the registered or principal office of the company.
- (iii) List of directors and Secretary giving details like present and former name and surname, his usual residential address, nationality, business occupation etc.
- (iv) The names and address of one or more persons resident in India authorized to accept on behalf of the company, service of process and any notices or other documents required to be served on the company.
- (v) The full address of the office of the company in India which is deemed to be its principal place of business in India.

The aforesaid documents shall be required to be filed at two places, first with the Registrar of the state where principal place of business (Mumbai) is situated i.e. Registrar of Maharashtra in this case, and second with the Registrar of New Delhi (Section 597).

7. (a) (i) X wants to remit certain sum of money out of lottery winnings: It is a

current account transaction and prohibited as per Schedule I to the Foreign Exchange Management (Current Account Transactions) Rules, 2000.

- (ii) Payment of certain sum of money under the technical collaborate agreement is to be remitted: The payment of 10% of local sales and 20% of export sales and lump sum payment of US \$3 million is beyond the permissible limits. Hence, Central Government's prior approval is needed.
 - (a) Permissible limit 5% of local sales
 - (b) Permissible limit of 8% of export sales
 - (c) lump sum payment limit is US \$ 2 million.
- (b) Competition Commission of India

As per provisions of section 36(4) of the Competition Act, 2002 the Competition Commission may call upon such experts from the fields of economics, commerce, accountancy, international trade or other disciplines as it deems necessary, to assist the Commission in the conduct of any inquiry or proceeding before it. As per regulation 54 of the Competition Commission (General) Regulations, 2004 made by the Commission under Section 64 of the Competition Act 2002, it may draw up a panel of such experts.

In view of the above stated specific powers given to the Competition Commission it can call upon the services of an expert to determine the truth of allegation or issue under consideration.

- (c) Producer Company - Vacation of Office of a Director:
 - 1. According to provisions of Companies Act, 1956, as contained in section 581Q, if the producer company in which a director has made a default in repayment of any advances or loans taken from any company or institution or any other person and such default continues for 90 days, the office of such director shall become vacant. In the given case the default on the part of X, the director continues for less than 90 (i.e. only 60 days) days, the office of director shall not fall vacant.
 - 2. The office of director of a producer company shall become Vacant if the Annual General Meeting or extraordinary general meeting of the producer company, in which he is a director, is not called in accordance with the provisions of this Act except due to natural calamity or such other reason. In the given case since the Annual General Meeting could not be held due to some natural calamity, the office of Z, the director shall not fall vacant. This is an exception.

- (d) **Associated Words- Interpretation:** When two words or expressions are coupled together one of which generally excludes the other, obviously the more general term is used in a meaning excluding the specific one. On the other hand there is the concept of "Noscitur A Sociis", that is to say, "the meaning of a word is to be judged by the company it keeps. When two or more words which are capable of analogous meaning are coupled together, they are to be understood in their cognate sense. They take, as it were, their colour from each other i.e. more general is restricted to a sense analogous to the less general. For example, in the expression 'commercial establishment' means an establishment which carries on any business, trade or profession. The term 'profession' is construed with the associated words 'business' and 'trade' and it has been held that a private dispensary does not fall within the definition.

Similarly, the expression 'place of public resort' would have one meaning when coupled with the expression 'roads and streets' and the same expression 'place of public resort' would have quite different meaning when coupled with the word "houses".

- (e) **Offence of Money Laundering:** Section 2 of the Prevention of Money Laundering Act, 2002 defines the term "scheduled offence", which accordingly means –
- (i) the offences specified under Part A of the Schedule; or
 - (ii) the offences specified under Part B of the Schedule if the total value involved in such offences is thirty lakh rupees or more.
 - (iii) The offences specified under Part C of the Schedule (Amendment Act, 2009)

These Schedule to the Act gives a list of all the above offences.

Punishment for the Offence of Money Laundering

Section 4 of the said act provides for the punishment for Money-Laundering. Whoever commits the offence of money-laundering shall be punishable with:

- (i) Rigorous imprisonment for a term which shall not be less than three years, but may be extended to seven years, and
- (ii) Shall also be liable to fine which may extend to five lakh rupees.

But, where the proceeds of crime involved in money-laundering relates to any offence specified under paragraph 2 of Part A of the Schedule, the maximum punishment may extend to ten years instead of seven years.