

PAPER – 4: CORPORATE AND ALLIED LAWS

PART – I : RELEVANT AMENDMENTS APPLICABLE FOR MAY 2012

Applicability of relevant Amendments/Circulars/Notifications/Regulations etc.

(i) The Companies Act, 1956

AMENDMENT	CONTENT	LINKS FOR REFERENCE
Amendment in Companies (Particulars of Employees) Rules, 1975	The Ministry of Corporate Affairs (MCA) vide Notification No. G.S.R. 289(E) dated 31 st March, 2011 has made Companies (Particulars of Employees) Amendment Rules, 2011 by amending Companies (Particulars of Employees) Rules, 1975.	http://www.mca.gov.in/Ministry/notification/pdf/G.S.R.289%28E%29_31mar2011.pdf
Marking a company as having management dispute by Registrar of Companies under MCA-21 system.	The MCA vide General Circular No. 19/2011 dated 2 nd May, 2011 has clarified that the Registrar of Companies (RoC) shall use the facility to mark a company 'marked as having management dispute' on the basis of complaints received in his office according to the prescribed conditions.	http://www.mca.gov.in/Ministry/pdf/Circular_19-2011_02may2011.pdf
Form 32 under Straight Through Process (STP) mode	MCA vide General Circular No. 20/2011 dated 2 nd May, 2011 has decided that the Form 32 will also be taken on records under Straight Through Process (STP) mode i.e., the information given in the e-form 32 is being taken on file maintained by the RoC through electronic mode on the basis of statement of correctness given by the filing company and further verification by the practicing professional.	http://www.mca.gov.in/Ministry/pdf/Circular_20-2011_02may2011.pdf
Filing of Balance Sheet and Profit and Loss Account	The MCA vide General Circular No. 09/2011 dated 31 st March, 2011, General Circular No. 25/2011 dated 12 th May, 2011, General Circular No. 37/2011 dated 7 th June, 2011, General Circular No. 43/2011 dated 7 th July, 2011 and General Circular No. 57/2011 dated 28 th July, 2011 has mandated certain class of companies to file Balance Sheets and Profit and Loss Account alongwith Director's and Auditor's Report for the year 2010-11 onwards by using XBRL taxonomy.	http://www.mca.gov.in/Ministry/notification/pdf/notification_XBRL_rules.pdf

Loan to Public Limited Companies under Section 295	MCA vide General circular No. 24/2011 dated 12 th May, 2011 has requested the companies to note that when the beneficiary of the loan /guarantee /security is a Public Limited Company, approval of Central Government should only be sought if the provisions of sub-section (d) or (e) of Section 295 of the Companies Act, 1956 are attracted.	http://www.mca.gov.in/Ministry/pdf/Circular_24-2011_12may2011.pdf
Participate by directors in board meetings	The MCA vide General Circular No. 28/2011 dated 20 th May, 2011 has clarified that directors may participate in meetings of Board/ Committee of directors under the Companies Act, 1956 through electronic mode.	http://www.mca.gov.in/Ministry/pdf/Circular_28-2011_20may2011.pdf
LLP as a Body Corporate	MCA vide Notification No. S.O. 1152(E) dated 23 rd May, 2011 has clarified that LLP of Chartered Accountants will not be treated as Body corporate for the limited purpose of section 226 (3)(a) of the Companies Act, 1956.	http://www.mca.gov.in/Ministry/pdf/Circular_30A-2011_26may2011.pdf
Schedule XIII (Section 198)	The MCA vide Notification No. G.S.R. 396(E) dated 23 rd May, 2011 has made further amendments in Schedule XIII by providing that approval of the Central Government is not required for a subsidiary of a listed company provided the prescribed conditions are fulfilled.	http://www.mca.gov.in/Ministry/notification/pdf/G.S.R_396%28E%29_23may2011.pdf
Depreciation for the purpose of declaration of Dividend under Section 205 in case of companies referred to in Section 616 (C)	MCA vide General Circular No. 31/2011 dated 31 st May, 2011 has clarified that companies referred to in Section 616(c) can distribute dividend out of profit arrived at after providing for depreciation following the rates as well as methodology notified by Central Electricity Regulatory Commission (CERC) and same shall be sufficient compliance of section 205 of the Companies Act, 1956.	http://www.mca.gov.in/Ministry/pdf/Circular_31-2011_31may2011.pdf
Fast Track Exit mode u/s 560	In order to give an opportunity for fast track exit by a defunct company, for getting its name struck off from the RoC, the MCA vide General Circular No. 36/2011 dated 7 th June, 2011 has decided to modify the existing route through e-form – 61 and has prescribed the new	http://www.mca.gov.in/Ministry/pdf/Circular_36-2011_07jun2011.pdf

	Guidelines for "Fast Track Exit mode" .	
Companies (Central Government's) General Rules and Forms (Amendment) Rules, 2011	The MCA vide Notification No. 514(E) dated 7 th July, 2011 has made Companies (Central Government's) General Rules and Forms (Amendment) Rules, 2011 by amending Companies (Central Government's) General Rules and Forms, 1956.	http://www.mca.gov.in/Ministry/notification/pdf/GSR_514%28E%29_07july2011.pdf
Schedule XIII	The MCA vide General Circular No. 46/2011 dated 14 th July, 2011 has amended Schedule XIII to the Companies Act, 1956. Pursuant to this amendment, no approval of Central Government will be required by the listed companies and their subsidiary companies, which are not having profits or having inadequate profits for payment of remunerations exceeding ₹ 4 lakh p.m., if the managerial person fulfills prescribed conditions.	http://www.mca.gov.in/Ministry/pdf/Circular_46-2011_14july2011.pdf
Simplified procedure u/s 297	The MCA vide General Circular No. 52/2011 dated 25 th July, 2011 has decided to simplify the procedures and to give online approval of Central Government under section 297 of the Act, if the proposed contract has been approved by the shareholders by way of special resolutions in a general meeting.	http://www.mca.gov.in/Ministry/pdf/Circular_52-2011_25july2011.pdf
Guidelines for RDs/ROCs in the matter of scheme of arrangement/amalgamation under section 391-394	The MCA vide General Circular No. 53/2011 dated 26 th July, 2011 has issued guidelines for the Regional Director / Registrar of Companies in order to streamline the procedure in the matter of scheme of arrangement/ amalgamation under section 391-394 of the Companies Act, 1956. These guidelines supersede all previous guidelines on the matter.	http://www.mca.gov.in/Ministry/pdf/Circular_53-2011_26july2011.pdf
Amendments in Companies (Central Government's) General Rules and Forms, 1956	MCA vide Notification No. G.S.R. 259(E) dated 26 th March, 2011, Notification No. G.S.R. 351(E) dated 29 th April, 2011, Notification No. G.S.R.407(E) dated 26 th May, 2011, Notification No. G.S.R.408(E) dated 26 th May, 2011, Notification No. G.S.R. 533(E) dated 14 th July, 2011, Notification No. G.S.R. (E) dated 14 th July,	http://www.mca.gov.in/Ministry/notification/pdf/notification_23AC_23ACA_XBRL.pdf

	2011, Notification No. G.S.R. 618(E) dated 11 th August, 2011, Notification No. G.S.R. (E) dated 23 rd September, 2011 and Notification No. G.S.R. (E) dated 5 th October, 2011 has amended Companies (Central Government's) General Rules and Forms, 1956.	
DIN	Allotment of Director Identification Number (DIN) under Companies Act, 1956 vide General Circular No. 5/2011 dated 4 th March, 2011, General Circular No. 11/2011 dated 7 th April, 2011, General Circular No. 32/2011 dated 31 st May, 2011, General Circular No. 44/2011 dated 8 th July, 2011 and General Circular No. 66/2011 dated 4 th October, 2011 issued by MCA	http://www.mca.gov.in/Ministry/pdf/Circular_66-2011_04oct2011.pdf
Compliance of Provision of the Companies Act, 1956 and Rules made there under	MCA vide General Circular No. 33/2011 dated 1 st June, 2011, General Circular No. 38/2011 dated 20 th June, 2011 and General Circular No. 63/2011 dated 6 th September, 2011 has decided no request, whether oral, in writing or through e-forms, for recording any event based information/changes shall be accepted by the RoC from defaulting companies, unless they file their updated Balance Sheet and Profit and Loss Account and Annual Return with the RoC	http://www.mca.gov.in/Ministry/pdf/Circular_33-2011_01jun2011.pdf

(ii) The SEBI Act, 1992

SEBI (Issue of Capital and Disclosure Requirement) Regulations, 2009	SEBI vide Notification No. LAD-NRO/GN/2011-12/25/30309 dated 23 rd September, 2011 has issued SEBI (Issue of Capital and Disclosure Requirements) (Second Amendment) Regulations, 2011 by amending SEBI (Issue of Capital and Disclosure Requirement) Regulations, 2009.	http://www.sebi.gov.in/cms/sebi_data/attachdocs/1316774298578.pdf
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(iii) The Competition Act, 2002

Section 20	The MCA vide Notification No. S.O. 480(E) dated 4 th March, 2011 enhance on the basis of the wholesale price index, the value of assets and the value of turnover, by fifty percent for the purposes of Section 5 of the Competition Act, 2002.	http://www.cci.gov.in/images/media/notifications/SO479%28E%29,480%28E%29,481%28E%29,482%28E%29240611.pdf
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Exemption granted to group	The MCA vide Notification No. S.O. 481(E) dated 4 th March, 2011 in exercise of the powers conferred by clause (a) of Section 54 of the Competition Act, 2002, exempts, in the public interest, the 'Group' exercising less than fifty percent of voting rights in other enterprise from the provisions of Section 5 of the said Act for a period of five years.	http://www.cci.gov.in/images/media/notifications/SO479%28E%29,480%28E%29,481%28E%29,482%28E%29240611.pdf
Exemption granted to enterprise	The MCA vide Notification No. S.O. 482(E) dated 4 th March, 2011 in exercise of the powers conferred by clause (a) of Section 54 of the Competition Act, 2002, exempts, in the public interest, an enterprise, whose control, shares, voting rights or assets are being acquired has either assets of the value of not more than ₹ 250 crores in India or turnover of not more than ₹ 750 crores in India from the provisions of Section 5 of the said Act for a period of five years.	http://www.cci.gov.in/images/media/notifications/SO479%28E%29,480%28E%29,481%28E%29,482%28E%29240611.pdf

Non-Applicability of the following Amendments/Circulars/Notifications

S.No.	Subject Matter	CA Final – Corporate and Allied Laws
1.	The Companies Bill, 2011	Not Applicable
2.	Companies (Second Amendment) Act, 2002 [relating to Winding up]	Not Applicable [Students are advised to study Only General Provisions of winding up as covered under Paragraph 9.4 of the study material]
3.	Provisions relating to Revival and Rehabilitation of Sick-Industrial Companies	Not Applicable
4.	Revised Schedule VI of the Companies Act, 1956 vide Notification No. S.O. 447(E) dated 28 th February, 2011 and Notification No. S.O. 653(E) dated 30 th March, 2011 issued by MCA.	Not Applicable

PART – II : QUESTIONS AND ANSWERS**QUESTIONS****SECTION – A: COMPANY LAW****Accounts**

1. (i) Orient Fabric Limited is having a foreign subsidiary company. The said Indian holding company failed to furnish particulars of its foreign subsidiary company in its Balance Sheet. Decide the liability of Orient Fabric Limited under the Companies Act, 1956.
- (ii) The Companies (Amendment) Act, 2000 has prescribed an additional duty on the Board of Directors to include in the Board's Report a 'Directors' Responsibility Statement'. Explain briefly the details to be furnished in the said statement.

Audit

2. (i) State the procedure for the following, explaining the relevant provisions of the Companies Act, 1956:
 - (a) Removal of Statutory Auditor (appointed in last Annual General Meeting) before the expiry of his term.
 - (b) What difference it would make, if the Auditor was First Auditor appointed by the Board of Directors?
- (ii) Examine the validity of the following with reference to the provisions of the Companies Act, 1956:-

Jaiswal Textiles Limited re-appointed Naresh & Company, Chartered Accountants, as auditors of the company at the Annual General Meeting held on 30th September, 2010. Mrs. Rita, wife of one of the partners of Naresh & Company, invested ₹ 1 lakh in the equity shares of Jaiswal Textiles Limited on 15th October, 2010. But Naresh & Company continues to function as statutory auditors of the company.

Dividend

3. Board of Directors of Good Luck Limited in its meeting held on 29th May, 2010 declared an interim dividend payable on paid up Equity Share Capital of the Company. In the Board Meeting scheduled for 10th June, 2010, 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.

Directors

4. (i) In Fast Track Limited three Directors were to be appointed. The item was included in agenda for the Annual General Meeting scheduled on 30th September, 2010,

under the category of 'Ordinary Business'. All the three persons as proposed by the Board of Directors were elected as Directors of the company by passing a 'single resolution' avoiding the repetition (multiplicity) of resolution. After the three directors joined the Board, certain members objected to their appointment and the resolution. Examine the provisions of Companies Act, 1956 and decide.

- (a) Whether the contention of the members shall be tenable and whether both the appointment of Directors and the 'single resolution' passed at the Company's Annual General Meeting shall be void.
 - (b) What would be your answer in case the company in question is an "Association not for Profit" incorporated under Section 25 of the Companies Act, 1956?
- (ii) The Articles of Association of a company have fixed the maximum strength of the board as 12 directors. At present the Board has 9 directors of whom 6 are liable to retire by rotation and 3 not liable to retire by rotation. The Board wishes to appoint 3 additional directors. Can they appoint as desired?
5. (i) Mr. kartik is Managing Director of Royal Blue Limited. He gave his resignation letter to the Chairman of the Board of Directors on 31st December, 2010 and requested that he should be relieved immediately. When does the resignation of Mr. Kartik take effect?
- (ii) Sameer, a Director of Lotus Quality Limited made default in filing of Annual Accounts and Annual Returns with the Registrar of Companies for a continuous period of three financial years ending 31st March, 2010. Referring to the provisions of the Companies Act, 1956 examine the validity of the following:
- (a) Whether Sameer can continue to be a Director of Lotus Quality Limited and also Wood Creators Limited, where he is a Director.
Also state whether he can be reappointed as a Director in Lotus Quality Limited as well as Wood Creators Limited.
 - (b) Would your answer be still the same in case Sameer is a nominee Director of a Public Financial Institution?
 - (c) What would be your answer in case the defaulting company (i.e. Lotus Quality Limited) is a Private Company?
6. (i) The Directors of Global India Limited desires to authorise the Managing Director to enter into the following transactions namely-
- (a) invest from time to time surplus funds in the purchase of shares of other companies:
 - (b) borrow from banks money required for the purpose:

- (c) give loans to persons, including firms in which directors or their relatives are partners and
- (d) give donations to charitable trusts in which any of the directors may be interested as trustees.

State whether these delegated powers are within the purview of the relevant provisions of the Companies Act, 1956.

- (ii) Advise Super Specialities Limited in respect of the following proposals under consideration of its Board of Directors:
 - (a) Appointment of Managing Director who is more than 70 years of age;
 - (b) Payment of commission of 4% of the net profits per annum to the ordinary directors of the company;
 - (c) Payment of remuneration to an ordinary director for rendering professional services; and
 - (d) Payment of remuneration of ₹ 40,000 per month to the whole time director of the company running in loss and having an effective capital of ₹ 95.00 lacs.

Meetings, Powers of the Boards and Related Party Transaction

- 7. (i) A meeting of the Board of Jasmine Manufacturing Limited was held on a public holiday. However due to lack of quorum, the proceedings of the meeting could not be held and therefore the Chairman of the meeting decided with the consent of the majority that the Board meeting be adjourned to next Monday. However, the date fixed for the adjourned meeting happened to be a 'public holiday'. Advise and draw your analogy with reference to the provisions of the Companies Act, 1956, whether the adjourned meeting of the Board can be held on a day which is a public holiday.
- (ii) Analyse and Advise with reference to the provisions of the Companies Act, 1956, the following situations:
 - (a) The Articles of a company want to fix the quorum for the Board Meeting.
 - (b) There are 9 directors in a company and out of which 2 offices of the directors have fallen vacant. What will be the quorum for the Board Meeting?
 - (c) There are 15 directors in a company and during discussion of a particular item, 13 of the directors are said to be 'interested'. What shall be quorum of the meeting?
 - (d) Continuing with above situation, what will be your advise, when all the 15 directors are said to be interested in the concerned resolution?
 - (e) What are the situations, when interested directors will be counted for the purpose of counting quorum for the meetings of the Board?

- 8 (i) A company proposes to appoint a Sole Selling Agent for its products. State the cases in which such appointment requires approval of Central Government. Draft a Board Resolution to appoint a sole selling agent in a case where such appointment does not require approval of Central Government.
- (ii) Mr. Dinesh, son of Mr. Ramesh, who is the Managing Director of RD Paper Limited, proposes to give his flat on lease to the company. The paid-up share capital of RD Paper Limited is ₹ 10 crores. Advise the company explaining the restrictions, if any, under the Companies Act, 1956.

Inspection and Investigation

9. The report submitted by the inspector appointed under Section 235/237 of the Companies Act, 1956 to investigate the affairs of a Company revealed that substantial funds of the Company have been misappropriated by the Managing Director of the Company. The Central Government is of the opinion that effective action may not be taken by the company for recovery of the funds misappropriated by the Managing Director. Examine with reference to the provisions of the Companies Act, 1956 the action that can be taken by the Central Government for recovery of damages or funds misappropriated by the Managing Director.

Compromise, Arrangements and Reconstructions

10. (i) A meeting of members of Sunvalley Constructions Limited was convened under the orders of the Court to consider a scheme of compromise and arrangement. Notice of the meeting was sent in the prescribed manner to all the 700 members holding in the aggregate 20,00,000 shares. The meeting was attended by 400 members holding 13,00,000 shares. 160 members holding 10,00,000 shares voted in favour of the scheme. 150 members holding 2,40,000 shares voted against the scheme. The remaining members abstained from voting. Examine with reference to the relevant provisions of the Companies Act, 1956 whether the scheme is approved by the requisite majority.
- (ii) Does the scheme of compromise or arrangement require approval of preference shareholders?

Prevention of Oppression and Mismanagement

11. Certain Members of Cross India Limited having share capital feel that the affairs of the company are being mismanaged by Directors. Members therefore, decide to move the Company Law Board, complaining the mismanagement of company affairs by Directors of the Company. Examine the provisions of the Companies Act, 1956 and state
- (i) Whether members are entitled to complain the Company Law Board.

- (ii) Whether the following acts of the Board, of Directors amount to mismanagement:
- (A) Continuation of Directors in their office after expiry of their tenure and infighting continues among them.
 - (B) Non-declaration of dividend when it does not lead to devaluation of shares.
12. A group of members of Gulmohour Material Limited has filed a petition before the Company Law Board alleging various acts of oppression and mismanagement by the majority shareholders of the Company. The Petitioner group holds 12% of the issued share capital of the Company. During the pendency of the petition, some of the petitioner group holding about 5% of the issued share capital of the Company wish to disassociate themselves from the petition and they along with the other majority shareholders have submitted before the Company Law Board that the petition may be dismissed on the ground of non-maintainability. Examine their contention having regard to the provisions of the Companies Act, 1956.

Corporate Winding up and Dissolution

13. (i) In relation to winding up of a company incorporated under the Companies Act, 1956; explain clearly the meaning of the term 'overriding preferential payments'. Examine the provisions of the Companies Act and decide whether the following debts of a company under the winding up shall be 'Preferential payments' and shall be paid in priority to the claim of unsecured creditors:
- (a) Wages amounting to ₹ 30,000/- (Rupees Thirty thousand only) of an employee for services rendered for a period of 8 months within the preceding 12 months next before the relevant date.
 - (b) ₹ 1 lac due to an employee from Provident Fund and 50,000/- towards gratuity.
 - (c) ₹ 20,000/- payable by the company on account of expenses incurred in respect of investigation held under Section 235 of the Companies Act, 1956.
- (ii) The official liquidator of Magic Eye Limited (in liquidation) instituted misfeasance proceedings under section 543 of the Companies Act, 1956 against 'A', a director of the company in liquidation. During the pendency of misfeasance proceedings 'A' died.
- What is meant by Misfeasance? Is it possible for the official liquidator to impede the legal representatives or 'A' and continue the proceeding against them?

Producer company

- 14 (i) A two year old Producer Company registered under Section 581C of the Companies Act, 1956 wants to donate some amount. The Chief Executive of the Producer Company has approached you to advise him as to how and for what purposes the donation can be made by such company. Also state the monetary restrictions, if any, laid down in the Companies Act, 1956 on making donations by a Producer

Company. You are informed that as per the Profit & Loss account of the Producer Company for its last accounting year, net profit was ₹ 20.00 lacs.

- (ii) Is it obligatory for every producer company to appoint a whole time secretary under the provisions of the Companies Act, 1956?

E-governance

15. (i) What things should be taken care of with regard to supporting documents with DIN (Director Identification Number) Application?
- (ii) What do you mean by marking a company as having management dispute by Registrar of Companies (RoC) under MCA-21 system?

Companies Incorporated outside India

16. Ashes Ltd is a company incorporated outside India. 50% of its preference share capital and 20% of its equity share capital is held by companies incorporated in India. It issued prospectus inviting subscriptions in India for its shares but did not state the country in which it is incorporated.

Examine

- (i) Is the prospectus of the company valid?
- (ii) What is none of the shares (preference and equity) were held by Companies Incorporated in India?
- (iii) What other disclosures are required to be made by a Foreign Company?

Corporate Secretarial Practice

17. Draft a resolution proposed to be passed at a General Meeting of a Public Company giving consent to the Board of Directors for borrowing upto a specified amount in excess of the limits laid down under Section 293(1)(d) of the Companies Act, 1956 and also state the borrowings, which are to be excluded from the said limits.

SECTION – B: ALLIED LAWS

The Securities and Exchange Board of India (SEBI)

18. Mr. Rahim is a member of Rose Wood Limited. He obtains an order against the company for redressal of his grievances against the company. But the company fails to redress the grievances of Mr. Rahim within the time fixed by the SEBI. The Board thereafter imposed penalty upon the company u/s 15C of the SEBI Act. Rose Wood Limited seeks your advice whether it has any remedy against the order of SEBI. Advise.
19. The Annual Accounts of CALM Ltd., a listed company from for the year ended 31st March, 2010 were finalized on 31st May, 2011. The Company had a paid up capital of ₹ 50.00 Lacs and free reserves of ₹ 100.00 Lacs. The Company did not have any accumulated

losses. The Board of Directors of the Company wishes to make a public issue of Equity Shares amounting to ₹ 10.00 Crores comprising of offer to public through offer document, firm allotment and promoters contribution. State, how this can be done under SEBI Regulations.

What would be your answer in the following cases?

- (a) If CALM Ltd. was a Private Sector Bank known as CALM Bank Ltd.
- (b) If the issue of above mentioned ₹ 10.00 Crores was a right issue

Securities Contracts (Regulation) Act, 1956

20. (i) 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.

- (ii) Securities and Exchange Board of India received serious complaints against the Affairs of a Member of a Stock Exchange. Explain the powers of SEBI under Securities Contracts (Regulation) Act, 1956 to make enquiries and to take action, if necessary, against the member of a Stock Exchange.

Foreign Exchange Management Act, 1999

21. (i) The Reserve Bank of India issued certain directions to Dream Construction Limited, an authorised person under the Foreign Exchange Management Act, 1999 to file certain returns. The Company failed to file the said returns. Decide, as to what penal provisions are applicable against the said authorised person under the said Act.
- (ii) Examine under the Foreign Exchange Management Act, 1999 whether "Payment of remuneration to foreign technicians" is a permissible transaction under the provisions of the said Act.

The Competition Act, 2002

22. (i) An arrangement has been made among the cotton producers that the cotton produced by them will not be sold to mills below a certain price. The arrangement is in writing but it is not intended to be enforced by legal proceeding. Examine whether the said arrangement can be considered as an agreement within the meaning of Section 2(b) of the Competition Act, 2002.
- (ii) The orange producers of Nagpur have formed an association to control the production of oranges.

Examine whether it will be considered as a cartel within the meaning of Section 2(c) of the Competition Act, 2002.

Interpretation of Statutes, Deeds and Documents

23. (i) The word "May" doesn't mean "Shall". Yet the word 'May' under certain circumstances means "Shall". Discuss the statement in the context of interpretation of statutes and the importance of distinction between mandatory and directory provisions.
- (ii) Does an explanation added to a section widen the ambit of a section? Support your answer with an example from the Companies Act, 1956.

Banking Regulation Act, 1949, The Insurance Act, 1938, The Insurance Regulatory and Development Authority Act, 1999, The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002

24. (i) XLR Bank Limited is not managing its affairs properly. Employees as well as depositors of the bank have complained to the Central Government from time to time about such mismanagement and requested the Central Government to acquire the undertaking of the Banking Company. Explain the powers of the Central Government in this regard under the Banking Regulation Act, 1949.
- (ii) How are rights or interest in financial assets acquired under the SARFAESI Act, 2002?

Prevention of Money Laundering Act, 2002

25. What is the Money Laundering? What is the punishment for the offence of money laundering?

SUGGESTED ANSWERS/HINTS

1. (i) **Attachment of documents in relation to an overseas subsidiary company:** Section 212 of the Companies Act, 1956, does not make any distinction between a local subsidiary company and an overseas subsidiary company. Under section 4(4), a company shall be deemed to be the holding company of another, if, but only, if that other is its subsidiary. Under section 4(5), the expression company includes any body corporate and the definition of body corporate in section 2(7) includes a company incorporated outside India. In view of the aforesaid position, the Indian holding company is legally bound to attach to its balance-sheet the documents mentioned under section 212 prepared in accordance with the requirements of the Companies Act.

However, there may be some practical difficulty in attaching the documents of foreign subsidiary, in which case the Board of Directors of the Indian

holding company may apply to the Central Government under section 212(8) either to waive the requirement or to modify the same. Hence, Orient Fabric Limited has violated the provisions of section 212 in not furnishing the particulars of the foreign subsidiary.

(ii) **Directors' Responsibility Statement:** The Companies (Amendment) Act, 2000 has prescribed additional duty on the board of directors to include in the director's report the additional particulars by way of Directors' responsibility statement. The details are:-

- (a) That in the preparation of the annual accounts the applicable accounting standards had been followed along with proper explanation relating to material departures.
- (b) That the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit or loss of the company for that period.
- (c) That the directors had taken proper and sufficient care for the maintenance of adequate accounting standards in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities.
- (d) That the directors had prepared the annual accounts on a going concern basis. [Section 217 (2AA)]

2. (i) Removal of Auditor

- (a) Auditor appointed in an Annual General Meeting may be removed from office before the expiry of his term only by the company in general meeting, after obtaining the previous approval from the Central Government in that behalf [Section 224 (7)]. Further the company has to follow the following procedure prescribed in Section 225 (2) and (3) as explained below:

No special notice under section 225 (1) is required for a resolution in the general meeting to remove the auditor.

The auditor shall be informed of the Board's decision immediately. [Section 225 (2)].

The auditor can make a representation. The copy of the representation should be sent to all the members to whom notice of meeting is sent. If the copy of the representation is not sent as it was received late or because of the company's fault, the auditor may insist that the representation may be read at the meeting. [Section 225(3)].

If company does not wish to send the representation to the members or read at the general meeting, the company has to apply to Central Government/Company Law Board. If Central Government/Company Law Board is satisfied that the right of representation is being misused by auditor to secure needless publicity for defamatory matter, the Central Government/Company Law Board may order that the representation need not be sent and the representation need not be read at the meeting. (Proviso to Section 225(3)).

An ordinary resolution is to be passed at the general meeting for the removal of the auditor.

- (b) 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.
- (ii) **Disqualification of auditor:** According to section 226(3)(e) of the Companies Act, 1956, a person who holds any security of the company, which carries voting rights, cannot be appointed as auditor of the company. In the case of a firm of chartered accountants, all the partners should not hold any such security. Further Section 226(5) provides that if an auditor becomes subject, after his appointment, to any of the disqualifications specified in sub-section 3 of section 226, he shall be deemed to have vacated his office of auditor. However section 226 (3)(e) is not applicable if the security is held in the name of wife or other relative. Hence Naresh and Company can continue to function as auditors of the Company even after 15th October 2010 i.e. after the investment made by wife of a partner in the equity shares of Jaiswal Textiles Limited.

3. Revocation of Dividend

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 Good Luck Limited must have deposited the amount of interim dividend declared on 29th May, 2010 into a separate bank account on or before 3rd June, 2010 i.e. within five days from 29th May, 2010 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 Good Luck Limited has no power to revoke the interim dividend declared on 29th May, 2010 and shall not have any power to use the interim dividend amount transferred to a separate bank account for any other purpose.

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.

4. (i) Appointment of directors to be voted on individually

The matter of appointment of directors at the general meeting has been correctly stated in the agenda as the ordinary business to be transacted at the general meeting. But in accordance with the provisions of the Companies Act, 1956 as contained in Section 263 at a general meeting of a public company or of a private company which is a subsidiary of a public company, a motion shall not be made for the appointment of two or more persons as directors of the company by a single resolution unless a resolution that it shall be so made has first been agreed to by the meeting without any vote being given against it. Any resolution moved in contravention of sub-section (1) shall be void, whether or not objection was taken at the time to its being so moved. However, Government and companies incorporated under Section 25, i.e. associations not for profit have been exempted from the above.

Answer to Problems:

- (a) Taking into account the above, the contention of the members shall be tenable. Each director has to be appointed by way of a separate resolution.

- (b) In the second case since the company is an association not for profit under section 25 of the Companies Act, 1956 the above provisions do not apply.

(ii) Appointment of Additional Directors

As per Section 260 of the Companies Act, 1956, Board can appoint additional directors provided the Articles give power to the Board to appoint such directors, and provided the number of directors and additional directors shall not exceed the maximum strength fixed by the Articles. In the instant case, after the appointment of 3 additional directors, the total strength of the Board will go up to 12, which is within the maximum fixed by the Articles. Hence, Board can appoint the additional directors.

5. (i) **Resignation by Managing Director:** A director can resign from his office by serving a notice of his resignation upon the Company or the Board. There is no need for its acceptance by the Board or the Company.

However, if a Managing Director resigns, he cannot give up his office at his pleasure simply by serving the notice. This is because he occupies two positions i.e., of a director and an employee. In case of Managing Director, the notice or letter of resignation is required to be approved or accepted by the company and he has to be relieved of his duties and responsibilities attaching to his office from which he has resigned. Similar views were accepted in the case of *Achutha Pal vs. Registrar of Companies (1956) 36 Comp. Cases 598*.

Accordingly, in the given case, the resignation of Mr. Kartik, the Managing Director shall be effective when approved or accepted by the company and he is relieved of his duties and responsibilities attaching to his office from which he has resigned.

(ii) Disqualification of Director

In accordance with the provisions of Section 274(1)(g) a person shall not be capable of being appointed as director of a company if such person is already a director of a public company, which –

has not filed the annual accounts and annual returns for any continuous three financial years commencing on and after the first day of April, 1999;

Provided that such person shall not be eligible to be appointed as a director of any other public company for a period of 5 years from the date on which such public company, in which he is a director failed to file annual accounts and annual returns under this clause.

Applying the above provisions as contained in Section 274(1)(g), answers to the given questions are:

- (a) In the given case, Sameer, the Director of Lotus Quality Limited is disqualified to be appointed as Director of other public companies for a period of 5 years from the date on which default has been committed.

Sameer does not cease to be a director in Lotus Quality Limited and Wood Creators Limited immediately because Section 283 which provides for 'vacation of office' has not been amended.

He can continue as a director till his term ends. But he can be reappointed in the defaulting company Lotus Quality Limited, but not in Wood Creators Limited as the disqualification applies only to 'any other public company'.

- (b) In the second case, Sameer, as a nominee of the Public Financial Institution, shall not be disqualified to be appointed as Director for the reason that the nominee director appointed by the Public Financial Institutions are exempted from the provisions of Section 274(1)(g) of the Companies Act, 1956.
- (c) A director of a private company is not disqualified even if that company is a defaulter in filing return.

6. (i) Delegation of Powers to Managing Director

- (a) Although Section 292 empowers the Board of Directors of a company to delegate to the Managing Directors the power to invest, in general terms, the funds of the company nevertheless because of the overriding provisions of Section 372(5) the transaction in the instant case would be invalid. Section 372(5) provides that no investment in shares of a company can be made by the Board of Directors of an investing company in pursuance of sub-section (2), unless it is sanctioned by a resolution passed at a meeting of the Board with the consent of all the directors present at the meeting except those not entitled to vote thereat, and unless further notice of the resolution to be moved at the meeting has been given to every director in the manner specified in Section 286. Since Section 372 does not provide for delegation of the power, the proposed delegation to the Managing Director in question, notwithstanding the general provision of Section 292, cannot be made.
- (b) In terms of Section 292 the Board of Directors may also delegate to the Managing Director the power to borrow money otherwise than debentures, which it can exercise only by means of resolutions passed at Board meetings. As per Explanation to Section 292(1), it is the arrangement for an overdraft or cash credit that constitutes the exercise of the borrowing power and not the actual utilisation of the arrangement. In other words, an arrangement for an overdraft or cash credit to the tune of say ₹ 5 lakhs constitutes the exercise of the borrowing power and not the actual drawing of this amount on the basis of the overdraft or cash credit. Consequently, the transaction in the instant case shall be valid. But before implementation of the proposal, the Board must pass a resolution at its meeting authorising the Managing Directors to borrow from banks money required for the purpose of the company's business. Also the resolution delegating this power shall specify the total amount outstanding at any one time up to which the delegate may borrow money.

If however, the moneys to be borrowed together with the money already borrowed by the company (apart from temporary loans obtained from the Company's bankers in the ordinary course of business) will exceed the aggregate of the paid up capital of the company and its free reserves, [that is to say, reserves not set apart for any specific purpose] the Board of Directors of the company in question must obtain the consent of the company in its general meeting. Consequently, care should be taken to ensure that while delegating the power to the managing director the aforesaid provision has not been violated; also it should be ensured that the memorandum of association permits borrowing.

- (c) Since according to Section 295(1), without obtaining prior approval of the Central Government in that behalf, a company can not directly or indirectly lend money to persons including firms, in which directors or their relatives are partners, the company in question must in the first instance seek the Central Government's approval. Secondly since the power to make loans may be delegated under Section 292(1)(e), the Board of Directors of the company in question must pass a resolution therefore and every resolution delegating this power to the Managing Director shall specify the total amount up to which loans may be made by the delegate, the purpose for which loans may be made and the maximum amount of loans which may be made for each such purpose in individual cases. Thirdly, by virtue of Section 291(1), the Board must see with reference to the memorandum and articles whether the company is authorised to exercise the power.
- (d) Under Section 293(1) (e), the Board of Directors of a public company can contribute or donate to charitable and other funds not directly related to the business of the company or the welfare of its employees any amount the aggregate of which will not, in any financial year exceed ₹ 50,000 or 5% of its average net profits during the three financial years preceding whichever is greater. If this power of the company is not ultra vires the memorandum of the company, then only the Board can act in pursuance of the above-mentioned resolution of the company and in so acting, it can authorise the Managing Director to exercise the power on behalf of the Board.

It may be noted that the power of the Board to donate to general charities is not conditional to the existence of any profits. In such case, they may contribute up to the limit given in Section 293(1)(e), even though the company may be working at a loss.

(ii) Remuneration of Director

- (a) Under Schedule XIII, Part I, Paragraph (c) of the Companies Act, 1956, a person shall be eligible for appointment as Managing Director who has attained the age of 70 years where his appointment is approved by a Special

resolution passed by the company in the general meeting. In that case, approval of the Central Government is not required.

- (b) Under Section 309(4)(b) of the Companies Act, 1956 ordinary directors may be paid commission if the company by special resolution authorise such payment not exceeding 1% of net profit, if the company has Managing Director/ Whole Time Director/ Manager or upto 3% of the net profits in any other case. Further, under section 309(7) of the Act, Special resolution shall not remain in force for a period of more than 5 years at a time.

Second proviso to section 309(4) states that a company in general meeting may, with the approval of the Central Government, authorise the payment of such remuneration at a rate exceeding one per cent or, as the case may be, three per cent of its net profits.

Thus, in the present case, commission of 4% of net profits of the company per annum can only be paid to the ordinary directors with the approval of the Central Government.

- (c) Under proviso to section 309(1) of the Act, any remuneration for services rendered to any director in any other capacity shall not be so included if-
- (i) the services rendered are of a professional nature, and
 - (ii) in the opinion of the Central Government, the director possesses the requisite qualification for the practice of the profession.

In that case, approval of the Central Government will not be required for payment of any remuneration to the concerned director.

- (d) In terms of section II of Part II of Schedule XIII of the Act, approval of the Central Government is not required for payment of monthly remuneration upto ₹ 75,000/- in case of a company with effective capital of less than ₹ 1 crore and having no profit or its profits are inadequate, to its managerial persons, provided -

- (1) the payment of remuneration is approved by the Remuneration Committee;
- (2) the company has not defaulted in repayment of its debts, including public deposits or debentures or interest payable thereon for a continuous period of 30 days in the preceding year before the date of such appointment.

Thus, in the given case, the company may pay the remuneration of ₹ 40,000 per month to its Whole Time Director without approval of the Central Government subject to the above restrictions.

7. (i) Adjourned Meeting on a Public Holiday

Whether or not the Board meeting can be held on a public holiday and out of business hours is a question open to conflict. Under Section 288, the adjourned Board meeting is to be held on a day which is not a holiday but no such restriction has been levied on the matter of holding the original Board meeting. On the basis of the provision of Section 288, one set of arguments may be that like the adjourned meeting, the holding of the original Board meeting is equally a normal and usual work of a company and that is why it should be held during usual business hours and on a day, which is not a public holiday. On this analogy, a similar inference may be drawn from the provision of Section 166(2) as well, because it prescribes only for each annual general meeting that it held on a day which is not a public holiday and during the business hours and also because annual general meeting is normal work of the company.

Another set of arguments is that a meeting of the board can take place even on a public holiday and out of business hours because there is not such restriction as contemplated either by Section 166(2) or by Section 288. It would be prudent to subscribe to latter set of arguments. This is because if the Legislature could think of imposing similar restrictions twice-once at the time of drafting Section 166(2) in respect of only annual general meeting and the other at the time of drafting Section 288 in respect of adjourned Board meetings-it could rationally think of similar restrictions for the third time in respect of original Board meetings. If the human element of forgetfulness on the part of the draftsmen is to be given any consideration, even then it can be upheld on the first occasion when Section 166(2) was drafted. But definitely such forgetfulness is not tenable on second occasion when Section 288 was enacted especially in respect of adjourned Board meeting. Had it been the intention of the legislature, it could easily enact a provision and add it as a sub-section to Section 288. It, therefore, seems that the legislature did not deliberately think it necessary to provide for original board meeting to be held on a day other than a public holiday and during usual business hours. The law will take its course, however the course may sound irrational.

Therefore, in the absence of any specific provisions in Act it seems that the original Board meeting can be held even on a holiday and out of the business hours.

(ii) Quorum

- (a) A quorum is the prescribed minimum number of qualified persons authorised to transact the business at a meeting. In relation to a Board meeting quorum implies fully qualified and disinterested directors who must be present at the meeting so as to enable the Board of which they are the constituents to legally transact the business thereat. In view of Section 287 which has fixed the quorum of the Board meeting, the Articles of Association of the company cannot fix the quorum for the Board meeting.

- (b) Accordingly such a quorum is one third of the total strength of Board (any fraction contained in the said one third being rounded off as one) or two directors whichever is higher. The total strength is to be derived after deducting the number of directors whose offices are vacant. Therefore, the Quorum = $\frac{1}{3}$ (of the total strength vacancies) where total number of directors are 9 and 2 offices of the directors have fallen vacant, we find: $\frac{1}{3}$ of $(9-2) = \frac{1}{3}$ of 7 = $2\frac{1}{3}$ directors. If the fraction of 3^{rd} were to be rounded off as one then 3, i.e. 2+1 directors would constitute the quorum for the Board meetings. If at any time the number of the remaining directors exceeds or is equal to two thirds of the total strength, the number of the remaining directors who are non-interested but present at the meeting, not being less than two shall constitute the quorum.
- (c) For example, there are in all 15 directors and the Board meeting commences with all the 15 directors. During the currency of the meeting, an item comes up for discussion in respect of which 13 happen to be “interested” directors. In this case, in spite of the excess of the interested directors being more than two-thirds, the prescribed minimum number of non-interested directors constituting the quorum, namely, 2 present at the meeting are to transact the particular item of business.
- (d) If all the 15 directors cited in the above illustration are equally interested in that particular item of business and the time is so vital that but for a decision thereon, the business of the company will be greatly hampered. How to resolve this impasse? The Act has not made any direct provision to take with such a situation, but the Article 48 of Table A of Schedule 1 of the Act, provides a remedy. According to the said article, the Board may, whenever it thinks fit, call an extraordinary general meeting. By invoking this Article, the Board should get the aforesaid impasse resolved by the shareholders at the general meeting. Since according to Section 173(1) (b), all business in the case of any other meeting than the annual general meeting is to be deemed special, by virtue of sub-section (2) the notice of the extraordinary meeting must annex to it a statement setting out all the material facts concerning the item of business, including, in particular, the nature of the concern or interest there in of every director.
- (e) The interested directors are excluded from the computation of the quorum under Section 300(1). However, in the terms of Section 300(2), the interested directors can be counted for the purpose of quorum in the following cases, namely – (a) where the company is a private company which is neither a subsidiary nor a holding company of a public company; (b) where the company is a private company which is a subsidiary of a public company, in respect of any contract or arrangement thereof; (c) where there is any contract of indemnity against any loss which the directors or any one or more of them may

suffer by reason of becoming or being sureties or surety for the company; (d) in respect of any contract or arrangement entered or to be entered into with a public company, or a private company, which is a subsidiary of a public company in which the director's interest consist solely (i) in his being a director holding shares of such number or value as to be just enough and not more than enough to qualify him for appointment as director, or (ii) in his being a member holding not more than 20% of the paid-up share capital of the company; (e) where it is a public company in respect of which the Central government has, through a notification in the official Gazette, waived the necessity to comply with the requirements of Section 300(1) on considerations of establishing or promoting any industry, business or trade in the public interest.

8. (i) Appointment of sole selling agents Under Section 294AA of the Companies Act, 1956: In the following cases, appointment of sole selling agents will require approval of Central Government:

- (a) An individual firm or body corporate who has a substantial interest in the company cannot be appointed as a sole selling agent without prior approval of Central Government [Section 294 AA(2)]. Substantial interest means shares of ₹ 5 lakhs or 5% paid up capital of the company, whichever is less. The shareholding may be singly or together with relatives (in the case proposed Sole Selling Agent being an individual), partners and their relatives (in the case of a firm) directors and relatives of directors (in the case of a body corporate (Explanation (b) to Section 294AA).
- (b) Any company having paid up share capital of ₹ 50 lakhs or more cannot appoint sole selling agent with approval in general meeting by a special resolution and also approval of Central Government [Section 294AA(3)]. These restrictions apply to all Companies i.e. both Private and Public Companies.

Board Resolution

Resolved that pursuant to the provisions of section 294 of the Companies Act, 1956, and subject to the approval of the Company at a general meeting by ordinary resolution, the Board approves the appointment of 'X' as the company's sole selling agent for the sale of in the territory of for a period of five years with effect from on the terms and conditions set out in the draft agreement produced to this meeting and initiated by the chairman for purposes of identification or with such modifications (not being less advantageous to the company) as may be mutually agreed by the Board and 'X'.

- (ii) **Lease of flat:** Section 297 of the Companies Act, 1956 requires certain contracts on which the directors of a company are interested to be sanctioned by the Board of Directors of the Company and in certain cases (i.e. where the paid up share capital of the company is ₹ 1 crore or more) it is also required to be approved with the

previous approval of Central Government. Section 297 applies only to contracts of sale, purchase or supply of goods, materials and services or for underwriting the subscription of any shares in, or debentures of the company. Providing premises on a rental or lease basis by a director or his relative to company is not covered by Section 297. Since this Section does not apply to transactions in immovable properties, hence the proposed lease does not require either board resolution or approval of the Central Government.

However it is an arrangement in which the Managing Director is interested and as such he is required to make a disclosure under Section 299 of the said act and he should not participate or vote in the Board's proceedings (Section 300) and the lease arrangement must be entered in the Register of Contract maintained under Section 301 of the said Act.

9. Proceedings for recovery of damages or property

Section 244 of the Companies Act, 1956 provides that where from the inspectors' report it appears that a fraud or misappropriation of property has been committed and the Company is therefore, entitled to bring an action for damages for misconduct or for the recovery of any property, which has been misapplied or wrongfully retained, the Central Government may itself in public interest bring proceedings for that purpose in the name of the Company. Thus, the Central Government is empowered to bring civil proceedings in the name of the Company in any case where it appears that such proceedings ought in the public interest to be brought, even if the company does not take such action. In such a proceeding, the inspector's report shall be admissible as evidence of the opinion of the inspection in relation to any matter contained in the report (Section 246). The Central Government should indemnify the company against any cost or expenses incurred by it or in connection with any proceedings brought by it. [Section 244 (2)].

10. Compromise or Arrangement

- (i) 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.

- 11.** Section 398 of the Companies Act, 1956 provides that a requisite number of members of the company as laid down in Section 399 may apply to Company Law Board for appropriate relief on the ground of mismanagement of the company.

Conditions Precedent:

Section 398 can be invoked in either of the two circumstances:

- (a) that affairs of the company are being conducted in a manner prejudicial to the interests of the company [Section 398(1)(a)]; or
- (b) that a material change has taken place in the management or control of the company and as a consequence the affairs of the company may be conducted in a manner prejudicial to the public interest or in a manner prejudicial to the interests of the company [Section 398(1)(b)].

Considering the above, the questions as asked can be answered as under:

- 1. Continuation of directors in their office after the expiry of their term and infighting among them has been held to be the act of mismanagement. (*Ranjan Dutta vs. Bhola Nath Paper House Ltd. (1983)*).
- 2. Non-declaration of dividend when it does not lead to devaluation of shares is not an act of mismanagement. (*V.J. Thomas Vettom vs. Kuttanad Rubber Co. Ltd. (1984)*).

12. Oppression and Mismanagement

The argument of the majority share holders that the petition may be dismissed on the ground of non-maintability is not correct. The proceedings shall continue irrespective of withdrawal of consent by some petitioners. It has been held by the Supreme Court in *Rajmundhry Electric Corporation vs. V. Nageswar Rao, AIR (1956) SC 213* that if some of the consenting members have subsequent to the presentation of the petition withdraw their consent, it would not affect the right of the applicant to proceed with the petition. Thus, the validity of the petition must be judged on the facts as they were at the time of presentation. Neither the right of the applicants to proceed with the petition nor the jurisdiction of Company Law Board to dispose it of on its merits can be affected by events happening subsequent to the presentation of the petition.

- 13. (i) Overriding Preferential Payments:** Under Section 529A of the Companies Act, 1956, notwithstanding anything contained in other provisions of the Companies Act, 1956 or any other law for the time being in force in the winding-up of a company - (i) workmen's dues and (ii) debts due to secured creditors to the extent such debts rank, under clause (c) of the proviso to Sub-section (1) of Section 529, pari passu with such dues, shall be paid in priority to all other debts. These debts payable under (i) and (ii) above shall be paid in full, unless the assets are insufficient to meet them, in which case they shall be paid in equal proportions.

- (a) Wages amounting to ₹ 30,000, of an employee for services rendered for a period of 8 months within the preceding 12 months next before the relevant date.

All wages and salaries of an employee for service rendered for a period not exceeding 4 months within the preceding 12 months next before the relevant date, but not Exceeding ₹ 20,000 in anyone case. In the given case, it is not a preferential payment. Only a part of it shall be the preferential payment.

- (b) ₹ 1 lac due to an employee from provident fund and ₹ 50,000 towards gratuity.

All sums due to any employee from any fund including a provident, pension or a Gratuity for the welfare of the employees, maintained by the company are the preferential Payment. Therefore in the given case both the sums i.e. ₹ 1 lac and ₹ 50,000 are the preferential payments.

- (c) ₹ 20,000 payable by a company on account of expenses incurred in respect of investigation held under Section 235 of the Companies Act, 1956.

Expenses payable by any company in respect of an investigation held under Section 235 and 237 are preferential payments. In the given case ₹ 20,000 payable by the company on account of expenses incurred in respect of investigation are preferential payments.

- (ii) Misfeasance:** The term 'misfeasance' has not been defined in the Companies Act, 1956. It can be considered as an act or omission in the nature of breach of trust in relation to the company which causes losses or injuring to the company. Although loss to the company has not been expressly stated in Section 543 nevertheless such 'loss' has to be implied in case of misapplication or retainer. Only such an act of misfeasance as results in the loss to the company will fall within the ambit of section 543.

As regards the second question (ii) in case of death of the directors, the Supreme Court held that the proceedings commenced against the delinquent director of a company liquidation under section 543 can be continued after his death against his legal representatives and the amount declared to be due in such misfeasance proceeding can be realized from the estate of the deceased on the hands of his

legal representatives. The Court further held that the legal representatives would not, however, be liable for any sum beyond the value of the estate of the deceased in their hands (*Official Liquidator vs. Supreme Bank Ltd. V.P.A. Tendolkar (1973) 43 Comp. (Case 382) (Official Liquidator vs. Parthasarthy Sinha (1983) 53. Comp. Case (SC) (3c)*). Hence the misfeasance proceeding can be continued against the legal representatives of A.

14. (i) As per provisions of section 581 ZH of the Companies Act, 1956, a Producer Company may, by special resolution, make donation or subscription to any institution or individual for the following purposes:-

- (a) For promoting the social and economic welfare of Producer Members or Producers or general public; or
- (b) For promoting the mutual assistance principles.

Thus, as per the above stated provisions of the Companies Act, 1956, a Producer Company may make a donation by passing a special resolution and for the above mentioned purposes.

The 1st Proviso to the said section 581ZH lays down the monetary limit for making the donation by a Producer Company. According to the said proviso the aggregate amount of all such donation and subscription in any financial year shall not exceed three per cent of the net profit of the Producer Company in the financial year immediately preceding the financial year in which the donation or subscription was made.

Since the net profit of the Producer Company as per its last profit & loss account was ₹ 20.00 lacs, it can make a total donation of ₹ 60,000/- in this year being three percent thereof.

- (ii) Under section 581X of the Companies Act, 1956 every Producer Company having an average turnover exceeding ₹ 5 crores in each of three consecutive financial years shall have a whole time secretary who is a member of Institute of Company Secretaries of India.
15. (i) Following are some precautions to be taken before attaching supporting documents with DIN application:
- Documents submitted are currently valid and not expired.
 - Documents issued by LIC may be enclosed as Date of Birth and Address proof.
 - Bank Statements, Utility Bills like telephone, electricity bill etc. furnished as residence proof are in the applicant's name only and not older than two months.
 - All supporting documents attached with form DIN-1 must be duly attested by an authorized person/ authority.

In case the director is illiterate, thumb impression should be certified from the concerned revenue authority (where the applicant resides) and then all the documents should be notarized or attested OR if applicant is not in a position to sign the application due to medical reasons and affixed thumb impression on the application then duly attested medical certificate from Government hospital is must with the application stating the reason of his / her ailment.

(ii) Marking a Company as having management dispute by RoC

In the present electronic MCA-21 system, there is a facility with the Registrar of Companies (RoC) to mark a company 'marked as having management dispute' on the basis of complaints received in his office. This marking created an alert and the documents are not approved and remain in the registry as work in process till it is demarked by the Registrar. In order to bring uniformity of practices by all RoC, Ministry of Corporate Affairs vide General Circular No. 19/2011 dated 2nd May, 2011 has clarified that the RoC shall use this facility as under:-

- (i) The RoC shall mark a company as having management dispute in only those cases where the court or Company Law Board has directed to maintain the status-quo with reference to any e-forms including status of Directors in the company or
- (ii) the Court or Company Law Board has granted any injunction or stay in taking the document on record and RoC is a party in such court cases and/or the directions have been issued to the RoC.
- (iii) In other matter, where the RoC is not a party and such orders have been passed and has not been served to the RoC, it is for the parties to comply to such orders and in case of non-compliance, the law shall take its own course.

16. Section 591(2) of the Companies Act, 1956, provides that where not less than fifty per cent of the paid up share capital (whether equity or preference or partly equity and partly preference) of a company incorporated outside India and having an established place of business in India, is held by one or more citizens of India or by one or more bodies corporate incorporated in India, or by one or more citizens of India and one or more bodies corporate incorporated in India, whether singly or in the aggregate, such company shall comply with such of the provisions of this Act as may be prescribed with regard to the business carried on by it in India, as if it were a company incorporated in India.

- (i) As 50% of the preference share capital and 20% of the equity share capital of Ashes Ltd. is held by companies incorporated in India, it shall be treated as if it were a company incorporated in India. As such it is not necessary for Ashes Ltd. to comply with the provisions relating to foreign companies. So the prospectus of the company shall be valid.
- (ii) If none of the shares (preference and equity) were held by companies incorporated in India, Ashes Ltd. would be a foreign company within the meaning of Section 591

of the Act. Section 595 of the Act provides that every foreign company shall in every prospectus inviting subscriptions in India for its shares or debentures, state the country in which the company is incorporated. As Ashes Ltd. did not mention the name of the country in which it is incorporated, the prospectus shall not be valid.

- (iii) Section 595 of the Act provides for the following additional disclosures to be made by a foreign company:
- (a) conspicuously exhibit on the outside of every office or place where it carries on business in India, the name of the company and the country in which it is incorporated, in letters easily legible in English characters, and also in the characters of the language or one of the languages in general use in the locality in which the office or place is situated;
 - (b) cause the name of the company and of the country in which the company is incorporated, to be stated in legible English characters in all business letters, bill heads and letter paper, and in all notices, and other official publications of the company; and
 - (c) If the liability of the members of the company is limited, cause notice of the fact-
 - to be stated in every such prospectus as aforesaid and in all business letters, bill heads, letter paper, notices, advertisements and other official publications of the company, in legible English characters; and
 - to be conspicuously exhibited on the outside of every office or place where it carries on business in India, in legible English characters and also in legible characters of the languages or one of the languages in general use in the locality in which the office or place is situated.

17. DRAFT BOARD RESOLUTION:

Draft of ordinary resolution under Section 293(1)(d)

Resolved that the company hereby consents to the Board of Directors borrowing monies not exceeding ₹.....(Rupees.....) in excess of the aggregate of the paid-up capital of the company and its free reserves, that is to say reserves not set apart for any specific purpose, as provided in Section 293(1)(d) of the Companies Act, 1956, and in addition to any temporary loans obtained from the company's bankers in the ordinary course of business.

Borrowings

Section 293(1)(d) does not apply to the borrowing by a company by way of temporary loans obtained from the company's bankers in the ordinary course of business. Therefore, in calculating the limits stipulated in this provision, temporary loans obtained from the company's bankers in the ordinary course of business shall be excluded.

The expression 'temporary loans' in i.e. (d) means loans repayable and demand or within six months from the date of the loan such as short term cash credit arrangements, the discounting of bills and the issue of other short terms loans of a seasonal character, but does not include loans raised for the purpose of financing expenditure of capital nature [Explanation II to Section 293(1)].

18. Remedy against order of SEBI: Rose Wood Limited was penalized by the SEBI. The following remedies are available to the Company:

- (1) **Appeal to the Securities Appellate Tribunal:** Section 15T of the SEBI Act, 1992 provides that any person aggrieved by an order of the Board may prefer an appeal to the Securities Appellate Tribunal. Such appeal shall be filed within 45 days from the date on which a copy of the order of the Board was received. However, the Tribunal may entertain an appeal after the expiry of the said period if it is satisfied that there was sufficient cause for not filing it within the said period of limitation.
- (2) **Appeal to the Supreme Court:** Section 15Z of the SEBI Act, 1992 provides that any person aggrieved by the decision or order of the SAT may file an appeal to the Supreme Court within 60 days from the date of communication of the decision or order on any question of law arising out of such order. The Supreme Court may entertain such appeal even after the expiry of said period of limitation if there was reasonable cause for such delay.

19. To determine, whether CALM Ltd can proceed with the public issue of equity shares amounting to ₹ 10.00 crores, one has to find out whether the company satisfied Regulation 26 of the SEBI (ICDR) Regulations, 2009 applying clause (c) of the said Regulation, 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. In this case, it exceeds 5 times the net worth as on 31st March, 2011. (Proposed issue is ₹ 10 crores and net worth as at 31st March, 2010 is ₹ 1.5 crores). Since the company does not satisfy the above stated condition, it has to satisfy any of the alternate conditions specified in Clause 2(a)(b), which states that, the issue is made through the book building process and the issuer undertakes to allot at least fifty per cent. of the net offer to public to qualified institutional buyers and to refund full subscription monies if it fails to make allotment to the qualified institutional buyers ; **or** at least fifteen per cent of the cost of the project is contributed by scheduled commercial banks or public financial institutions, of which not less than ten per cent shall come from the appraisers and the issuer undertakes to allot at least ten per cent of the net offer to public to qualified institutional buyers and to refund full subscription monies if it fails to make the allotment to the qualified institutional buyers;

- a. (i) the minimum post-issue face value capital of the issuer is ten crore rupees; **or**
- (ii) the issuer undertakes to provide market-making for at least two years from the date of listing of the specified securities, subject to the following:

- (A) the market makers offer buy and sell quotes for a minimum depth of three hundred specified securities and ensure that the bid-ask spread for their quotes does not, at any time, exceed ten per cent;
- (B) the inventory of the market makers, as on the date of allotment of the specified securities, shall be at least five per cent of the proposed issue.

20. (i) 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.

- (ii) **Disciplinary action against members of Stock Exchange:** SEBI can exercise the following powers under Securities Contracts (Regulation) Act, 1956 on receipt of serious complaints against the affairs of a member of a stock exchange.

- (i) SEBI may, if it is satisfied that it is in the interest of the trade or in the public interest, by order in writing call upon the member of the stock exchange to furnish in writing information or explanation in respect of the matter under inquiry [Section 6(3)(a)].
- (ii) SEBI instead of calling for information, may either appoint one or more persons to make an enquiry or direct the governing body of stock exchange to make inquiry and submit its report to SEBI [Section 6(3)(b)].

In case of adverse findings, SEBI can direct stock exchange to take disciplinary action against the member such as fine, expulsion from membership, suspension from membership for a specified period and any other penalty of a like nature not involving the payment of money. Bye-laws of the stock exchange usually provide for such punishment [Section 9(3)(b)]. Stock exchange is under obligation to take the action as directed.

21. (i) **Penal provisions:** Section 11(3) of the Foreign Exchange Management Act, 1999 states that where any authorized person contravenes any direction given by the

Reserve Bank of India under the said Act or fails to file any return as directed by the Reserve Bank of India, the Reserve Bank of India may, after giving reasonable opportunity of being heard impose a penalty which may extend to ₹ 10,000/- and in the case continuing contraventions with an additional penalty which may extend to ₹ 2,000/- for every day during which such contravention continues.

- (ii) **Foreign Technician:** Salary payable to a foreign technician is a current account transaction. According to Section 5 of the Foreign Exchange Management Act, 1999 any person can sell or draw foreign exchange to or from authorized person if such sale or drawal is a current account transaction. Reasonable restrictions on current account transactions can be imposed by the Central Government. Basically all current account transactions are free unless specifically restricted by the Central Government. Hiring of foreign nations as technicians is permissible without restriction. There is not ceiling on salary which can be paid as per contract. Their salary can be remitted abroad after tax deducted at source.

22. (i) As per Section 2(b) of the Competition Act, 2002, an Agreement includes any arrangement or understanding or action in concert:-

- (a) whether or not, such arrangement, understanding or action is formal or in writing; or
- (b) whether or not, such arrangement, or understanding or action is intended to be enforceable by legal proceedings.

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

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

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

23. (i) The use of the word ‘may’ in a statutory provision will not by itself show that the provision is directory in nature. In some cases the legislature may use the word ‘may’ as a matter of pure conventional courtesy and yet intend a mandatory force. Therefore, in order to interpret the legal import of the word ‘may’ we have to consider various factors, e.g. the object and the scheme of the Act, the context or background against which the words have been used, the purpose and advantages of the Act sought to be achieved by use of this word and the like.

Coming to the word 'shall' the use of the word 'shall' would not of itself make a provision of the Act mandatory. It has to be construed with reference to the context in which it is used. Thus, as against the government the word 'shall' when used in a statute is to be construed as 'may' unless a contrary intention is manifest. Hence, a provision in a criminal statute that the offender shall be punished as prescribed in the statute is not necessary to be taken as against the government to direct prosecution under that provision rather under some other applicable statute.

The distinction between a provision which is mandatory and one which is directory is that when it is mandatory, it must be strictly complied with; when it is 'directory', it would be sufficient that it is substantially complied with. Non-observance of mandatory provision involves the consequences of invalidity. But non-observance of directory provisions does not entail the consequence of invalidity, whatever other consequences may occur.

No general rule can be laid down for deciding whether any particular provision in a statute is mandatory or directory. In each case the court has to consider not only the actual words used, but has to decide the legislative intent. For ascertaining the real intention of the legislature, the court may consider, amongst other things, the following:

- (i) The nature and design of the statute.
- (ii) The consequence which would flow from construing from one way or the other.
- (iii) The impact of other provisions by resorting to which the necessity of complying with the provisions in question can be avoided.
- (iv) Whether or not the statute provides any penalty if the provision in question is not complied with.
- (v) If the provision in question is not complied with, whether the consequences would be trivial or serious.
- (vi) Most important of all, whether the object of the legislation will be defeated or furthered.

Where a specific penalty is provided in a statute itself for non-compliance with the particular provision of the act, no discretion is left to the court to determine whether such provision is directory or mandatory – it has to be taken as mandatory.

- (ii) Sometimes an explanation is added to a section of an Act for the purpose of explaining the main provisions contained in that section. If there is some ambiguity in the provisions of the main section, the explanation is inserted to harmonise and clear up and ambiguity in the main section. Something may 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.

24. (i) Under Section 36AE of the Banking Regulation Act, 1949, if the Central Government is of the opinion that a Banking company has failed to comply with the direction given by RBI relating to policy matters under section 21 and 35A and or the affairs of the Bank are being managed in a manner detrimental to the interest of depositors or that of the banking policy or for better provision of credit generally or of credit to any particular section of the community or in any particular area; it is necessary to the Government may after consultation with RBI, by notified order, acquire the undertaking of a Banking Company. In such a case, on the date specified in the notification, the undertaking of the Banking Company and its assets and liabilities shall stand transferred to and vest in Central Government. Before acquiring the undertaking, the Central Government shall give a reasonable opportunity of hearing to the Banking Company.
- (ii) **Section 5:** Notwithstanding anything contained in any agreement or any other law for the time being in force, any securitisation company or reconstruction company may acquire financial assets of any bank or financial institution-
- (a) by issuing a debenture or bond or any other security in the nature of debenture, for consideration agreed upon between such company and the bank or financial institution, incorporating therein such terms and conditions as may be agreed upon between them; or
 - (b) by entering into an agreement with such bank or financial institution for the transfer of such financial assets to such company on such terms and conditions as may be agreed upon between them.

Debenture as we commonly know, is an acknowledgement of debt. Bond also refers to the same nature of instrument as a debenture. Both of them acknowledge a debt and hence an obligation to pay.

In case the bank or financial institution is a lender in relation to any financial assets acquired by the securitisation company or the reconstruction company, then such securitisation company or reconstruction company shall, on such acquisition, be deemed to be the lender and all the rights of such bank or financial institution shall vest in such company in relation to the subject financial assets.

Unless otherwise expressly provided by this Act, all contracts, deeds, bonds, agreements, powers-of-attorney, grants of legal representation, permissions, approvals, consents or no-objections under any law or otherwise and other

instruments of whatever nature which relate to the said financial asset and which are subsisting or having effect immediately before the acquisition of financial asset and to which the concerned bank or financial institution is a party or which are in favour of such bank or financial institution shall, after the acquisition of the financial assets, be of as full force and effect against or in favour of the securitisation company or reconstruction company, as the case may be, and may be enforced or acted upon as fully and effectually as if, in the place of the said bank or financial institution, securitisation company or reconstruction company, as the case may be, had been a party thereto or as if they had been issued in favour of securitisation company or reconstruction company, as the case may be.

If, on the date of acquisition of financial asset, any suit, appeal or other proceeding of whatever nature relating to the said financial asset is pending by or against the bank or financial institution, save as provided in the third proviso to sub-section (1) of section 15 of the Sick Industrial Companies (Special Provisions) Act, 1985 (1 of 1986) the same shall not abate, or be discontinued or be, in any way, prejudicially affected by reason of the acquisition of financial asset by the securitisation company or reconstruction company, as the case may be, but the suit, appeal or other proceeding may be continued, prosecuted and enforced by or against the securitisation company or reconstruction company, as the case may be.

- 25. Money Laundering:** Whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime and projecting it as untainted property shall be guilty of offence of money laundering.

Punishment for the offence of Money Laundering: Chapter II comprises of Sections 3 and 4. Section 3 deals with the offence of money laundering which has been discussed in the definition part above. Section 4 provides for the punishment for Money-Laundering. Whoever commits the offence of money-laundering shall be punishable with rigorous imprisonment for a term which shall not be less than three years but which may extend to seven years and 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.