

MOCK TEST PAPER – 2
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. Thus, the Board can not appoint Mr. Avatar in the place of Mr. Arin.

The Board may however appoint Mr. Avatar 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. Avatar will hold the office until the conclusion of the next annual general meeting.

- (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) 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) 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 2012-13, 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 2012-13, 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.

2. (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, Akash 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 Akash 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. Purab 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) XYZ Forgings Ltd. is not a wholly owned subsidiary of XYZ 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 XYZ 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 Industrial Credit and Investment Corporation of India Limited (ICICI Ltd). since XYZ 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) 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) (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) **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) 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. 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)** As per the SEBI (ICDR) 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
- (a) 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;
 - (b) 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) **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) (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) (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) **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) **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 A, 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 Y, the director shall not fall vacant. This is an exception

- (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 any ambiguity in the main section. Something may be added 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) 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.