

PAPER – 4 : CORPORATE AND ALLIED LAWS

SECTION – A

Question No.1 is compulsory. Answer any six from the rest.

Question 1

Answer any two of the following:

- (a) Examine the validity of the following with reference to the provisions of the Companies Act, 1956:
- (i) The Balance Sheet and Profit and Loss Account of TXN Ltd. for the year ended 31st March, 2009 was signed by one of its Directors and the Secretary.
 - (ii) Mr. Prakash, a Chartered Accountant in full time practice was appointed as the auditor of ABC Ltd., a company which is a subsidiary of DGH Ltd. and DGH Ltd. has another subsidiary called PKM Ltd. Mr. Prakash had taken a loan of Rs.25,000 from PKM Ltd. and the loan is outstanding as on the date of his appointment as auditor of ABC Ltd. (5 Marks)
- (b) Board of Directors of M/s. RPP Ltd. in its meeting held on 29th May, 2009 declared an interim dividend payable on paid up Equity Share Capital of the Company. In the Board Meeting scheduled for 10th June, 2009, the Board wants to revoke the said declaration. You are required to state with reference to the provisions of the Companies Act, 1956 whether the Board of Directors can do so. (5 Marks)
- (c) Chairman of Board of Directors of ABC Ltd. came across a matter, which required the approval by way of a board resolution. In the prevailing circumstances, it is not possible to convene and hold a Board Meeting. The Chairman approaches you to advise him of the way and the relevant procedure to obtain such approval without holding the Board Meeting. You are required to advise him on the matter as per the provisions of the Companies Act, 1956. (5 Marks)

Answer

- (a) (i) Applicable provisions of section 215 of the Companies Act, 1956 provides that every Balance Sheet and every Profit & Loss account of a company (other than a banking company) shall be signed by its manager or secretary, if any, and by not less than two Directors of the Company one of whom shall be the Managing Director where there is a Managing Director in the Company.

In view of the above provisions of the Companies Act, 1956, the signing of the Balance Sheet and Profit & Loss Account by only a Director and Secretary does not fulfill the requirements of the law.

In the given case, if the company has a managing director, then the managing director and at least one other director together with the secretary of the company shall sign the Balance Sheet and Profit & Loss A/c. If there is no managing director then two directors authorized by the Board and the Secretary shall sign the same.

FINAL EXAMINATION : JUNE, 2009

- (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 Rs.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.

- (b) Prior to the passing of Companies (Amendment) Act, 2000 only Regulation 86 of Table "A" to the Companies Act, 1956 dealt with the question of interim dividend. The said Regulation empowered the directors to declare interim dividend. i.e., dividend in between two annual general meetings. The said amending Act introduced sub-Section 14A in Section 2 of the Companies Act, 1956 whereby interim dividend is now part of dividend. Accordingly, all provisions of the Companies Act, 1956 relating to dividend have become applicable to interim dividend also.

Section 205 of the Companies Act, 1956 has also been amended by the said amending Act to provide as follows:

- (i) The Board of Directors may declare interim dividend and the amount of dividend including interim dividend shall have to be deposited in a separate bank account within five days from the date of declaration of such dividend. [Section 205(1A)]
- (ii) The amount of interim dividend so deposited as stated above shall be used for payment of interim dividend. [Section 205(1B)]
- (iii) The provisions of Sections 205, 205A, 205C, 206, 206A, and 207 of the Companies Act, 1956 have also become applicable to interim dividend to the extent possible. [Section 205(1C)]

In view of the above legal position, the Board of Directors of RPP Ltd. must have deposited the amount of interim dividend declared on 29th May, 2009 into a separate bank account on or before 3rd June, 2009 i.e. within five days from 29th May, 2009 when the interim dividend was declared. As stated above, the amount once deposited into a separate bank account, can be used only for payment of interim dividend.

As per provisions of the Companies Act, 1956, the Board of RPP Ltd. has no power to revoke the interim dividend declared on 29th May, 2009 and shall not have any power to use the interim dividend amount transferred to a separate bank account for any other purpose.

PAPER – 4 : CORPORATE AND ALLIED LAWS

In case the amount of interim dividend has not been transferred to a separate bank account and is not paid within the time, the company and its directors have exposed themselves to the applicable penal provisions of the said Act.

- (c) 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.

Question 2

- (a) ABC Ltd. has 12 directors on its Board and has the following clause in its Articles of Association:

“The questions arising at any meeting of the Board of Directors or any Committee thereof shall be decided by a majority of votes, except in cases where the Companies Act, 1956 expressly provides otherwise.”

In one of the meetings of the Board of Directors of ABC Ltd., 8 directors were present. After completion of discussion on a matter, voting was done. 3 directors voted in favour

FINAL EXAMINATION : JUNE, 2009

of the motion, 2 directors voted against the motion while 3 directors abstained from voting.

You are required to state with reference to the provisions of the Companies Act, 1956 whether the motion was carried or not. It is clarified that the motion being voted upon was not concerning a matter which requires consent of all the directors present in the meeting. (5 Marks)

- (b) The Articles of Association of MKP Limited incorporated with an Authorised Share Capital of Rs.50 crores divided into 5 crores Equity Shares of Rs.10 each contained the following clause:

“The qualification of a director shall be the holding of at least 1,000 Equity shares in the Company and such a director if not already so qualified shall have to obtain his qualification within a period of 30 days from the date of his appointment as director.”

Examine the validity of the above clause in the light of the provisions of the Companies Act, 1956. (5 Marks)

Answer

- (a) Regulation 74(1) of Table A of Schedule 1 to the Companies Act, 1956 provides that save as otherwise expressly provided in the Companies Act, 1956, questions arising at any meeting of the Board shall be decided by a majority of votes.

In the problem given in the question, the similar article exists in the Articles of Association of ABC Ltd. In the given case, only 8 directors out of a total strength of 12 directors are present and out of those 8 directors present only 5 directors have exercised their votes. In such a case, only those directors who are present and vote on a motion are considered for determining whether the motion is carried or not. That means out of the 5 directors who voted on the motion are to be considered. Accordingly, since number of directors who voted in favour of the motion being 3, is higher than the number of directors who voted against the motion being 2, the motion is carried or is considered to be passed by majority.

- (b) The subject matter of the question is covered by the provisions of Section 270 of the Companies Act, 1956. The Companies Act, 1956 does not provide for any qualification for becoming a director of any company. According to the said Section, any person appointed as a director is required to obtain the qualification if it is so provided by the Articles of Association of the Company.

The said Section states that in case the Articles of Association of a company provides for the qualification of a director, then such a director is required to obtain the requisite qualification within a period of two months from the date of his appointment as a director. The Section further states that any clause in the Articles of association requiring the director to obtain the qualification shares within a shorter time than two months shall be void.

The said Section also puts a maximum limit on the qualification that can be prescribed by the Articles of Association. Such maximum limit being shares with nominal value not

PAPER – 4 : CORPORATE AND ALLIED LAWS

exceeding Rs. 5,000 or in a case where the nominal value of one share exceeds Rs. 5,000 then the qualification share shall be maximum one share.

Based on the provisions of Section 270 of the Companies Act, 1956 as explained above, the clause in the Articles of Association as given in the question is void since it stipulates the obtaining of the qualification shares within a period of 30 days which is shorter than two months. Moreover the clause also violates the maximum limit of share qualification by prescribing the same to be 1,000 shares of Rs.10 each totaling Rs.10,000 which is more than the limit of Rs. 5,000 as prescribed in the said Section.

It is pertinent to note that as per Section 9 of the Companies Act, 1956, any clause in the Articles of Association of any company which is ultra virus the Act is void.

Question 3

- (a) (i) Examine the validity of the following with reference to the relevant provisions of the Companies Act, 1956 and/or decided case laws:

The Articles of Association of Big Limited provide that a meeting of the Board of Directors of the company shall be held at 11.00 A.M. on the last day of every quarter ending 31st March, 30th June, 30th September and 31st December. Relying on such a clause in the Articles, the company did not send notices to the directors in respect of the board meeting held on 30th September, 2008. Some of the directors have questioned the validity of the board meeting on the ground that individual notices have not been sent to the directors.

- (ii) A Producer Company wants to issue bonus shares. You are required to state the relevant provisions of the Companies Act, 1956 in this regard. (5 Marks)

- (b) What do you understand by the term "Director Identification Number" (DIN)? Describe the procedure to obtain the same as enumerated under the Companies Act, 1956 read with the relevant Rules. (5 Marks)

Answer

- (a) (i) If the articles of association of Big Limited provides that a meeting of the board of directors shall be held on the last day of each quarter, it is not necessary that separate notices are required to be served on the directors. It was held in the case of *Arunachalam Chettiar vs. Kaleswarar Mills Ltd.* [(1956) 26 COMP. CAS. 431] that where articles of the company provide that there will be a meeting of the board of directors on the first Saturday of every month, there will be no necessity of service of notice to individual director and such clause in the articles of association is sufficient compliance of Section 286(1) of the Companies Act, 1956. In view of the said judgement the clause in the article is sufficient compliance of the requirement of sending the notice for a board meeting and the contention of some of the directors is not legally valid. However, as a good secretarial practice, notice for every board meeting should be sent to all the directors eligible to receive the notice.

FINAL EXAMINATION : JUNE, 2009

- (ii) As per provisions of Section 581ZJ of the Companies Act, 1956, any Producer Company may, upon recommendation of the Board and passing of resolution in the general meeting, issue bonus shares by capitalization of amounts from general reserves referred to in Section 581ZI in proportion to the shares held by the Members on the date of the issue of such shares.
- (b) Director Identification Number (DIN) is a unique identification Number given by the Ministry of Corporate Affairs. It is required to be obtained by every person who is or intends to become a director of any company. DIN is a pre-requisite for filling various forms with the Registrar of Companies. The electronic system of the Ministry of Corporate affairs will not allow to file/submit the forms if DIN of the signatory director is not mentioned in the form being filed/submitted.

In order to obtain DIN from the Ministry of Corporate Affairs, following procedure is to be adopted.

- (i) To check whether the computer system through which the DIN Application is being made has the requisite hardware and the software as well as the Internet facility.
- (ii) Using the internet facility, DIN Application Form has to be downloaded from the website of Ministry of Corporate Affairs.
- (iii) The DIN application Form is to be filled up and submitted electronically.
- (iv) On electronic submission of the DIN application Form, a provisional DIN will be generated and displayed on the said Application Form.
- (v) Thereafter, the form is to be printed, signed and submitted to the Ministry of Corporate Affairs – DIN Cell along with following papers/documents:
 - (a) Passport size photograph of the Applicant duly attested by a Magistrate or a Notary Public or a practising Chartered accountant or a practising Company Secretary or a practising Cost Accountant or a Gazetted Officer.
 - (b) Attested copy of any one of the following as a proof of identity:
 - a. Passport
 - b. Election/Voter Identity Card
 - c. Driving Licence
 - d. Income Tax Pan Card
 - e. Any other document which will prove the identity of the Applicant
 - (c) Attested copy of any one of the following as a proof of residence:
 - a. Passport
 - b. Election / Voter Identity Card
 - c. Ration card
 - d. Driving Licence

PAPER – 4 : CORPORATE AND ALLIED LAWS

- e. Electricity Bill
- f. Telephone Bill
- g. Bank account Statement
- h. Any other document which will prove the residential address of the Applicant

On Submission of the above, the DIN Cell of the Ministry of Corporate Affairs shall allot final DIN and send an intimation letter to the Applicant. The intimation is also sent via e-mail.

The status of DIN application can also be checked online.

Question 4

- (a) (i) Mr. KMP is director of XLS Ltd. He intends to construct a residential building for his own use. The cost of construction is estimated at Rs.1.50 Crores, which Mr. KMP proposes to finance partly from his own sources to the tune of Rs.60 lacs and the balance Rs.90 lacs from housing loan to be obtained from a housing finance company. For the purpose of obtaining the loan, he has approached the housing finance company which has in principle agreed to grant the loan, but has put a condition. The condition put by the housing finance company is that the Company XLS Ltd. of which Mr. KMP is a director should provide the guarantee for repayment of the loan and interest as per the terms of the proposed agreement for granting the loan to Mr. KMP. You are required to advise Mr. KMP on the matter with reference to the provisions of the Companies Act, 1956.
- (ii) Draft a Board Resolution of XLS Ltd. For providing guarantee for Rs. 90.00 lacs in respect of a Loan to be obtained by Mr. KMP, a director thereof from a Housing Finance Company for construction of a residential house for his own use. (5 Marks)
- (b) Big Ben Ltd., a reputed public company, had advanced certain sum of money to one of its Directors, namely, Mr. Tanmay on certain terms and conditions and fixing the time limit for repayment thereof. Now, Mr. Tanmay has approached the Company with a request to extend the time limit for repayment of balance of loan amounting to Rs.12.00 lacs by another six months.

You are required to state with reference to the provisions of the Companies Act, 1956, the answer to the following:

- (i) Who is authorized to grant the extension as requested by Mr. Tanmay?
- (ii) Draft an appropriate notice for the meeting where such extension may be granted.

(5 Marks)

Answer

- (a) (i) According to the provisions of Section 295 of the Companies Act, 1956, no company shall make any loan or give any guarantee or any security in connection with a loan made by any other person to any director of the lending company unless the

FINAL EXAMINATION : JUNE, 2009

previous approval of the Central Government is obtained in this respect.

In view of the above provisions of the law, Mr. KMP is required to approach XLS Ltd. intimating the company the full details of the loan transaction and the condition imposed by the housing finance company. The company XLS Ltd. is required to pass a Board Resolution as required by Section 292 of the Companies Act, 1956 and also a special resolution in terms of Section 372A if the facts of the case so require. Thereafter, the company is required to make an application to the Central Government for obtaining the approval under Section 295 of the Companies Act, 1956. On receipt of the approval of the Central Government, XLS Ltd. can provide the guarantee to housing finance company in respect of the loan proposed to be granted to Mr. KMP

(ii) RESOLUTION PASSED IN THE MEETING OF THE BOARD OF DIRECTORS OF XLS LTD. HELD ON _____

“RESOLVED that, subject to the approval of the Central Government, sanction be and is hereby accorded to the proposal of furnishing the guarantee in respect of a loan of Rs.90.00 lacs to be obtained by Mr. KMP, a director of the Company, from M/s _____, a housing finance company as per terms and conditions contained in the draft loan agreement to be entered into between the said housing finance company and Mr. KMP, a copy of which is placed before this meeting and initialed by the Chairman for the purpose of identification.

RESOLVED FURTHER that Mr. _____, Secretary of the Company by and is hereby authorized to digitally sign the e-form 24AB, submit the application to the Ministry of Corporate Affairs and comply with all other formalities in this regard.”

- (b) (i) As per provisions of Section 293(1)(b) of the Companies Act, 1956, the Board of Directors of Big Ben Ltd., a public company can not give time for the repayment of any debt due by Mr. Tanmay, a director of the company except with the consent of the Company by way of an ordinary resolution passed in a General Meeting. In view of this provision of the law, the Company in a General Meeting is authorized to grant the extension as requested by Mr. Tanmay.
- (ii) Notice for calling the General Meeting of the company:

BIG BEN LIMITED

Registered Office: _____

NOTICE FOR EXTRA ORDINARY GENERAL MEETING

NOTICE is hereby given that an Extra Ordinary General Meeting of the members of the company will be held at the Registered office of the Company on _____, the _____ day of _____, 2009 at 11.00 A.M. to transact the following business:

PAPER – 4 : CORPORATE AND ALLIED LAWS

- (1) To Pass, with or without modification, the following resolution as an Ordinary Resolution:

“RESOLVED THAT pursuant to the provision of Section 293(1)(b) of the Companies Act, 1956, consent be and is hereby accorded to the company for extending the time for the repayment of the balance amount of Rs. 12.00 Lacs advanced to Mr. Tanmay, a Director of the company, by a further period of six months ending on _____, 2009.”

FOR & ON BEHALF OF THE BOARD

Dated. _____, 2009

Company Secretary

Notes:

- (1) A member entitled to attend and vote at the Meeting is entitled to appoint a proxy to attend and vote instead of himself and such proxy need not be a member of the Company. Proxies in order to be valid must be deposited at least 48 hours prior to commencement of the Meeting.
- (2) Explanatory Statement pursuant to Section 173(2) of the companies Act, 1956 is annexed hereto.

Question 5

- (a) A group of share holders has approached you for advice regarding the affairs of LPM Paper Mills Ltd. According to them, the management of the company is not carrying out its functions in accordance with the prudent commercial practice and if the affairs of the company are allowed to run in future in the same manner, the company's solvency would be in danger. They want that a Special Audit under the Companies Act, 1956 be conducted to find out the actual nature of the transactions. You are required to draft an application to be submitted to the appropriate authority in this respect. (5 Marks)
- (b) A company incorporated in Singapore has established its place of business at Chennai. State the documents which are required to be furnished on such establishment of business in India under the Companies Act, 1956 and the authorities to whom such documents are to be furnished. (5 Marks)

Answer

- (a) Section 233A of Companies Act, 1956 deals with the matter relating to Special Audit. The special audit can be ordered by Central Government under certain circumstances, as enumerated in the said Section.

FINAL EXAMINATION : JUNE, 2009

Draft application to Central Government requesting Special Audit:

Dated _____

To,

The secretary,

Ministry of Corporate Affairs,

Government of India,

(Address)

New Delhi

Sir,

We, the undersigned, the shareholders of LPM Paper Mills Ltd. would like to bring to your kind notice that for a long time the affairs of the said company are not being managed in accordance with sound business principles and prudent commercial practices.

We are of the view that certain expenditure which are being incurred by the company are not related to the business of the company and the company is not getting any benefit out of such expenses. Moreover, we have the apprehension that there are certain business transactions which are being entered into by the directors with the concerns which are owned by the relatives of the Directors and the prices charged for such transaction are not comparable with the prices charged by other parties for similar transactions.

If such state of affairs is allowed to be carried on for long, the financial position of the company will reach a stage where it will endanger its solvency.

We feel that the modus operandi of the transaction is such that it may be difficult for the regular statutory auditor to detect them in course of normal audit.

It is, therefore prayed that the Central Government be pleased to appoint, pursuant to Section 233A of the Companies Act, 1956, a Special Auditor to properly audit the accounts of the Company and find the real nature of the transactions and determine the losses so far sustained and being sustained by the company on this account.

Yours faithfully

1.

2.

3.

4.

5.....

Shareholders

PAPER – 4 : CORPORATE AND ALLIED LAWS

(b) Foreign Company

A foreign company has to furnish to the Registrar of Companies the following documents within 30 days of the establishment of the place of business in India (Section 592 of the Companies Act, 1956).

- (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 (Chennai) is situated i.e. Registrar of Tamil Nadu in this case and second with the Registrar of New Delhi (Section 597).

Question 6

- (a) A company wants to include the following clause in its Articles of Association:

“Each director shall be entitled to be paid out of the funds of the company for attending meetings of the Board or a Committee thereof including adjourned meeting such sum as sitting fees as shall be determined from time to time by the Directors but not exceeding a sum of Rs.30,000 for each such meeting to be attended by the Director.”

You are required to advise the company as to the validity of such a clause and the correct legal position under the provisions of the Companies Act, 1956. (5 Marks)

- (b) State the conditions which must be satisfied before filing a petition under Section 397 of the Companies Act, 1956 for prevention of oppression. (5 Marks)

Answer

- (a) The payment of sitting fee to a Director is governed by the provisions of Section 310 of the Companies Act, 1956 read with Rule 10B of the companies (Central Government's) General Rules and Forms, 1956. According to the said provisions, a Company with a paid up share capital and free reserves of Rs.10 crores and above or a turnover of Rs.50 Crores and above can pay to its director by way of sitting fee for each meeting of the board of directors or a committee thereof an amount not exceeding Rs.20,000/- and in case of other companies, the limit has been set at Rs.10,000/-.

FINAL EXAMINATION : JUNE, 2009

In view of the above legal provisions, the company cannot have a clause in its Articles of Association which exceeds the limit prescribed by law. The company is advised to check whether the aggregate of its paid up capital and free reserves exceeds Rs. 10 Crore or whether its turnover exceeds Rs. 50 crore and accordingly it can have a clause in its Articles of Association. In case the company keeps the clause as given in the question, it shall be ultra vires the Companies Act, 1956 as Section 9 states that any provision contained in Memorandum of Association, Articles of Association, Agreements or Resolutions to the extent it is repugnant to the provisions of the Companies Act, 1956 shall be void.

- (b) The conditions which are required to be satisfied before filing a petition under Section 397 of the Companies Act, 1956 can be enumerated as follows:
- (i) An application under the said Section 397 can be made only by the members. In the case of a company having share capital minimum one hundred members or one-tenth of total number of member of the company, whichever is less; or a member or members holding not less than 10% of the paid up capital of the company can file such petition. In case of a company not having share capital, minimum one-fifth of the total number of members of the company are required for the purpose. However, Central Government may authorise any lesser number of members to file such petition.
 - (ii) It must be established that the affairs of the company are being conducted in a manner (a) oppressive to any member/members of the company or (b) prejudicial to public interest.
 - (iii) The oppression complained of must affect a person in his capacity as a member of the company. Rights and interests as a member of a company can only be agitated and not in relation to any commercial relation that a member has with the company as was decided by the Company Law Board in the case of Anil Gupta vs. Mirai Auto Industries Ltd. [(2003)113 COMP. CAS.63].
 - (iv) The acts complained of must be continuing acts of oppression. The acts constituting oppression must continue till the date of making the application.
 - (v) The applicant must make out a prima facie case that the degree of oppression is so severe that there is just and equitable ground for winding up of the company. But at the same time, it must also be established that the winding up of the company would not unfairly prejudice the applicant.
 - (vi) It may be noted that expression "issued share capital" in section 399(1) includes both the preference and equity share capital.

Question 7

- (a) Draft a board resolution for appointment of Mr. Paul as the Managing Director for 5 years with effect from 1st July, 2009 of DBM Limited passed in the board meeting of the said company held on 6th June, 2009. (5 Marks)

PAPER – 4 : CORPORATE AND ALLIED LAWS

- (b) Amar Textiles Ltd. is a company engaged in manufacture of fabrics. The Company has investments in shares of other bodies corporate including 70% shares in Amar Cotton Co. Ltd. and it has also advanced loans to other bodies corporate. The aggregate of all the investments made and loans granted by Amar Textiles Ltd. exceeds 60% of its paid up share capital and fee reserves and also exceeds 100% of its free reserves. In course of its business requirements, Amar Textiles Ltd. has obtained a term loan from Industrial Development Bank of India and the said loan is still subsisting. Now the company to increase its holding from 70% to 80% of the equity share capital in Amar Cotton Co. Ltd. by purchase of additional 10% shares from other existing shareholders.

State the legal requirements to be complied with by Amar Textiles Ltd. under the provisions of the Companies Act, 1956 to give effect to the above proposal. (5 Marks)

Answer

- (a) Resolution passed at the meeting of Board of Directors of DBM Limited held at its registered office at on 6th June, 2009 at A.M.

“RESOLVED that subject to the approval by the shareholders in a general meeting and pursuant to provisions of Sections 198, 309, 310, schedule XIII and other applicable provisions of the Companies Act, 1956, Mr. Paul be and is hereby appointed as the Managing Director of the Company with effect from 1st July, 2009 for a period of five years on a remuneration approved by the Remuneration committee as enumerated below:

1. Salary: Rs _____ per month.
2. Perquisites, Benefits & Facilities:

RESOLVED FURTHER that Mr. Paul, so long as he functions as the Managing Director of the Company, shall not be entitled to any sitting free for attending any meeting of the Board of Directors or any Committee thereof and that he shall not be liable to retire by rotation.

RESOLVED FURTHER that Mr. Paul, till he holds the office of Managing Director of the Company, shall not become interested or concerned in any selling agency directly or through his wife or minor children in future without prior approval of the Central Government.

RESOLVED FURTHER that Mr. Paul, the Chairman, as well as the company shall have right to terminate the appointment by giving 3 (three) months' notice in writing.

RESOLVED FURTHER that the Secretary of the company be and is hereby directed and authorized to electronically file necessary returns with the Registrar of Companies by putting his digital signature and to do all other necessary things required under the provisions of the Companies Act, 1956.”

- (b) Amar Cotton Co. Ltd is not a wholly – owned subsidiary of Amar Textiles Ltd. and hence investments in such a subsidiary company is not covered by exemption under Section 372(A)(8)(e) of the Companies Act. 1956. As the aggregate of the investments in shares

FINAL EXAMINATION : JUNE, 2009

and loans granted to other bodies corporate exceeds 60% of the paid-up share capital and free reserves and also 100% of the free reserves, it is necessary for Amar Textiles Ltd. to pass a special resolution in the General Meeting before increasing its holding from 70% to 80%. [First Proviso to section 372A(1)].

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 funding and such other details. [Third Proviso to Section 372A(1)]

In the present case, Amar Textiles Ltd. obtained a term loan from Industrial Development Bank of India (IDBI) which is a public financial institution within the meaning of Section 4A of the said Act and therefore the provisions of Section 372A(2) are attached as such loan is still subsisting. The company is required to obtain prior approval of IDBI for making any further investment.

As required by provisions of Section 372A(2), the investment proposal must be passed at the Board Meeting by unanimous decision of all the directors present at the meeting.

The company must enter the prescribed particulars of investment in a register of investment within 7 days of making the investment. [Section 372A(5)]

The company must also take into consideration the guidelines, if any prescribed by the Central Government under Section 372A(7) of the said Act.

Question 8

- (a) LMB Ltd., Kolkata is a multiproduct manufacturing company having paid up capital of Rs. 5.00 crores. In order to increase the product portfolio, the said company intends to procure certain machines and equipments worth Rs.1.00 crore from a partnership firm, namely, M/s. MLPK, in which the son of managing director of LMB Ltd. is a partner. The contract for purchase of said machines and equipments is to be placed the Board of Directors of the company for its consideration.

In view of above facts, you are required to explain briefly the procedure under the provisions of the Companies Act, 1956 to be followed by LMB Ltd. to enter into the said contract. (5 Marks)

- (b) Explain, how the provisions of the Companies Act, 1956 relating to Audit Committee will help in achieving some of the objectives of Corporate Governance. (5 Marks)

Answer

- (a) As per provisions of Section 297 of the Companies Act, 1956, when a company enters into a contract in which some of the directors are interested, then consent of the Board of Directors of the company is required to be obtained. In the present case since the Managing Director of LMB Ltd is interested in the contract for the purchase of machines and equipments because of his son's partnership in the supplier firm, the same should be approved by the Board of Directors of the company.

PAPER – 4 : CORPORATE AND ALLIED LAWS

Proviso to Section 297(1) of the said Act states that in the case of a company having a paid-up share capital of not less than rupees one crore, no such contract shall be entered into except with the previous approval of the Central Government. Since the paid up capital of LMB Ltd. is Rs.5.00 Crores the company is required to take prior approval of the Central Government.

For this purpose, following steps are required to be taken:

- (i) Hold a board meeting and place the terms of the contract for consideration. The Managing Director should disclose the nature of his interest as required under section 299 of the Companies Act, 1956.
- (ii) The managing director should not participate in discussion when in the board meeting, the matter in respect of the above mentioned contract is being discussed. He must not also vote on the relevant resolution. Moreover, his presence shall also not be counted for determining the quorum of the board meeting. [Section 300 of the Companies Act, 1956]
- (iii) The consent of the Board of Directors must be accorded by way of resolution and not otherwise.
- (iv) An application to the Central Government (by delegation to Regional Director) should be made in prescribed form (Form No. 24A). Following enclosures should be made with the said form:
 - (a) A certified true copy of the board resolution approving the contract.
 - (b) A copy of the proposed agreement
 - (c) A copy of the Memorandum and Articles of Association of the company.
 - (d) A copy of latest audited annual accounts with directors' and auditors' reports thereon
 - (e) Bank draft or treasury challan evidencing the payment of prescribed fees.
- (v) Necessary entries are to be made in Register of Contracts (Section 301).

On receiving the approval from the Central Government (Regional Director), the company can proceed to enter into the contract for supply of machines and equipments with the firm M/s MLPK in which the son of Managing Director is a partner.

(b) AUDIT COMMITTEE:

For better corporate governance the concept of Audit committee for companies was introduced by section 292A of the Companies Act, 1956. Every public company having paid up capital of not less than Rs.5.00 Crores must have an audit Committee.

The auditors, the internal auditor, if any and the Director-In-Charge of finance shall attend and participate at meetings of the Audit Committee [Section 292A(5)]

As per Section 292A(6) of the said Act, the functions of the Audit Committee includes the following:

FINAL EXAMINATION : JUNE, 2009

- (a) The Audit Committee should discuss with the auditors periodically about internal control systems, the scope of audit including the observations of the auditors.
- (b) The Audit Committee should review half yearly and annual financial statements before submission to the Board.
- (c) The Audit Committee should ensure compliance of internal control systems.

The Audit committee shall have authority to investigate into any matter in relation to the items specified in this Section or referred to it by the Board and for this purpose, shall have full access to information contained in the records of the company and external professional advice , if necessary. [Section 292A (7)].

The recommendations of the Audit Committee on any matter relating to financial management including the audit report shall be binding on the Board and if the Board does not accept the recommendations of the Audit Committee, it shall record the reasons therefore and communicate such reasons to the shareholders. (Section 292A(8) & (9)).

The above provisions of law relating to powers and functions of the Audit committee relating to financial statements will help in achieving one of the objective of corporate governance i.e. accountability and avoidance of poor financial reporting.

SECTION – B

Question No. 9 is compulsory. Answer any four from the rest.

Question 9

Answer any one of the following

- (a) Following information is available from the Records of Star Chemicals & Engineering Ltd.:
 - (i) The company is a closely held unlisted company.
 - (ii) The paid up share capital of the company since 1st April, 1999 is Rs.3.00 crores and its net worth as at 31st March,2008 was Rs.5.00 crores as per audited Balance Sheet.
 - (iii) The Net Tangible Assets of the company as per last 3(three) audited Balance Sheets as at 31st March, 2005, 2006 and 2007 were Rs.4.00 crores, 4.50 crores and 5.00 crores respectively, out of which monetary assets were less than Rs. 50 lacs in each of the three years.
 - (iv) The company was incorporated in 1996 and commenced its business on 1st April, 1996 and since then it has earned good profits and it has not incurred any loss in any year in past.
 - (v) The company has not declared any dividend so far, but according to the profits earned so far, the management could have declared the dividend in each of the last five years.

PAPER – 4 : CORPORATE AND ALLIED LAWS

- (vi) The name of the company was changed from Star Engineering Ltd. to its present name with effect from 1st January, 2007
- (vii) The company's turnover in the years ended 31st March, 2006, 2007 and 2008 was Rs.20 crores, 30 crores and 35 crores respectively.

The company wants to make a public issue of shares to raise Rs. 20.00 crores by issuing equity shares at premium. For the purpose of including the information in the prospectus, the Company has prepared its accounts for 12 months ended 31st December, 2007 showing segmentwise revenue which reveals that revenue from chemical segment is more than the revenue from Engineering segment.

You are required to state the relevant guidelines issued by SEBI and your conclusion whether the Company can make the desired issue of equity shares based on the facts stated above. (6 Marks)

- (b) Excel Ltd., a public limited company listed with the The Stock Exchange, Mumbai wants to issue equity shares on preferential basis pursuant to a scheme approved under Corporate Debt Restructuring framework specified by Reserve Bank of India, to various persons as may be selected by the Board of Directors of the Company. Following information relevant to the preferential issue is available:

Total No. of equity shares to be issued : 50 lac equity shares of Rs.10 each out of which 30 lac equity shares will be allotted shares will be allotted on 31st December, 2008 as fully paid up and balance 20 lac equity shares shall be allotted on the same date but paid up to Rs.5 each and balance Rs.5 shall be called upon at a later date and shall be paid up on 31st May, 2009.

- (i) Out of the proposed allottees some persons are holding their shares in Excel Ltd. in physical form and not in dematerialized form and some persons had sold their entire shareholding in Excel Ltd. in July, 2008.
- (ii) The meeting of general body of shareholders for approving the preferential issue was held on 15th October, 2008.

Based on the above information you are required to answer the following queries with reference to the SEBI (Disclosure and Investor Protection) Guidelines, 2000:

- (i) What would be that lock-in period for the shares allotted on preferential basis?
- (ii) Who are the persons not entitled for allotment of shares on preferential basis?

(6 Marks)

Answer

- (a) The relevant guidelines issued by SEBI in respect of issue of shares by an unlisted company are laid down in Chapter II of the SEBI (Disclosure and investor Protection) Guidelines, 2000 as amended vide SEBI/CFD/DIL/DIP/ circular No.11 dated August 14, 2003.

FINAL EXAMINATION : JUNE, 2009

According to Para 2.2.1 of the said Guidelines, an unlisted company can make an initial public offer of equity shares if the following conditions are fulfilled.

- (i) The company has net tangible assets of at least Rs. 3 crores in each of the preceding 3 full years (of 12 months each), of which not more than 50% is held in monetary assets.

Provided that if more than 50% of the net tangible assets are held in monetary assets, the company has made firm commitments to deploy such excess monetary assets in its business/project;

- (ii) The company has a track record of distributable profits in terms of Section 205 of the Companies Act, 1956 for at least three (3) out of immediately preceding five (5) years;
- (iii) The company has a net worth of at least Rs.1 crore in each of the preceding 3 full years (of 12 months each);
- (iv) In case the company has changed its name within the last one year at least 50% of the revenue for the preceding 1 full year is earned by the company from the activity suggested by the new name; and
- (v) The aggregate of the proposed issue and all previous issues made in the same financial year in terms of size (i.e.; offer through offer document+ firm allotment + promoters' contribution through the offer document), does not exceed five (5) times its pre-issue networth as per the audited balance sheet of the last financial year.

In the case given in the question, all the conditions are fulfilled. The company has net Tangible Assets exceeding Rs. 3.00 crores in each of the preceding three years and it has monetary assets which are less than 50% thereof. The company has a track record of having distributable profit in last three out of last five years. The declaration of dividend is not essential. The company has a net worth of more than Rs.1 crore in each of the preceding three full years. The company has changed its name by including the word "Chemicals" therein and as per the information provided, the revenue earned by the company from this activity is more than 50% of the total revenue earned by it during the preceding one full year of 12 months. Finally, the issue size is Rs.20.00 crores, which is less than five times its pre-issue net worth of Rs.5.00 Cores. The company is free to price their equity shares. Hence the company can raise Rs.20.00 crores through public issue of equity shares at a premium. The turnover information is not relevant for deciding the desired public issue of shares.

- (b) (i) Lock – in – Period:

As per Guidelines issued by SEBI [Para 13.3.1(e)], the lock- in period in respect of the shares issued on preferential basis pursuant to a scheme approved under Corporate Debt Restructuring framework specified by Reserve Bank of India, shall commence from the date of allotment and shall continue for a period of one year in case of fully paid up shares. In the case of allotment of partly paid shares, the lock-

PAPER – 4 : CORPORATE AND ALLIED LAWS

in period shall commence from the date of allotment and continue for a period of one year from the date when shares become fully paid up.

In view of the above guidelines of SEBI, the lock-in period for 30 shares to be allotted as fully paid up shall commence from 31st December, 2008 and shall continue for one year from the date. In case of 20 lac shares allotted as partly paid up on 31st December, 2008 and to be made fully paid up on 31 May, 2009, the lock –in–period shall commence from 31st December, 2008 and shall continue till one year from 31st May, 2009, the date on which the same were made fully paid up.

(ii) Non- eligibility for preference shares:

As per Guidelines issued by SEBI [Pare 13.3.1 (f)], where any shares are issued on preferential basis any person who does not hold his entire shareholding in the issuing company in dematerialized form shall not be entitled for the preferential allotment of shares. Para 13.3.1(h) of the said guidelines disentitles any persons from receiving shares in a preferential issue, if such person has sold his shares in the issuing company during the six months period prior to the relevant date.

In view of the above guidelines, the persons who are holding the shares in Excel Ltd. in physical form and not in dematerialized form and the persons who have sold their shares in the said company in July, 2008 being falling within the period of six months prior to the relevant date, are not entitled to receive the shares in the preferential issue.

Relevant date for this purpose means the date thirty days prior to the date on which the meeting of general body of shareholders is held under Section 81(1A) of the Companies Act, 1956 to consider the proposed issue.

Question 10

Industrial Finance Corporation of India, established under the Industrial Finance Corporation Act, 1948 having its registered office at Mumbai issued 8% Redeemable Bonds redeemable after 7 years. These bonds were issued directly to the members of the public and not through mechanism of Stock exchanges.

You are required to state with reference to the provisions of Securities Contracts (Regulation) Act, 1956, whether such direct issue of bonds by the Industrial Finance Corporation of India is not violating the provisions of the said Act. (6 Marks)

Answer

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

FINAL EXAMINATION : JUNE, 2009

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.

Question 11

- (i) Mr. Sekhar resided in India for a period of 150 days during the financial year 2007-2008 and thereafter went abroad. He came back to India on 1st April, 2008 as an employee of a business organization. What would be his residential status under Foreign Exchange Management Act, 1999 during the financial year 2008-2009?
- (ii) Mr. Atul, an Indian National desires to obtain Foreign Exchange for the Following purpose:
 - (a) Remittance of US Dollars 10,000 for payment for goods purchased from a party situated in Nepal.
 - (b) US Dollars 10,000 for remitting as commission to his agent in U.S.A for sale of Commercial plot situated near Bangalore, consideration in respect of which was received by Mr. Atul by way of foreign currency inward remittance amounting to US Dollars 1,00,000.

Advise him, if he can get the Foreign Exchange and under what conditions for making the above remittances. (6 Marks)

Answer

- (i) According to the provisions of Section 2(v) of the Foreign Exchange Management Act, 1999, a person in order to qualify for the purpose of being treated as a "Person Resident in India" in any financial year, must reside in India for a period of more than 182 days during the preceding financial year. In the given case, Mr. Sekhar has resided in India for a period of only 150 days, i.e. less than 182 days, during the financial year 2007-2008. Hence he cannot be considered as a "Person Resident in India" during the financial year 2008-2009 irrespective of the purpose or duration of his stay.
- (ii) 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, drawal of 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 while in case of some Current Account transactions, prior permission of Reserve Bank of India is required.

PAPER – 4 : CORPORATE AND ALLIED LAWS

- (a) In respect of item (a), i.e. remittance to Nepal, such remittance is prohibited and the same is included in First Schedule to the Foreign Exchange Management (Current Account Transactions) Rules, 2000. Hence Mr. Atul can not withdraw foreign Exchange for this purpose.
- (b) The type of payment as envisaged in item (b) is covered under Third Schedule to the Foreign Exchange Management (Current Account Transactions) Rules, 2000 and for withdrawing foreign Exchange exceeding 5% (five percent) of the inward remittance as commission to agent abroad for sale of commercial plot in India Mr. Atul will require the prior permission of the Reserve Bank of India.

Question 12

- (i) The promoters of a company to be registered under the Companies Act, 1956 having its main object of carrying on the business as manufacturers and stockists of Iron and Steel proposes that the name of the company is to be “ABC Steel Bank Limited”. You are required to state with reference to the provisions of the Banking Regulation Act, 1949 whether the said company with the proposed name can be registered.
- (ii) Union Bank of India, a National Bank acquired on 1st January, 2002 a building, fully occupied by various tenants, from Mr. Rahul, the owner of the building, in discharge of a term loan advanced to Mr. Rahul, who had mortgaged the said building as security with the said Bank and failed to repay the loan. The said bank wants to keep the building permanently with it and earn the rent from tenants. You are required to state with reference to the provisions of the Banking Regulation Act, 1949 whether the said bank can do so. (6 Marks)

Answer

- (i) As per provisions of Section 7 of the Banking Regulation Act, 1949 no company other than a banking company can use, as part of its name, the word “Bank” unless it is a banking company as defined in Section 5(c) of the said Act. In view of such a legal provision, the promoters of the company having the main object of carrying on the business as manufacturers and stockists of iron & steel can not keep the name of the company as “ABC Steel Bank Limited”.
- (ii) Union Bank of India being a nationalized bank is a banking company within the meaning of the Banking Regulation Act, 1949. As per provisions of Section 9 thereof, no banking company shall hold any immovable property, howsoever acquired, for a period exceeding seven years except:
 - (i) If such property is required for banking company’s own use.
 - (ii) If the Reserve Bank of India extends the said period of seven years by up to another five years on the ground that such extension would be in the interest of the depositors of the banking company.

Accordingly, Union Bank of India in this case would normally be required to dispose off the building acquired from Mr. Rahul before 1st January, 2009. However, if the Reserve Bank of India on above stated ground grants the extension, then also the said Bank will

FINAL EXAMINATION : JUNE, 2009

have to dispose off the same before 1st January, 2014. But in no case, Union Bank of India can hold it permanently because the building is not for bank's own use.

Question 13

- (i) With reference the provisions of Insurance Act, 1938, what do you mean by "Life Insurance Business"?
- (ii) What are the provisions in the Insurance Act, 1938 regarding nomination by of Life Insurance Policy holder? Whether a minor can be a nominee in a Life Insurance Policy?

(6 Marks)

Answer

- (i) As per Section 2(11) of the Insurance Act, 1938, Life Insurance Business means the business of effecting contracts of insurance upon human life, including any contract whereby the payment of money is assured on death (except death by accident only) or the happening of any contingency dependent on human life, and any contract which is subject to payment of premiums for a term dependent on human life and shall be deemed to include:
 - (a) The granting of disability and double or triple indemnity accident benefits, if so provided in the contract of insurance.
 - (b) The granting of annuities upon human life; and
 - (c) The granting of superannuation allowances and annuities payable out of any fund applicable solely to the relief and maintenance of persons engaged or who have been engaged in any particular profession, trade or employment or of the dependents of such persons.
- (ii) 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 anytime 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

PAPER – 4 : CORPORATE AND ALLIED LAWS

the policy on behalf of the minor in the event of death of the policyholder during the minority of the nominee.

Question. 14

Explain the principles of “Rule of Beneficial Interpretation”.

(6 Marks)

Answer

While framing the language of a statute, generally, the care is taken to make it in such a manner that there does not remain any confusion in its interpretation. But sometimes, the language of the statute may be capable of more than one interpretation. In such cases the most firmly established rule of construction is the principle laid down in the Heydon's case. This rule is also called the “mischief rule”. This rule enables construction of four matters in construing an Act as stated below:

- (i) What was the law before the making of the Act.
- (ii) What was the mischief or defect for which the law did not provide;
- (iii) What is the remedy that the Act has provided; and
- (iv) What is the reason for the remedy.

The rule then directs that the courts must adopt that construction which ‘shall suppress the mischief and advance the remedy’. Therefore, even in a case where the usual meaning of the language used falls short of the whole object of the legislature, a more extended meaning may be attributed to the words, provided they are fairly susceptible of it. If however, the circumstances show that the phraseology in the Act is used in a larger sense than its ordinary meaning then that sense may be given to it. If the object of a statute is public safety then its working must be interpreted widely to give effect to that object. Thus the legislature having intended, while passing the Workmen's Compensation Act, the main object being provision of compensation to workman, it was decided that the act ought to be so construed, as far as possible, so as to give effect to its primary provisions.

It has been emphasized by the Supreme Court that the rule in Heydon's case is applicable only when the words used are reasonably capable of more than one meaning.

This rule does not normally apply to a fiscal statute like Income tax Act,. While construing a fiscal statute the words of the statute are given three plain meanings. If a tax payer is within the plain meaning of the terms of an exemption, he cannot be denied the benefit by resorting to any supposed intention of the exempting authority. This was held by the Supreme Court in the case of Hemraj Gordhandas vs. H.H. Dave.