

GUIDELINE ANSWERS

INTERMEDIATE EXAMINATION

JUNE 2008

GROUP II



The Institute of
Company Secretaries of India

IN PURSUIT OF PROFESSIONAL EXCELLENCE

Statutory body under an Act of Parliament

These answers have been written by competent persons and the Institute hopes that the **GUIDELINE ANSWERS** will assist the students in preparing for the Institute's examinations. It is, however, to be noted that the answers are to be treated as model answers and not as exhaustive and the Institute is not in any way responsible for the correctness or otherwise of the answers compiled and published herein.

The Guideline Answers contain the information based on the Laws/Rules applicable at the time of preparation. However, students are expected to be well versed with the amendments in the Laws/Rules made upto **six** months prior to the date of examination.

C O N T E N T S

		<i>Page</i>
	GROUP II	
1. Company Law	...	1
2. Company Secretarial Practice	...	20
3. Economic, Labour and Industrial Laws	...	39
4. Securities Laws & Regulation of Financial Markets	...	58

(i)

NOTE : Guideline Answers of the last Six Sessions have been updated with a view to keep the students abreast of new developments. While updating the answers the changes and references to be consulted have been given hereinbelow :

INTERMEDIATE EXAMINATION

UPDATING SLIP

COMPANY LAW

GROUP – II – PAPER 5

<i>Examination Session</i>	<i>Question No.</i>	<i>Updating required in the answer</i>
June 2005 to Dec. 2007	—	(i) Companies (Central Government's) General Rules and Forms, 1956 have been amended vide Companies (Central Government's) General Rules and Forms (Amendment) Rules, 2006 dated 10.02.2006. Through this amendment, existing forms have been substituted by new e-forms. (ii) Sections 610B to E relating to filing of applications, documents etc electronically have been inserted by the Companies (Amendment) Act, 2006. All the answers pertaining to filling and filing of forms with the Central Government/ Registrar of Companies may be updated accordingly. (iii) Sections 226A to G relating to Director Identification Number have been inserted by the Companies (Amendment) Act, 2006. All the answers pertaining to appointment, resignation, retirement etc. of the Directors may be updated accordingly. (iv) The 'Ministry of Company Affairs' has been renamed as the 'Ministry of Corporate Affairs' vide Presidential Notification, dated 9th May, 2007 amending the Government of India (Allocation of Business) Rules, 1961. All the answers may be updated accordingly.

(ii)

UPDATING SLIP

COMPANY SECRETARIAL PRACTICE

GROUP – II – PAPER 6

<i>Examination Session</i>	<i>Question No.</i>	<i>Updating required in the answer</i>
Dec. 2005 to June 2008	—	(i) Companies (Central Government's) General Rules and Forms, 1956 have been amended vide Companies (Central Government's) General Rules and Forms (Amendment) Rules, 2006 dated 10.02.2006. Through this amendment, existing forms have been substituted by new e-forms. (ii) Sections 610B to E relating to filing of applications, documents etc electronically have been inserted by the Companies (Amendment) Act, 2006. All the answers pertaining to filling and filing of forms with the Central Government/ Registrar of Companies may be updated accordingly. (iii) Sections 226A to G relating to Director Identification Number have been inserted by the Companies (Amendment) Act, 2006. All the answers pertaining to appointment, resignation, retirement etc. of the Directors may be updated accordingly.

INTERMEDIATE EXAMINATION

JUNE 2008

COMPANY LAW

Time allowed : 3 hours

Maximum marks : 100

- NOTE :** 1. Answer **SIX** questions including Question No. 1 which is **COMPULSORY**.
2. All references to sections relate to the Companies Act, 1956 unless stated otherwise.

Question 1

Comment on any four of the following :

- (i) A company cannot ratify its pre-incorporation contracts.*
- (ii) Registered office of a company can be shifted from one State to another without the approval of the State Government.*
- (iii) A company can accept deposits by issuing advertisement.*
- (iv) Statutory meeting is held only once in the lifetime of a company.*
- (v) Buy-back of shares does not amount to reduction of share capital.*

(5 marks each)

Answer 1(i)

Contracts entered into by the promoters on behalf of the company before its incorporation is known as preliminary contracts. Since a company comes into existence only after it is incorporated, the relationship of principle and agent does not exist. A principle who is not in existence cannot appoint an agent. Since at the time of contract, the company was not in existence, a contract by a promoter purporting to act on behalf of the company prior to its incorporation does not bind the company. The promoters alone, therefore, remain personally liable for any contract they purport to make on behalf of the company, unless the company enters into afresh contract in terms of such agreement after incorporation adopting the contract entered into by the promoter.

In *Kelner v. Baxter*, (1866) LR 2CP 174, it was held that the company could not ratify pre-incorporation contracts. Even if the company has received some benefit under the contract, the company cannot ratify and there is no viability of the company for such contracts. A company cannot ratify a pre-incorporation contract, but it is open to it to enter into a new contract after its incorporation to give effect to a contract made before its formation [*Howard v. Patent Ivory Co.* (1888) 38 Ch.D]. Since the pre-incorporation contract is a nullity, even the company cannot sue the vendor of property if he fails to carry out such a contract.

Answer 1(ii)

A special resolution shall be passed at a general meeting so as to change the place of registered office from one State to another. The alteration shall not take effect until it is confirmed by the Company Law Board on petition. The Company Law Board shall cause notice of the petition for confirmation of the change to be served on the Registrar for objections and suggestions, if any.

Approval of State Government not required

At one time, the shifting of the registered offices of certain companies to places outside a State was opposed by the State on the grounds of loss of revenue and employment opportunities and the Courts (now the Central Government) were hesitant in giving confirmation. In *Orient Paper Mills Ltd. v. The State*, A.I.R. (1957) Ori. 232, the Orissa High Court declined confirmation of change of registered office from Orissa to another State on the ground that in a federal Constitution every State has got the right to protect its revenue and, therefore, the interests of the State must be taken into account.

In *Rank Film Distributors of India Ltd. v. Registrar of Companies*, West Bengal, A.I.R. (1969) Cal. 32, a Division Bench of the Calcutta High Court observed that State has no statutory right under Section 17 to oppose the shifting of the registered office from one State to another.

Under the Act, it is for the members of a company and not for the State to decide whether the registered office of the company should be transferred from one State to another in the interest of the company for the reasons specified in Section 17.

Answer 1(iii)

No company can accept deposits except after publication of an advertisement specifying therein the financial condition, management structure and other specified particulars. The advertisement shall be made not later than 6 months of the close of the financial year based on which financial details are given therein, in a leading English newspaper and in one vernacular language newspaper circulating in the State in which the registered office of the company is situated.

The Board meeting should also approve and adopt the text of the advertisement inviting deposits from the public. The advertisement must contain the particulars as per Rule 4(2) of the Companies (Acceptance of Deposits) Rules. These include (among others):

- (a) name of the company;
- (b) the date of incorporation of the company;
- (c) business carried on by the company and its subsidiaries;
- (d) brief particulars of the management of the company;
- (e) names, addresses and occupations of the directors;
- (f) profits before and after providing for tax, for the 3 financial years, immediately preceding the date of advertisement;
- (g) dividends declared in respect of the said 3 financial years;
- (h) a summarized financial position as in 2 immediately preceding audited balance sheets prior to the date of advertisement;
- (i) the amount which the company can raise by way of deposits under the rules and the aggregate of deposits actually held on the last day of the immediately preceding financial year; and
- (j) a statement to the effect that on the date of the advertisement, the company has no overdue deposits other than unclaimed deposits or a statement showing the amount of such overdue deposits, as the case may be.

The advertisement shall remain valid for a period of 6 months from the date of closure of the financial year in which it is issued or until the date the balance sheet is laid before the company in general meeting or where the annual general meeting is not held, the latest date on which the meeting should have been held, whichever is earlier. A fresh advertisement has to be made in each succeeding financial year for inviting deposits thereafter.

Answer 1(iv)

As per Section 165 of the Companies Act, 1956 every company limited by shares/ limited by guarantee and having a share capital shall within a period of not less than one month and not more than six months from the date on which the company is entitled to commence business hold a statutory meeting. It is clear that such statutory meeting is required to be held only once in the life time of a company. The purpose of holding the statutory meeting is to apprise the shareholders about

- (1) shares allotted and amount paid thereon and the consideration received;
- (2) receipt and payment of cash;
- (3) preliminary expenses of the company;
- (4) names, addresses and occupation of directors, auditors, manager and secretary;
- (5) particulars of contracts of modification thereof if any proposed to the meeting for approval;
- (6) underwriting contracts;
- (7) unpaid calls;
- (8) commission/brokerage paid or payable.

The above shall be in the form of a report called as the statutory report, copy of which is required to be circulated amongst the members' at least 21 days in advance of the meeting.

Answer 1(v)

As per Section 77(A) of the Companies Act, 1956, a company is authorized to buy back its own shares from the shareholders. By this process only the paid up share capital of the company gets reduced and the amount of shares bought back is transferred to Capital Reserves. This does not result into reduction of capital. In the following cases, the diminution of share capital is not to be treated as reduction of the capital.

- (1) Cancellation of shares agreed to be taken but not taken by any person.
- (2) Redemption of preference shares.
- (3) Shares forfeited for non payment of calls.
- (4) Where the company buys back its own shares under Section 77A.

Question 2

- (a) *Discuss the provisions relating to 'registration of charges'.* (6 marks)
- (b) *Discuss the majority rule and minority rights.* (10 marks)

Answer 2(a)

Company organizations raise finance from banks and financial institutions for the purpose of the business against the security of company's assets including book debts. The Companies Act, 1956 requires under Section 125 that charge created on the assets of the company should be filed in e-form 8 with Registrar of Companies, within 30 days of creation of charge. On payment of additional fee, further 30 days time is allowed to file the charge. After repayment of the loan, the company has to file the form for satisfaction of charge in e-form 17.

The charges which must be registered are:

- (a) a charge for the purpose of securing any issue of debentures;
- (b) a charge on uncalled share capital of the company;
- (c) a charge on any immovable property, wherever situate or any interest therein;
- (d) a charge on any book debts of the company;
- (e) a charge, not being a pledge, on any movable property of the company;
- (f) a floating charge on the undertaking or any property of the company including stock-in-trade;
- (g) a charge on calls made but not paid;
- (h) a charge on a ship or any share in a ship; and
- (i) a charge on goodwill or a patent or a licence under a patent, or on a trade mark, or on a copyright or a licence under a copyright.

Failure to register a charge shall render the same inoperative against the liquidator in the event of winding up of the company.

Answer 2(b)**Powers of Majority**

As a company is an artificial person with no physical existence, it functions through the instrumentality of the Board of directors who is guided by the wishes of the majority, subject, of course, to the welfare of the company as a whole. It is, therefore, a cardinal rule of company law that prima facie a majority of members of a company are entitled to exercise the powers of the company and generally to control its affairs.

The Principle of Non-interference (Rule in Foss v. Harbottle)

The court will not usually intervene at the instance of shareholders in matters of internal administration, and will not interfere with the management of a company by its directors so long they are acting within the powers conferred on them under the articles of the company. The basic principle of non-interference with the internal management of company by the court is laid down in a celebrated case of *Foss v. Harbottle* 67 E.R. 189; (1843) 2 Hare 461. No action can be brought by a member against the directors in respect of a wrong alleged to be committed to a company. The company itself is the proper party of such an action.

Justification of the Rule in Foss v. Harbottle

The justification for the rule laid down in *Foss v. Harbottle* is that the will of the majority prevails. On becoming a member of a company, a shareholder agrees to submit to the will of the majority. The rule really preserves the right of the majority to decide how the company's affairs shall be conducted. If any wrong is done to the company, it is only the company itself, acting, as it must always act, through its majority, that can seek to redress and not an individual shareholder.

Exceptions to the Rule in *Foss v. Harbottle* — Protection of Minority Rights and shareholders remedies

The rule in *Foss v. Harbottle* is not absolute but is subject to certain exceptions. In other words, the rule of supremacy of the majority is subject to certain exceptions and thus, minority shareholders are not left helpless, but they are protected by:

- (a) the common law; and
- (b) the provisions of the Companies Act, 1956.

Actions by Shareholders in Common Law

The cases in which the majority rule does not prevail are commonly known as exceptions to the rule in *Foss v. Harbottle* and are available to the minority. In all these cases an individual member may sue for declaration that the resolution complained of is void, or for an injunction to restrain the company from passing it. The said rule will not apply in the following cases;

(1) *Ultra Vires Acts*

Where the directors representing the majority of shareholders perform an illegal or ultra vires act for the company, an individual shareholder has right to bring an action.

(2) *Fraud on Minority*

Where an act done by the majority amounts to a fraud on the minority, an action can be brought by an individual shareholder.

(3) *Wrongdoers in Control*

If the wrongdoers are in control of the company, the minority shareholders' representative action for fraud on the minority will be entertained by the court [Cf. *Birch v. Sullivan*, (1957) 1 W.L.R. 1274].

(4) *Resolution requiring Special Majority*

A shareholder can sue if an act requires a special majority but is passed by a simple majority.

(5) *Personal Actions*

Individual membership rights cannot be invaded by the majority of shareholders.

(6) *Breach of Duty*

The minority shareholder may bring an action against the company, where although there is no fraud, there is a breach of duty by directors and majority shareholders to the detriment of the company. [*Daniels v. Daniels*, (1978) 2 W.L.R. 73]

(7) *Prevention of Oppression and Mismanagement*

The minority shareholders are empowered to bring action with a view to preventing the majority from oppression and mismanagement.

Statutory Remedies (under the Companies Act) with reference to Prevention of Oppression and Mismanagement

Prevention of Oppression (Section 397)

The first remedy in the hands of an oppressed minority is to move the Company Law Board. Section 397 provides that any member of a company who complain that the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member(s) (including any one or more of themselves) may make an application to the Company Law Board by way of petition for relief.

On being satisfied about the above requirements, the Company Law Board may make the necessary orders for ending the matters complained of.

Prevention of Mismanagement (Section 398)

Section 398 provides for relief in cases of mismanagement. For a petition under this section to succeed, it must be established that the affairs of the company are being conducted in a manner prejudicial to the interest of the company or public interest, [(Section 398 (1) (A)] or that, by reason of any change in the management or control of the company, it is likely that the affairs of the company will be conducted in that manner [(Section 398 (1) (b)]. If the court is so convinced, it may, with a view to bringing to an end or preventing the matter complained of or apprehended, make such order as it thinks fit [Section 398 (2)].

Question 3

- (a) *When is a trust said to be extinguished and when revoked ?* (8 marks)
- (b) *An existing company wants to commence a new business. Elucidate the procedure laid down therefor.* (8 marks)

Answer 3(a)

Indian Trust Act, 1882 defines trust as an obligation annexed to the ownership of property and arising out of confidence reposed in and accepted by the owner or declared and accepted by him for the benefit of audit or of another and the owner. Trust connotes a legal relationship created for lawful purposes only.

A Trust is extinguished:

- (i) when its purpose is completely fulfilled or
- (ii) when the purpose of the trust becomes unlawful or
- (iii) when the fulfillment of the purpose of the trust becomes impossible by destruction of the trust property or otherwise or
- (iv) when the trust being revocable is revoked.

When a trust is revoked:

- I. If a trust is created by a will it may be revoked by the revocation of the trust.
- II. If the trust has been created otherwise than by a will or orally, it can be revoked only
 - (a) with the consent of all the beneficiaries competent to contract;
 - (b) by the exercise of power of revocation expressly reserved by the author of the trust in case of trusts declared orally or by non-testamentary instruments or
 - (c) where the trust is created for the payment of debts of the author of the trust and has not been communicated to the creditors, at the pleasure of the author of the trust. However, if the creditors are parties to the agreement creating the trust, the trust cannot be revoked without their consent.

A trust is generally irrevocable unless a power of revocation is expressly reserved.

Answer 3(b)

According to the clarification given by the Department of Company Affairs (Now, Ministry of Corporate Affairs), new business means a business which is not germane to the existing business carried on by the company. The guiding criterion is, therefore, whether the new activity is germane to the original business or not. In case the reply is 'yes', no special resolution is necessary and vice versa.

Section 13 requires that every company formed on or after October 15, 1965 must state in its memorandum (i) the main objects to be pursued by the company on its incorporation and objects incidental or ancillary to the attainment of the main objects; (ii) other objects not included in (i) above, separately.

Procedure in case an existing company wants to commence a new business.

1. Call a board meeting after giving notice to all the directors of the company and approve the commencement of new business.
2. Convene the general meeting by passing a special resolution by three-fourth majority.
3. Forward three copies of the notices and a copy of the proceedings of the General Meeting to the Stock Exchange with which the shares of the company are listed. This is required in case of a listed company.
4. File the special resolution with the concerned ROC in e-form 23 within thirty days of the passing thereof.
5. The Central Government, may, however, on application by the Board of directors allow the company to commence new business, even if the special resolution is not passed by the company in general meeting, but passed by a simple majority.
6. It also requires the filing with the Registrar a declaration in e-Form No. 20A verified by one of the directors or the secretary or where the company has not appointed a secretary, a secretary in whole-time practice, that the approval by special resolution has been given by the company in general meeting.

However, the above procedure does not apply to a private company which can commence any new business permitted by the Memorandum of Association after passing a board resolution.

Question 4

Write short notes on any four of the following :

- (i) Government company*
- (ii) Doctrine of ultra vires*
- (iii) Multi-State co-operative societies*
- (iv) Investor Education and Protection Fund*
- (v) Audit committee.*

(4 marks each)

Answer 4(i)**Government company**

Government Company is defined as any company in which not less than fifty one percent of the paid up share capital is held by

- (1) Central Government or
- (2) Any state Government or
- (3) State Governments or
- (4) Partly by Central and partly by State Govt.

A subsidiary of a Government company is also treated as Government Company.

The provisions of Companies Act, 1956 also apply to Government companies but with exemptions which can be summarized as under:

- 1. Sections 255, 256 & 257 regarding appointment and retirement of directors.
- 2. Section 297 -contracts entered into with any other Government company.
- 3. Section 205A regarding transfer of unpaid dividend to special dividend account.
- 4. Provisions regarding managerial remuneration.
- 5. Section 187C - disclosure of beneficial interest.
- 6. Section 295 regarding loans to directors.
- 7. Sections 165, 187D, 294, Section 294AA.
- 8. Section 43A, 149(2A) 205B, 263 to 266, 307, 308,316,317 & 356.
- 9. Section 108.

Answer 4(ii)**Doctrine of ultra vires**

The word 'ultra' means beyond and the word 'vires' means the powers. In the case of a company whatever is not stated in the memorandum as the objects or powers is

prohibited by the doctrine of ultra vires. As a result, an act which is *ultra vires* is void, and does not bind the company. Neither the company nor the other contracting party can sue on it. Also, as stated earlier, the company cannot make it valid, even if every member assents to it.

The general rule is that an act which is ultra vires the company is incapable of ratification. An act which is intra vires the company but outside the authority of the directors may be ratified by the company [*Rajendra Nath Dutta v. Shilendra Nath Mukherjee*, (1982) 52 Comp. Cas. 293 (Cal.)].

The rule is meant to protect shareholders and the creditors of the company. But if the act is ultra vires (beyond the powers of) the directors only, the shareholders can ratify it. Or if it is ultra vires the articles of association, the company can alter its articles in the proper way.

The doctrine of ultra vires was first enunciated by the House of Lords in a classic case, *Ashbury Railway Carriage and Iron Co. Ltd. v. Riche*, (1878) L.R. 7 H.L. 653.

Answer 4(iii)

Multi-State co-operative societies

A co-operative society which operates in more than one state is called Multi State Co-operative society. Such societies are registered under Multi State Co-operative Act to serve the interest of members in more than one state with the object to promote the economic and social betterment of its members, mutual aid and in accordance with the co-operative principles. Multi state co-operative society is required to be registered with the Central Registrar of Co-operative societies, New-Delhi. Membership of multi state co-operative societies is open to:

- (1) An individual competent to contract under Section 11 of the Indian Contract Act (which means the individual should be a major and of sound mind and is not disqualified for contracting according to the law to which he is subject).
- (2) Any Multi-State Co-operative Society or any Co-operative Society.
- (3) The Central Government.
- (4) The State Government.
- (5) The National Co-operative Development Corporation.
- (6) Any other Corporation owned or controlled by the Government.
- (7) Any Government company as defined in Section 617 of the Companies Act, 1956.
- (8) Such class or classes of persons or association of persons as may be permitted by the Central Registrar having regard to the nature and activities of a multi-state co-operative society.

Answer 4(iv)

Investor Education and Protection Fund

As per Section 205 C inserted w.e.f. 31.10.1988 in the Companies Act, 1956 the Central Government has established a fund called the Investor Education and Protection Fund.

Following amounts shall be credited to the said fund:

- (a) amounts in the unpaid dividend accounts of companies;
- (b) the application moneys received by companies for allotment of any securities and due for refund;
- (c) matured deposits with companies;
- (d) matured debentures with companies;
- (e) the interest accrued on the account referred to in clauses (a) to (d);
- (f) grants and donations given to the Fund by the Central Government, State Government, companies or any other institutions for the purposes of the Fund; and
- (g) the interest or other income received out of the investments made from the Fund.

The amounts at points (a) to (d) above shall not form part of fund unless such amounts have remained unclaimed or unpaid for a period of 7 years from the date they become due for payment.

The company when effecting a credit to the account of the fund, is required to separately furnish to the Registrar of Companies a statement in e-form 1.

Answer 4(v)

Audit Committee

Section 292A of the Companies Act, 1956 contains provisions for constitution of Audit Committee. According to it, Audit Committee must have a minimum of three members. Two-thirds of the total number of members should be non-executive directors. The remaining one-third members may be executive directors (managing and/or whole-time directors). There is no limit on the maximum number. This is a "committee of the Board"; hence it must consist only of directors. A person who is not a director of the company cannot be appointed as a member of the Audit Committee although such person can be invited by the Board at its discretion.

Unlike clause 49 of the Listing Agreement, Section 292A does not spell out functions and duties of Audit Committee. It has left that to the Board to decide. The power of electing a chairman of Audit Committee is vested in the Committee. The composition of Audit Committee must be disclosed by the company in every Annual report.

According to Sub-section (5), the auditors, the internal auditor, if any, and the director-in-charge of finance shall attend and participate at meetings of the Audit Committee but shall not have the right to vote. This Sub-section enjoins on Audit Committee to interact with the statutory auditors concerning the matters specified in it. Secondly, it enjoins to review the half-yearly and annual financial statements before submission to the Board. Thirdly, it enjoins to ensure compliance of internal control systems. Audit Committee has been given power to have "full access to information contained in the records of the company" and also external professional advice, if necessary.

The recommendations of the Audit Committee on any matter relating to financial management, including the audit report, shall be binding on the Board. In case the Board

wants to disregard the recommendations, the Board shall record its reasons for denying the same. The chairman of the Audit Committee is required to attend the annual general meetings of the company to provide any clarification on matters relating to audit.

Question 5

- (a) Choose the most appropriate answer from the given options in respect of the following :
- (i) Promoter is a person who is :
 - (a) Elected as director
 - (b) Appointed as chairman
 - (c) Appointed as managing director
 - (d) Engaged in promoting a company.
 - (ii) Minimum number of directors which every public limited company should have is :
 - (a) 5
 - (b) 10
 - (c) 3
 - (d) 7.
 - (iii) Maximum number of companies in which an individual can become director is :
 - (a) 20
 - (b) 50
 - (c) 15
 - (d) 5.
 - (iv) Maximum value of shares an investor must hold to become a 'small shareholder' is :
 - (a) Rs. 10,000
 - (b) Rs. 5,000
 - (c) Rs. 25,000
 - (d) Rs. 20,000.
 - (v) Percentage of deposits maturing in a year that is to be placed in a bank account is :
 - (a) 20%
 - (b) 15%
 - (c) 30%
 - (d) 5%.
 - (vi) A private limited company can commence its business after obtaining :
 - (a) Certificate of commencement of business
 - (b) Certificate of incorporation

(c) Approval from Central Government

(d) Approval from Registrar of Companies. (1 mark each)

(b) Following information has been extracted from the balance sheet of Richy Rich Ltd. :

(i) Paid-up share capital	Rs. 20 crore
(ii) Reserves and surplus	Rs. 80 crore
(iii) Capital reserve	Rs. 5 crore
(iv) Investment in securities	Rs. 10 crore
(v) Loan to companies	Rs. 30 crore

DEF Ltd. has requested Richy Rich Ltd. for a loan of Rs. 50 crore which the Board of directors will consider at its ensuing meeting. Explain the legal position and advise the Board. (10 marks)

Answer 5(a)(i)

(d) Engaged in promoting a company.

Answer 5(a)(ii)

(c) 3.

Answer 5(a)(iii)

(c) 15.

Answer 5(a)(iv)

(d) Rs. 20,000.

Answer 5(a)(v)

(b) 15%.

Answer 5(a)(vi)

(b) Certification of Incorporation.

Answer 5(b)

As per Section 372A of the Companies Act, 1956 a company can give loan/give guarantee etc. to companies to the extent of 60% of its paid up capital and free reserves or 100% of free reserves, whichever is higher, with the prior approval of the Board. Any investment, or loan or, guarantee beyond this limit can be made with the previous approval of the members in general meeting by way of special resolution.

In case of Richy Rich Ltd. the limit upto which the company can give loans/give guarantee is as follows:

Paid up capital	Rs. 20 crores
Free Reserves	Rs. 80 crores
Total	Rs. 100 crores

60% of Rs.100 crores	Rs. 60 crores
100% of free reserves	Rs. 80 crores

As 100% of free reserves i.e. Rs. 80 crores is more than 60% of paid up share capital and free reserve i.e. Rs. 60 crores, therefore, the overall limit for release of loan is Rs. 80 crores.

The company can give loan/give guarantee upto Rs. 80 crores without obtaining approval of members.

Existing Loans	:	Rs. 30 crores
Investment in securities	:	Rs. 10 crores
Total		Rs. 40 crores
Proposed loan to DEF Ltd.		Rs. 50 crores
Total loan and Investments		Rs. 90 crores

It can be seen that the total loan/investment exceeds the limit of 60% of paidup capital and free reserves and 100% of free reserves. Thus, a loan of Rs. 50 crores can be given to DEF Ltd. with the previous approval of the members by passing a special resolution in a general meeting as required under Section 372A of the Companies Act, 1956.

However, in case of a listed company, the special resolution required must be passed through postal ballot in accordance with rule 4 of the Companies (Passing of the Resolution by Postal Ballot) Rules, 2001.

Question 6

- (a) *Ajay sold his shares and executed a transfer deed in favour of Vijay. The documents were lodged for transfer with the company. However, before effecting and registering the transfer by the company, Ajay, the transferor passed away. What is the impact of the death of Ajay on the registration of transfer of shares in favour of Vijay, if the death of Ajay is – (i) intimated to the company before the registration; and (ii) intimated to the company after registration of the transfer of the shares in favour of Vijay ?*
- If Vijay dies before registration of the transfer of shares, what will be the consequences — (i) if the death of Vijay is intimated to the company before registration of transfer; and (ii) if the death of Vijay is not intimated to the company before the registration of transfer ? (8 marks)*
- (b) *Two companies are incorporated with the same set of shareholders. Are they same or distinct under the Companies Act, 1956 ? Discuss. (4 marks)*
- (c) *The entire assets of a company are acquired by another company. Will it constitute taking over the management of the company ? Why ? (4 marks)*

Answer 6(a)

In accordance with Section 108(1) of the Companies Act, 1956 a company shall register the transfer of shares when a proper instrument of transfer duly stamped and

executed by or on behalf of the transferor, and transferee has been delivered to the company along with the share certificates.

In the given case Ajay sold his shares by executing a transfer deed in favour of Vijay and such documents were lodged for transfer. Therefore, if Ajay, the transferor dies, the company would register the transfer in both cases i.e. where the death of Ajay is intimated to company before registration of transfer and where death is intimated after registration of transfer.

If Vijay, the transferee dies before registration, and company has notice of his death, transfer of shares cannot be registered in the name of the Vijay who has already deceased. With the consent of the transferor and the legal representatives of the transferee, the transfer may be registered in the name of the legal heirs of the Vijay (who has already died) or his nominee, if any. But if there is a dispute, an order of the Court will be insisted by the company before effecting the transfer.

In case, the death of Vijay is not notified to the company, the company can register the transfer in the name of the deceased transferee, in as much as the company is not aware of the death of the transferee and the transfer is done bonafide by the company, as per the information available with it.

Answer 6(b)

On incorporation, a company becomes a separate legal person in the eyes of law. The company is vested with a corporate personality quite distinct from individuals who are its members. Being a separate legal entity it bears its own name and acts under a corporate name. It has a seal of its own. Its assets are separate and distinct from those of its members. It is also a different 'person' from the members who compose it. As such it is capable of owning property, incurring debts, borrowing money, having a bank account, employing people, entering into contracts and suing or being sued in the same manner as an individual. As such two companies which are incorporated with the same set of shareholders are nevertheless distinct and separate entities [*Patinson v. Bindya Debi* AIR 1933 Pat 196]. [*Theory of Corporate Veil; Saloman v. Saloman & Co. Ltd.*]

Answer 6(c)

The company has an identity and existence independent of the estate and undertaking owned by it. As such, even if the entire estate or assets are taken over by the govt. by an order such action does not constitute a taking over of the management of the company.

In the case of [*Gopalpur Tea Company v. Peshok Tea Company Ltd.* (1982) 52 Com Cases 239, 241 (Cal)], a similar issue was encountered. It was held that what had been taken over was only the estate of the company and not the company itself. There can be no doubt that in law the company, as constituted under the Indian Companies Act, has an identity and existence independent of the estate owned by it so that even if the estate is taken over by the Central Govt., that does not constitute a taking over of the management of the company.

Question 7

- (a) Explain 'independent director' and 'inside director'. Does inside director and interested director connote the same meaning ? (5 marks)

- (b) *Companies are required to obtain Secretarial Compliance Certificate in certain cases. What are these ? Who is competent to issue the said certificate ?*
(5 marks)
- (c) *When is dividend payable ? When may dividend be payable out of capital profits ?*
(6 marks)

Answer 7(a)

Independent Director

In clause 49 of the Listing Agreement, independent director is defined as a non-executive director of the company who

- (a) apart from receiving director's remuneration does not have any material pecuniary relationships or transactions with the company, its promoters, its senior management or its holding company, its subsidiaries and associated companies;
- (b) is not related to promoters or management at the Board level or at one level below the Board;
- (c) has not been an executive of the company in the immediately preceding three financial years;
- (d) is not a partner or executive of the statutory audit firm or the internal audit firm that is associated with the company and has not been a partner or an executive of any such firm for the last three years. Similar provisions are applicable for legal firms and consulting firm that have material association with the company;
- (e) is not a supplier, service provider or customer of the company. This should include also include the relationship of lesser and lessee;
- (f) is not a substantial shareholder of the company holding two or more percent of the block of voting shares.

However, independent directors on the Board of Companies shall be considered as independent director whether the institution is an investing institution or a lending institution.

Inside directors are those who are in the whole-time employment of a company which includes the Managing Director, Executive Director, whole-time Director, Technical Director etc.

Interested director means any director whose presence cannot by reason of Section 300, count for the purpose of forming quorum at a meeting of the Board at the time of discussion or vote on any matter in which such director is interested or interested. The interest should be specifically indicated at the meeting before the related matter is taken up.

In view of the above, it can be concluded that inside director and interested director connote two different aspects and generally do not mean the same thing.

Answer 7(b)

Instances where a company is required to obtain Secretarial Compliance Certificate

Every company which is not required to employ a whole-time secretary under Section 383A(1) and having a paid-up capital of rupees ten lakhs and more are required

to obtain Secretarial Compliance Certificate from a secretary in whole-time practice in such form and within such time and subject to such conditions as may be prescribed as to whether the company has complied with all the provisions of the Act and file the same with the Registrar of Companies as also attach the same with the Directors' Report referred to in Section 217 of the Act. The certificate is required to be filed along with e-form 66 as an attachment within 30 days from the date of the Annual General Meeting.

Person competent to issue the secretarial compliance certificate

Only a secretary in whole-time practice is competent to issue the Secretarial Compliance Certificate as provided under Section 383A(1).

Obtaining Secretarial Compliance Certificate and submission of the same by a company which required to appoint a whole-time Secretary cannot be treated as a substitute for such appointment.

Answer 7(c)

When Dividend is payable

Under Section 207 of the Companies Act, 1956, dividend has to be distributed within 30 days of the declaration. Posting of dividend warrants within 30 days will be deemed to be payment irrespective of the fact whether the warrant has been encashed or not under [Regulation 91 of Table A of Schedule I to the Act]. In the case of joint holders, the warrant has to be sent to the registered address of the first named joint holder or to such person and to such address as the joint holders may in writing direct.

Exceptions

In the following circumstances dividend need not be paid within 30 days of declaration:

- (i) Where dividend could not be paid by reason of the operation of any law e.g. in the case of non-residents, dividend need not be paid within 30 days if permission for remittance where required has not been received therefor from the Reserve Bank of India within 30 days;
- (ii) Where a shareholder has given directions to the company regarding the payment of dividend and these directions cannot be complied with;
- (iii) Where there is a dispute regarding the right to receive dividend;
- (iv) Where the dividend has been lawfully adjusted by the company against any sum due to it from the shareholder; or
- (v) Where for any other reason for failure to pay the dividend or to post the warrant was not due to any default on the part of the company.

When Dividend is payable out of capital profits

Capital profits means those profits which arise otherwise than in the normal course of the business and earned out of capital transactions such as profit on sale of fixed assets, re-issue of forfeited shares, share/debenture premium etc.

The Companies Act does not mention specifically whether capital profits can be

distributed as dividend. However, the Courts have held that capital profits cannot be considered as available for distribution as dividend unless –

- (i) the Articles of Association authorize such a distribution; and
- (ii) the surplus is realized and remain after a valuation of the whole of the assets and liabilities.

Question 8

Distinguish between the following :

- (i) 'Company' and 'co-operative society'.
- (ii) 'Shares in physical form' and 'shares in dematerialised form'.
- (iii) 'Certificate of incorporation' and 'certificate of commencement of business'.
- (iv) 'Mortgage' and 'charge'. (4 marks each)

Answer 8(i)

'Company' and 'Co-operative society'

<i>Company</i>	<i>Co-operative society</i>
1. Registered under the Companies Act,	1. Registered under the Co-operative societies act.
2. Functioning of companies is regulated by Companies Act and rules framed thereunder.	2. Functioning of Co-operative societies is governed and regulated by Co-operative societies act and rules framed thereunder.
3. Voting rights of members in case of poll at general meeting is as per number of shares held by a shareholder i.e. One share - one vote.	3. Voting right at general meeting is one man-one vote.
4. Aim of Companies is to earn profit.	4. Principle of co-operation is to provide service to the members rather than making profits.
5. There are no concessions from the Govt. in respect of taxes, excise etc.	5. There are number of concessions available to co-operative societies in respect of taxes, stamp duty etc.

Answer 8(ii)

'Shares in physical form' and 'shares in dematerialized form'

<i>Shares in physical form</i>	<i>Shares in dematerialized form</i>
1. Share certificates are issued in physical form.	1. Shares are issued in electronic form.
2. For share transfer form 7B has to be executed.	2. No form is necessary for transfer. Only delivery instructions of depository participant are essential.

<i>Shares in physical form</i>	<i>Shares in dematerialized form</i>
3. No necessity of opening account with any body.	3. It is necessary to open a demat account with depository participant.
4. Transfer of shares takes longer time due to physical transit of documents.	4. It does not take time for transfer.
5. Stamp duty is to be paid on transfer deed.	5. No stamp duty is to be paid on transfer.
6. There are chances of thefts, forgery etc.	6. The chances of theft, forgery are remote.
7. Chances of bad delivery are there.	7. There are no chances of bad delivery.

Answer 8(iii)**‘Certificate of incorporation’ and ‘certificate of commencement of business’**

<i>Certificate of incorporation</i>	<i>Certificate of commencement of Business</i>
1. A certificate of incorporation is issued whereby the Registrar certifies under his hand that the company is incorporated and, in the case of a limited company, that the company is limited. [Section 34(1)].	1. When the company fulfils the conditions stated under Section 149(1) and (2), the Registrar certifies that it is entitled to commence business and that the certificate shall be conclusive evidence that the company is so entitled. [Section 149(3)].
2. From the date of incorporation mentioned in the certificate of incorporation, such of the subscribers of the memorandum and other persons, as may from time to time be members of the company, shall be a body corporate by the name contained in the memorandum. It becomes capable of exercising all the functions of an incorporated company having perpetual succession and a common seal. [Section 34(2)].	2. A certificate of commencement of business empowers a public company having a share capital to commence business and exercise its borrowing powers.
3. Certificate of incorporation is must for each company.	3. A private company can commence business immediately after obtaining certificate of incorporation.
4. The certificate of incorporation is the birth certificate of a company.	4. The certificate of commencement of business is a certificate that the company is entitled to commence business.

<i>Certificate of incorporation</i>	<i>Certificate of commencement of Business</i>
5. The documents to be filed with ROC for getting Certificate of Incorporation are Memorandum of Association, Articles of Association, e-form 18, e-form 32 and e-form 1.	5. The documents to be filed with ROC for getting Certificate of Commencement of Business are either e-form 19 alongwith copy of prospectus as an attachment or e-form 20 alongwith copy of statement in lieu of prospectus as an attachment.

Answer 8(iv)**'Mortgage' and 'Charge'**

<i>Mortgage</i>	<i>Charge</i>
(a) Mortgage is created by act of parties.	(a) Charge may be created by act of parties or by operation of law.
(b) Mortgage requires registration prescribed under Transfer of Property Act.	(b) Charge created by act of parties required registration.
(c) A mortgage is for a fixed term.	(c) A charge may be in perpetuity.
(d) Simple mortgage carries personal liability unless excluded by express contract.	(d) In case of charge, no personal liability is generally created.
(e) Mortgage is transfer of an interest in a specific immovable property.	(e) A charge only gives a right to receive payment out of charged property.
(f) A mortgage is good against subsequent transferees.	(f) Charge is good against subsequent transferees with notice.

COMPANY SECRETARIAL PRACTICE

Time allowed : 3 hours

Maximum marks : 100

- NOTE :** 1. Answer SIX questions including Question No. 1 which is **COMPULSORY**.
2. All references to sections relate to the Companies Act, 1956 unless stated otherwise.

Question 1

Draft any four specimen resolutions with requisite explanatory statement, wherever necessary, for transacting the following items of business indicating the kind of meeting at which each resolution is to be passed and the type of resolution required for :

- (i) *Buy-back of equity shares upto 15% by a listed company.*
 - (ii) *Adoption of annual report by Divakar Ltd. for the year ended 31st March, 2008.*
 - (iii) *Appointment of auditors Shankar & Co. in place of Sundar & Co., who resigned from the office of auditors.*
 - (iv) *Adoption of common seal of the company.*
 - (v) *Alteration of objects clause.*
- (5 marks each)

Answer 1(i)

Type of Resolution : *Special Resolution*

Kind of Meeting : *To be passed through Postal Ballot*

“RESOLVED that, pursuant to Section 77A and other applicable provisions of the Companies Act, 1956 and the Securities & Exchange Board of India (Buy-Back of Securities) Regulations, 1998 and subject to such approvals, permissions and sanctions as may be necessary and agreed to by the Board of Directors of the Company, the consent of the members be and is hereby accorded to the Board to buy-back, at its sole discretion at such time as it may consider appropriate, upto 15% of the paid-up equity share capital and free reserves of the Company, at a price not exceeding Rs.100 per equity share from the equity shareholders of the Company, through tender offer on a proportionate basis.”

“RESOLVED FURTHER that the Board be and is hereby authorised to do all such acts, deeds, matters and things as it may deem necessary, in relation to the implementation of the scheme of buy-back”.

Explanatory Statement

As per the requirements of Sections 173(2) and 77A and other applicable provisions of the Companies Act, 1956, and the Securities & Exchange Board of India (Buy-Back of Securities) Regulations, 1998, the following details are furnished to the shareholders:

1. The Company intends to acquire upto 15% of the fully paid-up equity share capital of the Company, at a price not exceeding Rs. 100 per equity share aggregating to Rs. 55 crores from the equity shareholders other than the promoters and persons in control of the Company.

2. The Board of Directors at the meeting held on 30th August 2007, considered and approved the proposal for buy-back of its equity shares by the Company.
3. The Company is proposing the buy-back to provide an exit opportunity at a reasonable price and to enhance the overall shareholders value.
4. The Company will adopt the “Tender Offer” method to buy-back the equity shares of the Company on a proportionate basis.
5. A maximum amount of Rs.55 crores is required for the buy-back and the same is proposed to be financed entirely out of internal accruals.
6. The buy-back is expected to be completed within 12 months time as permitted under the Companies Act, 1956 although the company will endeavour to complete the process at an early date.
7. The maximum buy-back price of Rs.100 has been arrived at taking into account the trends in the market price of the equity shares of the Company and the Board is also authorized to determine the specific price (within the maximum price) at which buy back may be made.
8. (a) The aggregate shareholding of the promoters as on date of the notice is 83,02,576 equity shares of Rs.10 each constituting 24.72% of the equity share capital of the Company.
(b) The promoters have purchased an aggregate of 6193 equity shares during the period of six months preceding the date of the Board meeting at which the buy back was approved and from the date of Board Meeting till the date of notice of postal ballot and have not sold any shares of the Company in the said period.
9. The promoters do not intend to participate in the buy-back.
10. The Directors confirm that there are no defaults subsisting in repayments of deposits, redemption of debentures or preference shares or repayment of term loans to any financial institution or bank.
11. The Directors confirm that :
 - (a) Immediately following the date on which the results of postal ballot are declared, there are no grounds on which the company could be found unable to pay its debt.
 - (b) As regards its prospects for the year immediately following the date of declaration of results of postal ballot, the company will be able to meet its liabilities as and when they fall due and will not be rendered insolvent within a period of one year from that date.
12. None of the Directors are interested.

Answer 1(ii)

Type of Resolution : *Ordinary Resolution*

Kind of Meeting : *Annual General Meeting*

“RESOLVED THAT the audited Balance Sheet of the Divakar Ltd. as at 31st March, 2008 and Profit and Loss Account for the year ended 31st March, 2008 be and are

hereby adopted alongwith the schedules and notes thereof and the Reports of the Directors and Auditors thereon”.

Answer 1(iii)

Type of Resolution : *Ordinary Resolution*

Kind of Meeting : *General Meeting*

“RESOLVED THAT, pursuant to proviso to Sub-section (6)(a) of Section 224 of the Companies Act, 1956, M/s Shankar & Co., Chartered Accountants, New Delhi, be and are hereby appointed as auditors of the company to fill the vacancy caused by the resignation of M/s Sundar & Co., Chartered Accountants, New Delhi, present auditors of the company, to hold the office from the date of this meeting until the conclusion of the next annual general meeting of the company on a remuneration of Rs..... plus reimbursement of out-of-pocket expenses that may be incurred by the auditors in the performance of their duties as auditors of the company.”

Explanatory Statement

Proviso to Section 224(6)(a) of the Companies Act, 1956, lays down that where vacancy in the office of an auditor is caused by the resignation of the existing auditor, the vacancy shall be filled only by the company in general meeting. Hence this is the resolution for approval by the members.

The letter of resignation of M/s Sundar & Co., may be inspected at the registered office of the company at 5th August, 2008 during the business hours on any working day.

None of the directors is interested or concerned in the proposed resolution.

Answer 1(iv)

Type of Resolution : *Board Resolution*

Kind of Meeting : *Board Meeting*

“RESOLVED THAT the common seal of the company, the impression of which appears in the margin against this resolution, be and is hereby approved and adopted as the common seal of the company.”

“Impression of the Common Seal.”

‘RESOLVED FURTHER that the Common Seal of the Company be kept in the safe custody of the Company Secretary of the Company.’

Answer 1(v)

Type of Resolution : *Special Resolution*

Kind of Meeting : *General Meeting*

“RESOLVED that pursuant to the provisions of Section 17 of the Companies Act, 1956, Clause 3 being the objects clause of the Memorandum of Association of the company be altered as follows :

- (i) To substitute the following sub-clause in place of the existing sub-clause (h):
 - (h) to borrow or raise money or to invite, receive or accept money on deposit for the purposes of the company (not amounting to the business of banking

as defined under the Banking Regulation Act, 1949) in such manner and upon such terms and conditions as may seem expedient and to secure or arrange the repayment thereof by the company and create, issue and allot redeemable or irredeemable bonds, mortgages or other instruments, mortgage debentures, secured or unsecured debentures issuable or payable either at par or at premium or discount or as partly or fully paid and for any such purposes to charge all or any part of the property and profits of the company both present and future including its uncalled capital”.

Explanatory Statement

Your Board has to consider from time to time proposals for diversification into areas which would be profitable for the company as part of diversification plans. For the purpose the objects clause of the company which is presently very restricted in scope, requires to be so made out as to cover a wide range of activities to enable your company to consider embarking upon new projects and activities considered to be convenient, advantageous and feasible for the company's business. Certain incidental powers are also being added for the convenience of the Company's operations. Your Directors recommend that the special resolution be passed.

None of the Directors of the Company is interested or concerned in the said resolution except as members of the Company.

Question 2

- (a) *Re-write the following sentences after filling-up the blank spaces with appropriate word(s)/figure(s) :*
- (i) *The register of members cannot be closed for a period exceeding _____ at any one time.*
 - (ii) *A company having paid-up share capital of not less than Rs. _____ must appoint a whole-time Secretary and such Secretary must be a member of the Institute of Company Secretaries of India.*
 - (iii) *As per Section 198, total managerial remuneration payable by a public company in respect of any financial year shall not exceed _____ of the net profit of that company.*
 - (iv) *Appointment of auditors in a company in which paid-up capital is held to the extent of 30% by Central Government, State Government and public sector banks shall require passing of _____.*
 - (v) *Board's report in the absence of chairman must be signed by _____.*
 - (vi) *Full amount of dividend payable must be deposited with a scheduled bank within _____ of its declaration.*
 - (vii) *Every director must disclose his interest or concern in any company or firm under section _____ of the Companies Act, 1956.*
 - (viii) *A legal heir of the deceased member can obtain his shares by means of _____. (1 mark each)*

- (b) *Aman Ltd. has resolved at its annual general meeting to shift its registered office from Mumbai to some other place in the State of Maharashtra, which falls in the jurisdiction of other Registrar of Companies. In terms of Section 17A, Aman Ltd. filed e-Form 1AD with Regional Director along with enabling fee and the following documents :*

- (i) *certified copy of minutes of the annual general meeting; and*
- (ii) *certified copy of newspaper advertisement.*

After scrutiny of the filed form, the Regional Director rejected the request of Aman Ltd. In terms of provisions of Section 17A, what remedy is available to Aman Ltd. ? (4 marks)

- (c) *Mrs. Rakhi is a member of ABC Producer Company since its inception. She was so involved in the activities of the company that she acquired fullest knowledge of its activities, processes, marketing, etc. After gaining confidence of highest order, she got incorporated another XYZ Producer Company with the same objects and commenced its operations.*

At the meeting of the members of ABC Producer Company, other members objected to the continuation of the membership of Mrs. Rakhi. You are required to explain whether the objection raised by other members is valid or not.

(4 marks)

Answer 2(a)

- (i) The register of members cannot be closed for a period exceeding **30 days** at any one time.
- (ii) A company having paid-up share capital of not less than **Rs. 2 crores** must appoint a whole-time Secretary and such Secretary must be a member of the Institute of Company Secretaries of India.
- (iii) As per section 198, total managerial remuneration payable by a public company in respect of any financial year shall not exceed **11%** of the net profit of that company.
- (iv) Appointment of auditors in a company in which paid-up capital is held to the extent of 30% by Central Government, State Government and public sector banks shall require passing of **Special Resolution at Annual General Meeting**.
- (v) Board's report in the absence of chairman must be signed by **at least two directors one of whom must be the Managing Director of the Company, where there is one**.
- (vi) Full amount of dividend payable must be deposited with a scheduled bank within **Five days** its declaration.
- (vii) Every director must disclose his interest or concern in any company or firm under **Section 299** of the Companies Act, 1956.
- (viii) A legal heir of the deceased member can obtain his shares by means of **Transmission**.

Answer 2(b)

According to Section 17A of the Companies Act, 1956 a company can not change the place of its registered office from one place to another from the jurisdiction of one Registrar to another within the same State wherein more than one Registrars of Companies have jurisdiction, unless such change is confirmed by the concerned Regional Director.

Hence, a company, which needs to change its registered office within the same State but under the jurisdiction of another Registrar of Companies, shall after holding general meeting (annual or extra ordinary) and having passed special resolution to this effect, make application to the Regional Director in the Form 1AD for confirmation along with :

- (i) A fee of Rs. 500/-;
- (ii) Copy of the minutes of the meeting
- (iii) Copy of the newspaper advertisement;
- (iv) Particulars of investor grievances, if any; and
- (v) Any attachment to support the details of the prosecution filed against the company and its officers in default, if any.

In the given case, Aman Ltd. while filing application to ROC should have provided NIL report or relevant details for the particulars of investor grievances and prosecution filed against the company and its officers in default. On receiving the insufficient details, the Regional Director was constrained to reject the request of the Aman Ltd.

In view of the above, the remedy available to Aman Ltd. is to resubmit e-form 1AD to Regional Director alongwith full details as mentioned above to obtain its approval for shifting of its registered office from Mumbai to some other place in the state of Maharashtra, which falls in the jurisdiction of other Registrar of Companies.

Answer 2(c)

In terms of the provisions of Section 581D of the Companies Act, 1956, no person, who has business interest which conflicts with the business of the producer company, shall become a member of that company and if subsequently, a member acquires any business interest which is in conflict with the business of the producer company, he shall cease to be a member and be removed as a member in accordance with articles.

In view of the above, the objection raised by other members of ABC Producer company on the continuing membership of Mrs. Rakhi is valid. Infact Mrs. Rakhi shall cease to be a member of ABC Producer company, the moment she got the permission for incorporation of XYZ Producer company.

Question 3

- (a) *State the items that are to be covered under the director's responsibility statement prepared under Section 217(2AA).* (8 marks)
- (b) *Enumerate the matters to be passed by resolutions requiring special notice.* (5 marks)

- (c) *Name the secretarial standards issued by the Institute of Company Secretaries of India.* (3 marks)

Answer 3(a)

The Board's report shall also include a Directors' Responsibility Statement as required under Section 217(2AA) indicating therein

- (i) that in the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures;
- (ii) that the directors had selected such accounting policies and applied them consistently and made judgements 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 account of the company for that period;
- (iii) that the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;
- (iv) that the directors had prepared the annual accounts on a going concern basis.

Answer 3(b)

Matters which require special notice are :

- (a) A resolution at an annual general meeting appointing as auditor, a person other than a retiring auditor [Section 225(1)];
- (b) A resolution at an annual general meeting providing expressly that a retiring auditor shall not be reappointed [Section 225(1)];
- (c) A resolution to remove a director before the expiry of his period of office [Section 284(2)];
- (d) A resolution to appoint another director in place of the removed director [Section 284(2)];
- (e) Where the articles of a company provide for the giving of a special notice for a resolution in respect of any specified matter or matters.

Answer 3(c)

Secretarial Standards issued by the Institute of Company Secretaries of India

SS-1 – Meetings of the Boards of Directors

SS-2 – General meetings

SS-3 – Dividend

SS-4 – Registers and Records

SS-5 – Minutes

SS-6 – Transmission of Shares and Debentures.

Question 4

- (a) *What are the duties of a Company Secretary in respect of holding an extra-ordinary general meeting ?* (10 marks)
- (b) *When does a small shareholders' director vacate office ?* (6 marks)

Answer 4(a)

The duties of the company secretary in connection with holding extra ordinary general meeting are :

(A) Before the Meeting :

- (1) To convene a Board meeting after giving notice as per Section 286, in consultation with the chairman or the managing director to transact the following business :
 - (i) To approve agenda for the proposed extraordinary general meeting;
 - (ii) To approve notice for the meeting and also the explanatory statement in compliance with the provisions of Section 173 of the Companies Act, 1956;
 - (iii) To fix time, date and place for the meeting; and
 - (iv) To authorise the Company Secretary or any other competent officer to issue notice for the meeting.
- (2) To arrange for the printing of the notice along with its enclosures and to despatch notice at least 21 days before the date of the General Meeting. However, a shorter notice may be given if the same has been consented to by the members holding 95% of the total paid-up share capital of the company or having, if the company has no share capital, not less than 95% of the total voting power.
- (3) In case of listed company, send three copies of the notice to the Stock Exchange.
- (4) To make seating arrangement for the expected number of shareholders and to serve them with light refreshments. If the expected number is large, also arrange loud speakers and mike.

(B) At the Meeting :

- (1) To get attendance slip of members/proxies.
- (2) To check whether quorum is present for the meeting.
- (3) To read the notice, if directed by the chairman.
- (4) To take notes of the proceedings for preparing the minutes.
- (5) To assist the chairman and supply to him information's, clarifications, papers, registers, documents etc. that may be required by him for conducting the meeting.
- (6) To ensure that proxies, if any present at the meeting, do not speak on any matter before the meeting, unless the articles provide otherwise.
- (7) To make preparations for poll, if any, and to keep ballot papers ready.
- (8) To assist the scrutineers in scrutinising the votes cast in the event of a poll being demanded and allowed by the chairman, on any of the matters before the meeting.

(C) After the Meeting :

- (1) To prepare minutes of the proceedings of the meeting, get them approved by the chairman, record them or have them recorded in the Minutes Book and get the same signed by the Chairman or in the event of his inability to sign, to get them signed by a person so authorised by the Board, within thirty days of the meeting.
- (2) To send copies of the minutes to the stock exchange on which the shares of the company are listed.
- (3) To file with the Registrar of Companies e-Form No. 23 and other forms relevant to the decisions taken in the meeting, along with certified copies of the resolutions passed at the meeting, along with the prescribed filing fee, within thirty days of the meeting.
- (4) If the meeting has approved alteration of any of the clauses of the memorandum or any article in the articles of association of the company, to ensure that the alteration are carried out in all the printed copies with the company.
- (5) To take action on other decision of the shareholders.

Answer 4(b)

A person appointed as a small shareholders' director shall have to vacate office if :

- (i) such person so elected, as director of small shareholders' ceases to be a small shareholders' director on and from such date on which he ceased to be a small shareholder;
- (ii) he has been found to be of unsound mind by a court of competent jurisdiction and the finding is in force;
- (iii) he fails to pay any call in respect of shares of the company held by him, whether alone or jointly with others, within six months from the last date fixed for payment of the call;
- (iv) he absents himself from three consecutive meetings of the Board of directors or from all meetings of the Board for a continuous period of three months, whichever is longer, without obtaining leave of absence from the Board;
- (v) he is a partner of any private company of which he is a director, accepts a loan, or any guarantee or security for a loan, from the company in contravention of Section 295;
- (vi) he acts in contravention of Section 299;
- (vii) he becomes disqualified by an order of Court under Section 203;
- (viii) he is removed in pursuance of Section 284.

Question 5

- (a) *A company wishes to appoint a person, who is a relative of a director of the company, at a very senior position in the company. As a Company Secretary of that company, what steps would you take at the time of such appointment ?*

(5 marks)

- (b) Write a note on 'compliance certificate' under Section 383A. (5 marks)
- (c) What is the procedure adopted by the Board of directors at its meeting for making inter-corporate loans, investments, etc. ? (6 marks)

Answer 5(a)

The steps to be taken by a Company Secretary at the time of appointment of a person, who is a relative of a director of the company to hold an office or place of profit are :

- (1) A Board resolution needs to be passed for the appointment of a director or his relative to a place of profit. If the total monthly remuneration is not less than Rs. 10,000, the Board has to secure the approval of the shareholders by means of a special resolution.
- (2) The appointment should be approved by the Central Government if the total monthly remuneration of a relative of director is more than Rs. 50,000/-. For this purpose, application in e-form 24-B should be submitted to the Central Government along with the following attachments:
 - (i) Copy of the resolution passed by the Board of Directors relating to the appointment;
 - (ii) Copy of rules of the company relating to terms and conditions in regard to perquisites as applicable to its employees. If no rules exist, a certificate from the secretary or director of the company to the effect that similar perks at the same rates are being paid to the other employees of the company in the equivalent grade.
 - (iii) Shareholding pattern of the company;
 - (iv) An undertaking from the appointee that he will be in exclusive employment of the company and will not hold a place of profit in any other company,
 - (v) Copy of the minutes of the selection committee.
 - (vi) Particulars of the employees in receipt of remuneration of Rs. 50,000/- or more per month.
- (3) A copy of the application along with the enclosures should be filed with the Registrar of companies simultaneously.
- (4) The Central Government, shall on being satisfied, approve the appointment on such terms and conditions, as it may deem fit.
- (5) The notice of the general meeting should be sent to the members, directors and auditor of the company.
- (6) In case of a listed company, three copies of the notice of the meeting and abstract of term of contract should be sent to each of the stock exchanges in which the securities of the company are listed.
- (7) At the general meeting, the special resolution for appointment should be duly passed.

- (8) The minutes of the general meeting should be recorded and signed by the Chairman within 30 days of the meeting.
- (9) In the case of a listed company, copy of the proceedings of the meeting and the intimation regarding the appointment thereof should be sent to each of the stock exchanges in which the securities are listed.
- (10) Within 30 days of appointment, a return in e-form 23 should be filed with the Registrar of Companies together with the filing fees.

Answer 5(b)**Compliance Certificate under Section 383A**

Pursuant to the provisions of Section 383A of the Companies Act, 1956 every company having paid up share capital of Rs. 2 Crore or more shall have a whole time company secretary.

Provided that every company not required to have a whole time company secretary and having a paid up share capital of Rs. 10 lakh or more shall file with the Registrar of companies a certificate from the secretary in whole time practice in such form and within such time and subject to such conditions as may be prescribed, as to whether the company has complied with all the provisions of the Companies Act, 1956 and a copy of such certificate shall be attached with the Board's report to the members of the company under Section 217 of the Act. This certificate is called compliance certificate.

The Central Government has prescribed the Companies (Compliance Certificate) Rules, 2001 for issue of compliance certificate by a secretary in whole time practice. The Rules prescribe the form for compliance certificate. Thus, the Companies having paid up share capital of Rs. 10 lakhs or more but less than Rs. 2 Crores must obtain the compliance certificate and file the same with the ROC in e-form 66. The Compliance certificate shall also be attached with the Directors' Report to the shareholders.

Answer 5(c)**Procedure for inter-corporate loans/investments/giving guarantee/providing security**

A company which proposes to make inter corporate loans/give guarantee/provide security / make investments in another body corporate must follow the following procedure at the Board meeting :

Consider the proposal at its Board meeting and if the aggregate amount of the proposed loan / guarantee /security/investments are within the limits specified in Section 372A, then pass the resolution with the consent of all the directors present at the meeting specifying the limit for such loan/guarantee/ scrutiny/investment.

If the aggregate amount of proposed loan etc. exceeds the limits specified in Section 372A, then the Board should pass the resolution subject to approval by shareholders by special resolution at a general meeting. The Board shall fix time, date and venue for holding general meeting to pass the special resolution.

If the Board wants to give guarantee without being previously authorised by a special resolution then—

- (a) A resolution is required to be passed in a Board meeting to give guarantee as per Section 372A;
- (b) There must exist exceptional circumstances which prevent the company from obtaining previous approval by a special resolution; and
- (c) The Board resolution is required to be confirmed within 12 months in a general meeting of the company or the annual general meeting held immediately after passing of the Board resolution, whichever is earlier.

Question 6

- (a) *Vivek purchased 5,000 equity shares of Prosperous Ltd. and lodged the same for transfer with the company. The company returned these shares under objection that the share transfer stamps affixed on the transfer deed were not cancelled. Vivek thereafter cancelled the stamps and re-lodged the shares for transfer. At this time, the company effected the transfer and returned the duly transferred shares to Vivek. In the meantime, the market price of the shares went down substantially. Vivek filed a case against the company claiming that, due to unwarranted objection raised by the company, he was deprived of the profits which he could have earned by disposing of the shares at higher price. State with reasons whether the claim of Vivek is tenable. (6 marks)*
- (b) *The Board of directors of Swarn Ltd. had five directors. One of them died and the Board appointed Rajat in his place to fill-up the casual vacancy. However, Rajat resigned from the Board after two months of his appointment. The Board wishes to appoint Bhagat in place of Rajat to fill-up the casual vacancy. As a Company Secretary of that company, what would be your advice to the Board and why ? (5 marks)*
- (c) *On 14th March, 2007, Abhishek was appointed as additional director on the Board of directors of Amrit Ltd. The annual general meeting of the company was scheduled to be held on 25th September, 2007, but due to devastating fire all records of the company were destroyed. In order to re-build the records, the company approached the Registrar of Companies for extension of time for holding the annual general meeting till 30th November, 2007. As a Company Secretary of Amrit Ltd., what would be your advice to the Chairman about Abhishek, who was appointed as additional director during the year ? (5 marks)*

Answer 6(a)

Pursuant to the provisions of Section 108 (1) of the Companies Act, 1956, a company shall not register transfer of its shares unless a proper instrument of transfer, duly stamped and executed by or on behalf of the transferor and by or on behalf of the transferee and specifying the name, address and occupation, if any, of the transferee, has been delivered to the Company along with the certificate relating to the shares.

In the above sub-section, the words “Duly Stamped” are of great importance. Section 12 of the Indian Stamp Act provides that any instrument bearing an adhesive stamp which has not been cancelled so that it cannot be used again, shall, so far as

such stamp is concerned, be deemed to be unstamped. The share transfer stamps affixed on the share transfer form are required to be cancelled either before or at the time of execution of the deed. Therefore, the company shall have the right to return the shares under objection, if the stamps are not properly cancelled.

In the given problem, the Company returned the shares under objection as the share transfer stamps affixed on the transfer deed were not duly cancelled. Vivek, the transferee, subsequently, cancelled the stamps and relodged the shares for transfer and the company affected the transfer. In the meantime, the market price of the shares went down and Vivek filed a case against the company claiming that due to unwarranted objection raised by the company, he was deprived of the opportunity to sell the shares at higher price. In *Re. Coronation Tea Co. Ltd.* AIR 1961 Cal 528 it was held that if the stamp is not cancelled, then the effect is the same as if the instrument is not stamped.

In view of the provisions of Section 108(1) read with the provisions of the Indian Stamp Act, 1899 the claim of Vivek is not tenable in the Court of law and his case would be dismissed.

Answer 6(b)

Section 262 of the Companies Act, 1956 governs the appointment of directors for filling the casual vacancy. Accordingly, in case of a public company or a private company which is a subsidiary of a public company, if the office of any director appointed by the company in general meeting is vacated before his term of office expire in the normal course, the resulting casual vacancy may be filled by the Board of Directors at a meeting of the Board in accordance with the procedure laid down in its Articles.

Any person so appointed shall hold office up to the date up to which the director in whose place he is appointed would have held office if he had not vacated as aforesaid.

Where a casual vacancy is filled by the Board and the person appointed to fill such casual vacancy also vacates, the resulting vacancy is not a casual vacancy and can not be filled by the Board of Directors under the above Section, as the section only applies to a casual vacancy in the office of a director appointed by the company in general meeting. A 'Casual Vacancy' arising out of a 'Casual Vacancy' is not a 'Casual Vacancy'.

In the given problem, Swarn Limited appointed Rajat to fill the casual vacancy. Rajat also resigned from the Board after two months of his appointment. The Board desired to appoint Bhagat in place of Rajat under the provisions of Section 262 of the Companies Act, 1956. Since the appointment of Rajat was not made by the shareholders at the general meeting, his resignation from the board shall not be treated as casual vacancy and the board shall not have the authority to fill the vacancy caused due to resignation of Rajat.

As a Company Secretary, I would advise the management to appoint Bhagat as Additional Director instead of appointing him as a Director to fill the casual vacancy.

Answer 6(c)

Section 260 of the Companies Act, 1956 governs the appointment of Additional Directors. Accordingly, the Board of Directors shall have the power to appoint any person

as Additional Director, if authorized by the Articles of Association. Such additional directors shall hold office up to the date of the next annual general meeting of the company.

According to a clarification issued by the Ministry of Corporate Affairs, an additional director appointed by the Board of Directors ceases to hold office as additional director immediately before the commencement of the next annual general meeting of the company and in any event he can not continue in office after expiry of the statutory period laid down in Section 166 for holding an annual general meeting of the company.

Pursuant to the provisions of Section 166 of the Companies Act, 1956, the Registrar may, for any special reason, extend the time within which any annual general meeting shall be held, by a period not exceeding three months. Such extension given by Registrar, would be included in the statutory period within which the AGM is to be held.

In the given problem, Abhishek was appointed as Additional Director on 14th March, 2007. The Annual General Meeting of the Company was scheduled to be held on 25th September, 2007 but due to fire all the records of the company were destroyed and the company approached the Registrar of Companies for extension of time for holding AGM and postponed the AGM till 30th November, 2007. Therefore on grant of extension by the Registrar, the statutory period for holding AGM would extend to 30th November 2007. This is the period upto which Abhishek can hold the office of Director. So, Abhishek can continue to be an additional director till 30th November, 2007.

Question 7

- (a) *What are the broad contents of clause 49 of the listing agreement ? Write each point in brief. (8 marks)*
- (b) *In what respect Form No. 25C is required to be filed and in addition to the official of the company who else has to digitally sign it and the purpose thereof ? (4 marks)*
- (c) *What are the contents of Form No. 1A relating to availability or change of name? (4 marks)*

Answer 7(a)

The broad contents of clause 49 of the Listing Agreement are as under:

Board of Directors : Board should have optimum combination of executive and non-executive directors with not less than 50% of the Board consisting of non-executive directors. If the Board has a non-executive Chairman then at least 1/3rd of the Board should consist of independent directors and in case of an executive Chairman, at least half of the Board should consist of independent directors.

There should be minimum number of four meetings in a year with a maximum gap of four months between two meetings. Certain minimum information is to be made available to the Board.

Audit Committee : A qualified and independent Audit Committee shall be constituted. It shall have minimum three members. Two/third of the members shall be independent. All members must be financial literate and at least one member shall have financial and accounting knowledge. The Chairman of the Committee shall be an independent director

and he shall be present at the AGM to answer shareholder queries. The Audit Committee shall meet at least four times in a year.

The Audit Committee shall oversee the Company's financial reporting process, disclosure of financial information and review the annual accounts before submission to the Board. It shall also review the internal audit function and internal control systems.

Disclosures

Related party transaction : A statement of transactions in the ordinary course of business and details of material individual transactions with related parties which are not in the ordinary course of business shall be placed before audit committee.

Remuneration of Directors : The details of the remuneration of directors shall be disclosed in the annual report. All pecuniary relationship or transactions of the non-executive directors vis-à-vis the company and the criteria of making payments to non-executive directors shall also be disclosed in Annual Report.

Management : Management discussion and analysis report should form part of the annual report. It should contain details regarding (a) industry structure and developments; (b) opportunities and threats; (c) segment wise or product wise performance; (d) outlook; (e) Risks and concerns; (f) Internal Control Systems and their adequacy; (g) discussion on financial performance; (h) material developments in human resources.

Shareholders : Information to shareholders to be given about appointment of new directors or their reappointment, their resume, expertise in specific areas, details of directorships. Information on quarterly results should be put on the website of company. There is also requirement for constitution of a Committee for redressal of shareholders grievances.

CEO/CFO Certification

The CEO, i.e., the Managing Director or Manager appointed in terms of the Companies Act, 1956 and the CFO i.e., the whole-time Finance Director or any other person heading the finance function shall certify to the Board that they have reviewed financial statements and the cash flow statement for the year to the best of their knowledge and belief, these statements do not contain any materially untrue statement or omit any material fact or misleading statements.

Report on Corporate Governance

- (i) There shall be a separate section on Corporate Governance in the Annual Reports of company, with a detailed compliance report on Corporate Governance. Non-compliance of any mandatory requirement of this clause with reasons thereof and the extent to which the non-mandatory requirements have been adopted should be specifically highlighted.
- (ii) The companies shall submit a quarterly compliance report to the stock exchanges within 15 days from the of quarter. The report shall be signed either by the Compliance Officer or the Chief Executive Officer of the Company.

Compliance

The company shall obtain a certificate from either the auditors or practicing company secretaries regarding compliance of conditions of corporate governance as stipulated in

this clause and annex the certificate with the directors' report which is sent annually to all the shareholders of the company. The same certificate shall also be sent to the Stock Exchanges along with the annual report filed by the company.

Answer 7(b)

E-Form 25-C is to be filed as "Return of Appointment of Managing Director or Whole-time Director or Manager" as per the provisions of Section 269(2) and Schedule XIII of the Companies Act, 1956. When a public company or a private company which is a subsidiary of a public company has appointed managerial personnel such as managing director or whole-time director, it has to file with ROC, e-form no. 25C within 90 days of such appointment.

The form has to be digitally signed by Managing Director/Director/Manager or a Company Secretary of the company duly authorized by the Board of Directors. In addition to the above signatory, Company Secretary or Chartered Accountant or Cost Accountant in whole-time practice have to digitally sign the form. The purpose is to certify the contents of the said form.

Answer 7(c)

E-Form 1A is an application form for availability or change of name pursuant to Sections 20 and 21 of the Companies Act, 1956. The contents of the said form are as under:

Application for Incorporation of New Company/Change of name of an existing company

Part A - Availability of name

1. (a) Name of applicant
(b) Occupation
(c) Address
(d) e-mail id
(e) Phone and Fax
2. Details of promoters
3. Name of the state in which the proposed company is to be registered
4. Name of the Registrar of Companies in which the proposed company is to be registered
5. Whether the proposed company is public or private.
6. Proposed name of the company (6 names in order of preference).
7. Significance of the key or coined word(s), if any, in the proposed name(s) (in brief).
8. Main objects of the proposed company (if the objects include banking, stock exchange, mutual fund, etc. a copy of the in-principle approval of the appropriate authority should be enclosed).

9. Whether the proposed name(s) is in consonance with the principal object.
10. Whether the proposed company is a government company
11. Particulars of director(s)
12. Particulars of other directorship held by Director(s) & if he is a promoter of any other company, its detail.
13. Proposed authorised capital
14. Whether the proposed name(s) are based on a registered trade mark or is the subject matter of an application pending for registration under the Trade Marks Act

Part B - In case of change of name

15. (a) CIN of company
(b) Global location number (GLN) of company
16. (a) Name of the company
(b) Address of the registered office of the company
17. Reasons for change in name

Question 8

- (a) "A private company can accept deposits from friends, relatives and associates *without invitation from the public.*" *Comment.* (4 marks)
- (b) "No dividend can be recommended by the Board of directors of the company in case the company has incurred losses during the financial year for which dividend is to be recommended." *Comment.* (4 marks)
- (c) "All resolutions cannot be passed by the Board of directors of a company by circulation." *Comment.* (4 marks)
- (d) Define 'member'. What are the various modes of acquiring membership of a company? (4 marks)

Answer 8(a)

Section 3(1)(iii)(d) of the Companies Act, 1956 provides that a Private Company should through its Articles prohibit any invitation or acceptance of deposits from persons other than its members, directors or their relatives.

Therefore, in respect of a private company, an invitation is not prohibited but invitation to the public is prohibited. If a company invites deposits from members, directors or their relatives, then it will not be invitation to public.

As per Section 6 of the Act, the definition of relative does not include friends and associates.

Therefore, a private company can accept deposits from relatives but not from friends and associates without invitation from public.

Answer 8(b)

Pursuant to the provisions of Section 205 of the Companies Act, 1956, dividend can be declared by a company out of any four of the following:

- a) Profits of the company for that financial year arrived at after providing for depreciation ; or
- b) Profits of the company for any previous financial year or years arrived at after providing for depreciation; or
- c) Out of both (a) and (b) above; or
- d) Moneys provided by the Central Government or a State Government for payment of dividend in pursuance of a guarantee given by the concerned government.

Thus, availability of profit or accumulated profit is a pre-requisite for the declaration of Dividend except in cases where dividend is to be paid out of monies provided by the Central or State Government pursuant to a guarantee given by that Government.

Therefore, even if there is inadequacy or absence of profits in any year, a company can declare dividend out of the accumulated profits earned by the company in any previous financial year or years. If such profits have been transferred to reserves, such declaration of dividend shall not be made except in accordance with the Companies (Declaration of Dividend out of Reserves) Rules, 1975 or except with the previous approval of the Central Government where the declaration is not in accordance with the said Rules [Section 205A(3)].

Answer 8(c)

It is true that all resolutions cannot be passed by the Board of Directors of a company by circulation. Pursuant to the provisions of Section 292 of the Companies Act, 1956, the Board of Directors of a Company shall exercise the following powers on behalf of the Company and it shall do so only by means of resolutions passed at meetings of the Board and not by circulation :

- (a) the power to make calls on shareholders in respect of money unpaid on their shares;
- (b) the power to authorize the buy back referred to in the first proviso to clause (b) of Section 77A(2);
- (c) the power to issue debentures;
- (d) the power to borrow moneys otherwise than on debentures;
- (e) the power to invest the funds of the company; and
- (f) the power to make loans.

In addition to above powers there are several matters which should not be decided through circular resolution, some of these are: to fill a casual vacancy occurred in the Board [Section 262(1)]; Decision to make any political contribution [proviso to Section 293A(2)]; To invest in the shares of any other body corporate within the limits specified in Sub-section (2) of Section 372 [Section 372(5)]; to give notice of disclosure

of interest by a deemed director under Section 307. [Section 308(2)]; to make a declaration of solvency where it is proposed to wind up the company voluntarily [Section 488(1)] etc.

Answer 8(d)

According to Section 41 of the Companies Act, 1956

- (i) The subscribers of the Memorandum of Association of a Company shall be deemed to have agreed to become member of the Company and on its registration, shall be entered as members in its register of members.
- (ii) Every person who agrees in writing to become a member of a company and whose name is entered in its register of members shall be a member of the company.
- (iii) Every person holding equity share capital of a company and whose name is entered as beneficial owner in the records of the depository shall be deemed to be a member of the concerned company.

The Modes of acquiring membership

A person may acquire membership of company :

- (a) by subscribing to the Memorandum of Association; or
 - (b) by agreeing in writing to become a member:
 - (i) by making an application to the company for allotment of shares; or
 - (ii) by executing an instrument of transfer of shares as transferee; or
 - (iii) by consenting to the transfer of share of a deceased member in his name;
or
 - (iv) by acquiescence or estoppel.
 - (c) by holding equity share capital of a company and whose name is entered as beneficial owner in the records of a depository.
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ECONOMIC, LABOUR AND INDUSTRIAL LAWS

Time allowed : 3 hours

Maximum marks : 100

NOTE : Answer SIX questions including Question No. 1 and 7 which are **COMPULSORY**.

Question 1

With reference to the relevant legal enactments, write short notes on any five of the following :

- (i) Concept of sustainable development*
- (ii) Element of 'novelty' in an invention*
- (iii) Financial Action Task Force*
- (iv) Project exports*
- (v) Predatory pricing*
- (vi) Competition policy.*

(3 marks each)

Answer 1(i)

Concept of Sustainable Development

Universe is one of the rarest gift that the nature has given to the human being. Even after prolonged experiments the scientist could not establish, that human can survive in any other planet except earth. Therefore humanity must live within the carrying capacity of the earth. It is essential for the people who live now to use the resources of earth sustainably and prudently so that they do not deny certain benefits to future generations. Modern states use the natural resources of the earth recklessly. This will result that the Earth will not be able to support everyone unless there is less waste and extravagance. We should, therefore have, a new approach to future, that is, to secure a widespread and deeply held commitment for sustainable living. We have to integrate conservation and development. Conservation to keep our actions within the earth's capacity and development to enable the people everywhere to enjoy long, healthy and fulfilling lives.

The concept of 'sustainable development was first highlighted at the United Nations Conference on the Human Environment held at Stockholm in June, 1972. Since then, various countries such as Japan, US, France, Germany, etc. besides India, have enacted legislative measures for protection of the environment introducing strict penal measures for damages caused due to hazardous substances, etc. Various international conferences have been held on the subject of environmental planning etc. the important being the 'The United Nations Conference on Environment and Development popularly known as the Earth Summit held at Rio De Janeiro in Brazil in June, 1992 which aimed at focusing the attention of the world on problems of our environment and look for ways in which these can be avoided in future. India too has been an active participant at these conferences.

Answer 1(ii)

Elements of 'novelty' in an invention

Section 2(j) of the Patent Act, 1970 defines the term Invention as to mean a new product or process involving an inventive step and capable of industrial application.

In terms of Section 2(ja) Inventive step means a feature of an invention that involves technical advance as compared to the existing knowledge or having economic significance or both that makes the invention not obvious to a person skilled in the art.

Thus there are three criteria for an invention to be a patented namely, Novelty, Inventive step and Industrial application, The term “novelty” has not been defined under the Patent Act, 1970. However, Section 2(l) of the Act defines the term new invention to mean an invention or technology which has not been anticipated by publication in any document or used in the country or elsewhere in the world before the date of filing of patent application with complete specification, i.e. the subject matter has not fallen into public domain or that it does not form part of the state of the art.

Thus the Patent Act recognises the worldwide novelty of an invention.

Answer 1(iii)

The Financial Action Task Force

The main international body engaged in continuous and comprehensive efforts both to define policy and to promote the adoption of countermeasures against money laundering is the Financial Action Task Force (FATF). The FATF, set up by the governments of the G-7 countries at their 1989 Economic Summit, has representatives from twenty-four OECD countries, Hong Kong, Singapore, the Gulf Cooperation Council, and the European Commission. Participants include representatives from members' financial regulatory authorities, law enforcement agencies, and Ministries of Finance, Justice and External Affairs. Representatives of international and regional organizations concerned with combating money laundering also attend FATF meetings as observers. The main tasks of the FATF are:

- Monitoring members' progress in applying measures to counter money laundering.
- Reviewing money laundering techniques and countermeasures.
- Promoting the adoption and implementation of appropriate measures by non-member countries.

Answer 1(iv)

Project Exports

Export of engineering goods on deferred payment terms including execution of turnkey projects and civil construction contracts abroad are collectively treated as project export. Project exports are broadly divided into three categories, i.e. Civil Engineering Construction Projects, Industrial Turn Key Projects and Consultancy Services. Project exports are regarded as a key indicator of technological maturity and industrial capabilities of a country. These projects have occupied an important place in India's export portfolio.

Regulation 18 of the Foreign Exchange Management (Export of Goods and Services) Regulation 2000 deals with project exports and provides that where the export of goods or services is proposed to be made on deferred payment terms or in execution of a turnkey project or a civil construction contract, the exporter shall before entering into any such export arrangement, submit the proposal for prior approval of the Working Group or the Exim Bank or Authorised dealer, as the case may be, which shall consider

the proposal in accordance with the guidelines issued by Reserve Bank from time to time.

Answer 1(v)

Predatory Pricing

Explanation (b) to section 4(2) of the Competition Act, 2002 defines the term predatory price as to mean the sale of goods or provision of services, at a price which is below the cost, as may be determined by regulations, of production of goods or provision of services, with a view to reduce competition or eliminate the competitors.

Section 33(1) (j) of the MRTP Act, 1969 also relates to any agreement to sell goods at such prices as would have the effect of eliminating competition or a competitor. This covers the practice of what is called predatory pricing- selling below the cost of production so as to eliminate a competitor or competition, though in cases of very sluggish demand, sale below cost may be necessitated to prevent losses from getting aggravated. For predatory pricing it would be necessary to look for an element of mala fide intention i.e. of elimination competition by creating transitory phase of low pricing which the competitor may not be able to withstand.

Answers 1(vi)

Competition Policy

Competition policy typically has two elements: one is a set of policies that enhance competition in local and national markets, and the second is legislation designed to prevent anti-competitive business practices with minimal Government intervention, i.e., a competition law. Competition law by itself cannot produce or ensure competition in the market unless this is facilitated by appropriate Government policies. On the other hand, Government policies without a law to enforce such policies and prevent competition malpractices would also be incomplete.

Competition policies cover a much broader set of instruments than competition law, and typically include all policies aimed at increasing the intensity of competition or rivalry in local and national markets by lowering entry barriers and opportunities for harmful coordination, to ensure that markets work effectively and serve the interests of all citizens. Competition law is only a subset of a nation's competition policies. Competition policies typically include pro-competition approaches to trade, investment, sectoral regulation, and consumer protection.

Question 2

State, giving reasons in brief, whether the following statements are true or false. Attempt any five :

- (i) *An export oriented unit (EOU) can export goods manufactured by it through another export oriented unit (EOU).*
- (ii) *Unfair trade practices include offering gifts or prizes for promotional contests.*
- (iii) *Tie-up arrangements hardly serve any purpose beyond suppression of competition.*
- (iv) *The object of the Foreign Contribution (Regulation) Act, 1976 is to legalise foreign donations and hospitality to office bearers of political parties.*

(v) *The term of copyright in published literary works and cinematograph films is 60 years.*

(vi) *A patent is granted for a definite period.* (3 marks each)

Answer 2(i)

True

Reason

An EOU may export goods manufactured/software developed by it through other exporter or any other EOU subject to following condition —

- (a) Goods are produced in the EOU concerned
- (b) The level of NFE (Net Foreign Exchange Earnings) or any other conditions relating to the imports and exports or prescribed, continue to be discharged by the EOU concerned.
- (c) The Export orders so procured are executed within the parameters of EOU schemes and goods are directly transferred from the unit to the port of shipment.
- (d) Fulfillments of NFE by EOU units in regard to such exports are reckoned on the basis of the price at which the goods are supplied by EOUs to other exporters or other EOU.
- (e) All export entitlements, including recognition as Status Holder would accrue to the exporter in whose name foreign exchange earnings are realized. However, such export are counted towards fulfillment of obligation under EOU scheme only.

Answer 2(ii)

True

Reason

Section 36A(3)(a) of the MRTP Act, 1969 deals with the unfair trade practices relating to offering of gifts or prizes with the intention of not providing them or creating an impression that something is being given free of charge when it is fully or partly covered by the amount charged in the whole transaction.

Where there has been an increase in the price of the articles/commodity etc. by virtue of an offer of gifts or prizes, the practice of offering such prizes etc. will be treated as unfair trade practice. However, if the charged party can convince the Commission that increase in the price of product has no nexus with the gift scheme, it would not be construed as unfair.

Answer 2(iii)

True

Reason

Tie-up arrangements, within the meaning of Section 33(1)(b) of the MRTP Act, 1969 is one, whereby a seller agrees to sell a product or service (the main or the tying item)

only on the condition that the buyer agrees to buy another (second or tied item) from the seller or not to buy the tied product from any other supplier. Such arrangements are generally used to push the sale of a slow-moving and less in demand product along with a more popular product or for introducing a new product in the market.

How a tying arrangement/agreement affects competition has been explained by the United States Supreme Court [quoted by the MRTP Commission in Hindustan Levers case; RTP Enq. No. 48 of 1983 dt. 4.8.1987] as follows:

Tying agreements serve hardly any purpose beyond the suppression of competition. By conditioning the sale of one commodity on the purchase of another a seller coerces the abdication of buyers independent judgement as to the 'tied products merits and insulates it from the competitive stresses of the open market. Intrinsic superiority of the tied product, if there be any, would convince freely choosing buyers to select it over others anyway. The effect of the tying device on competing sellers attempting to rival the tied product, is indeed drastic as it enables the seller adopting the tying arrangement to enjoy market control while other existing and potential sellers are foreclosed from offering their goods to a free competitive judgment though being effectively excluded from fair market dealing.

Explanation (a) to Section 3(4) of the Competition Act, 2002 defines the term tie-in arrangement as to mean any agreement requiring a purchaser of goods, as a condition of such purchase, to purchase some other goods.

Answer 2(iv)

False

Reason

Foreign Contribution (Regulation) Act, 1976 has been enacted to regulate the acceptance and utilisation of foreign contribution or foreign hospitality by certain categories of persons or associations, with a view to ensuring that Parliamentary institutions, political associations and academic and other voluntary organisations as well as individuals working in the important areas of national life may function in a manner consistent with the values of a sovereign democratic republic, and for matters connected therewith or incidental thereto.

Answer 2(v)

False

Reason

Sections 22 to 29 of Copyright Act, 1957 deal with term of copyright in respect of published literary, dramatic, musical and artistic works; anonymous and pseudonymous; posthumous, photographs, cinematograph films, sound recording, Government works, works of PSUs and works of international organisations.

Literary, dramatic, musical or artistic works enjoy copyright protection for the life time of the author plus 60 years beyond i.e. 60 years after his death. In the case of joint authorship which implies collaboration of two or more authors in the production of the work, the term of copyright is to be construed as a reference to the author who dies last.

In the case of copyright in posthumous, anonymous and pseudonymous works, photographs, cinematograph films, sound recordings, works of Government, public undertaking and international organisations, the term of protection is 60 years from the beginning of the calendar year next following the year in which the work has been first published.

Answer 2(vi)

True

Reason

Section 53 of Patent Act provides that the term of every patent granted after the commencement of the Patents (Amendment) Act, 2002 and the term of every patent which has not expired and has not ceased to have effect, on the date of such commencement, shall be twenty years from the date of filing of application for the patent.

Explanation to Section 53(1) clarifies that the term of patent in case of international applications filed under the Patent Cooperation Treaty (PCT) designating India, shall be twenty years from the international filing date accorded under the Patent Cooperation Treaty.

Question 3

(a) *Distinguish between any two of the following :*

- (i) 'Person' and 'authorised person' under the Foreign Exchange Management Act, 1999.
 - (ii) 'Political party' and 'an organisation of political nature' under the Foreign Contribution (Regulation) Act, 1976.
 - (iii) 'Invention' and 'patentable invention' under the Patents Act, 1970.
- (4 marks each)

(b) *Re-write the following sentences after filling-up the blank spaces with appropriate word(s)/figure(s) :*

- (i) Offshore banking unit means a branch of a bank located in a _____ and which has obtained the permission under the Banking Regulation Act, 1949.
- (ii) Group means two or more enterprises, which directly or indirectly are in a position to exercise _____ or more of voting rights in other enterprises.
- (iii) The term restrictive trade practice, inter alia, intends to bring about _____ of process or conditions of delivery to effect the flow of supplies in the market relating to goods or services.
- (iv) The total financial commitment of the Indian party in joint ventures/wholly owned subsidiaries does not exceed _____ of the net worth as on the date of the last audited balance sheet.
- (v) Without furnishing the declaration, goods not exceeding the value of _____ per transaction can be exported to Myanmar under the Barter

Trade Agreement between the Government of India and the Government of Myanmar.

- (vi) *Release of foreign exchange exceeding US\$_____ for business travel requires prior approval of the Reserve Bank of India (RBI).*
- (vii) *A remittance exceeding US\$ _____ by an entity in India by way of reimbursement of pre-incorporation expenses requires prior approval of RBI.*
(1 mark each)

Answer 3(a)(i)

Person

Section 2(u) of FEMA, defines the term 'Person' to include (i) an individual, (ii) a Hindu Undivided Family, (iii) a Company, (iv) a Firm, (v) an association of persons or body of individuals whether incorporated or not; and (vi) every artificial juridical person not falling within the above sub clause (vii) any agency, office or branch owned or controlled by such person;

Authorised Person

The term authorized person is defined in Section 2(c) of FEMA to include an authorize dealer, money changer, offshore banking unit or any other person for the time being authorized to deal in foreign exchange or foreign securities.

Under Section 10 of the FEMA, 1999 any person who has made an application to the RBI may be authorised by it to act as an authorised person to deal in foreign exchange or in foreign securities as an authorised dealer, money changer or offshore banking unit or in any other manner as the RBI deem fit. This authorisation is in writing and subject to the conditions laid down by the RBI.

Normally, nationalised banks, leading non nationalized banks and foreign banks are appointed as authorized persons.

Answer 3(a)(ii)

As per Section 2(1)(g) of the Foreign Contribution (Regulation) Act, 1976 FCRA Political Party means –

- (i) an association or body of individual citizens of India which is, or is deemed to be, registered with the Election Commission of India as a political party under the Election Symbols (Reservation and Allotment) Order, 1968, as in force for the time being; or which has set up candidates for election to any Legislature, but is not so registered or deemed to be registered under the Election Symbols (Reservation and Allotment) Order, 1968;
- (ii) a political party mentioned in column 1 of Table I to the notification of the Election Commission of India No. 56/J&K 84, dated the 27th September, 1984 as in force for the time being .

Section 5 of FCRA prohibits an organisation of a political nature not being a political party, from accepting any foreign contribution, except with the prior permission of the Central Government. In this context, it has been clarified that an organisation of a political nature not being a political party means such organisation as the Central

Government may specify by order published in the Official Gazette, having regard to the activities of the organisation or the ideology propagated by the organisation or the programme of the organisation or the association of the organisation with the activities of any political party.

Answer 3(a)(iii)

Section 2(j) of the Patent Act defines invention as to mean a new product or process involving an inventive step and capable of Industrial application The term ‘inventive step’ has been defined under the Patent Act as to mean a feature of an invention that involves technical advance as compared to the existing knowledge or having economic significance or both that makes the invention not obvious to a person skilled in the art.

Any invention or technology which has not been anticipated by publication in any document or used in the country or elsewhere in the world before the date of filing of patent application with complete specification, i.e. the subject matter has not fallen into public domain or that it does not form part of the state of the art, which is registered with Controller of Patent is patentable invention.

Section 3 enumerated the list of inventions which are not patentable.

Answer 3(b)(i)

“Offshore Banking Unit” means a branch of a bank located in a **Special Economic Zone** and which has obtained the permission under the Banking Regulation Act, 1949.

Answer 3(b)(ii)

Group means two or more enterprises which directly or indirectly are in a position to exercise **26%** or more of voting rights in other enterprises.

Answer 3(b)(iii)

The term restrictive trade practice inter alia intends to bring about **manipulation** of price or conditions of delivery or to effect the flow of supplies in the market relating to goods or services.

Answer 3(b)(iv)

The total financial commitment of the Indian party in joint ventures/ wholly owned subsidiaries does not exceed **400 %** of the net worth as on the date of the last audited balance sheet.

Answer 3(b)(v)

Without furnishing the declaration, goods not exceeding the value of **US \$ 1000** per transaction can be exported to Myanmar under the Barter trade Agreement between the Government of India and the Govt. of Myanmar.

Answer 3(b)(vi)

Release of forex exceeding **US \$ 25,000** for business travel requires prior approval of RBI.

Answer 3(b)(vii)

A remittance exceeding **US \$ 1,00,000** by an entity in India by way of reimbursement of pre-incorporation expenses requires prior approval of RBI.

Question 4

- (a) *With reference to the relevant provisions of the Foreign Exchange Management Act, 1999 and the rules and regulations made thereunder, advise on the following :*
- (i) *Tomb Ltd. desires to make payment of commission on the exports made towards equity investment in its wholly owned subsidiary abroad.*
 - (ii) *Hari, while on a visit abroad, used his international credit card for making payment towards meeting stay expenses.*
 - (iii) *Jolly, a resident in India, desires to acquire 5% of the paid-up share capital of the company abroad to hold the post of director in the foreign company, as qualification shares.*
 - (iv) *Ramesh, an NRI, desires to invest on repatriation basis in derivatives contracts, approved by the Securities and Exchange Board of India through stock exchanges.* (2 marks each)
- (b) *Explain the powers of the Central Government to prohibit receipt of foreign contribution under the Foreign Contribution (Regulation) Act, 1976.* (4 marks)
- (c) *Mention briefly powers of the Competition Commission of India under the Competition Act, 2002.* (3 marks)

Answer 4(a) (i)

Rule 3 read with Schedule I to the Foreign Exchange Management (Current Account Transaction) Rules 2000 prohibits Drawal of foreign exchange towards payment of Commission on exports made towards equity investment in joint ventures/wholly owned subsidiaries abroad of Indian companies.

Tomb Ltd can not makes payment of commission on exports made towards equity investment in its wholly owned subsidiary abroad.

Answer 4(a)(ii)

Rule 5 of Foreign Exchange Management (Current Account Transaction) Rules, 2000 requires prior approval of Reserve Bank for release of foreign exchange, exceeding US\$ 25,000 to a person, irrespective of period of stay, for business travel, or attending a conference or specialized training or maintenance expenses of a patient going abroad for medical treatment or check-up abroad, or for accompanying as attendant to a patient going abroad for medical treatment/check-up.

As per Rule 7 of the Foreign Exchange Management (Current Account Transactions) Rules, 2000 nothing contained in transaction specified in the III Scheduled shall apply to the use of International credit card for making payment by a person towards meeting expenses while such person is on a visit outside India.

In the light of the above provision Hari can use International Credit Card for making payment towards meeting staying expenses, while on visit abroad.

Answer 4(a)(iii)

A person resident in India being an individual may acquire foreign securities as qualifications shares issued by a company incorporate outside India for holding the post of a director in the company subject to the following conditions:

- (a) the number of shares so acquired shall be minimum required to be held for holding the post of director and in any case shall not exceed 1% of the paid-up capital of the company; and
- (b) the consideration of acquisition of such shares does not exceed the ceiling as stipulated by RBI from time to time.

Jolly, can not acquire shares aggregating more than 1% of the paid –up capital of the company abroad to hold the post of director in the foreign company.

Answer 4(a)(iv)

A NRI may invest in exchange traded derivative contracts approved by SEBI from time to time out of INR funds held in India on non-repatriable basis subject to the limits prescribed by SEBI. Such investments are not eligible for repatriation benefits.

Ramesh can not invest on repatriation basis.

Answer 4(b)

Section 10 of the Foreign Contribution (Regulation) Act, 1976 empowers of the Central Government to prohibit the receipt of foreign contribution in certain cases. Accordingly, the central Government has been empowered to

- (a) prohibit any association not specified in Section 4 of the FCRA or any person from accepting any foreign contribution;
- (b) require any association specified in Section 6(1), to obtain prior permission of the Central Government before accepting any foreign contribution;
- (c) require any person or class of persons or any association, not being an association specified in Section 6, to furnish intimation within such time and in such manner as may be prescribed as to the amount of any foreign contribution received by such person or class of persons or association, as the case may be, and the source from which and the manner in which such contribution was received and the purpose for which and the manner in which such foreign contribution was utilised;
- (d) require any person or class of persons, not specified in Section 9, to obtain prior permission of the Central Government before accepting any foreign hospitality;
- (e) require any person or class of persons, not specified in Section 9 to furnish intimation, within such time and in such manner as may be prescribed as to the receipt of any foreign hospitality, the source from which and the manner in which such hospitality was received.

However, the Central Government is not authorised to make any such prohibition, unless it is satisfied that the acceptance of foreign contribution/foreign hospitality by such association or person or class of persons, as the case may be, is likely to affect

prejudicially the sovereignty and integrity of India; or the public interest; or freedom or fairness of election to any Legislature; or friendly relations with any foreign state; or harmony between religious, racial, linguistic or regional groups, castes or communities.

Answer 4(c)

The Competition Commission of India has been empowered to lay down its own procedure and regulations. It is not bound by the procedure laid down by the Code of Civil Procedure, 1908 but has been put under obligation to observe the principles of natural justice and subject to the provisions of the Act. Section 36(2) of Competition Act, 2002 makes it clear that the Commission shall have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 while trying the suit. Section 33 empowers Competition Commission to grant interim relief.

Question 5

Attempt any three of the following :

- (i) *Define the term 'service' as contained in the Consumer Protection Act, 1986. Are railway passengers and telephone subscribers 'consumers' under the Consumer Protection Act, 1986 ? Refer to decided case law.*
- (ii) *Name the persons who can make an application for the sealing of patent under the Patents Act, 1970.*
- (iii) *Mention the remedies for infringement of copyrights under the Copyright Act, 1957.*
- (iv) *What are the acts which do not amount to infringement of a trade mark under the Trade Marks Act, 1999 ? (5 marks each)*

Answer 5(i)

The term 'service' is defined under Section 2(1)(o) of the Consumer Protection Act, 1986 as to mean service of any description which is made available to potential users and includes but not limited to the provision of facilities in connection with the banking, finance, insurance, transport, processing, supply of electrical or other energy, board or lodging or both, housing construction, entertainment, amusement or the purveying of news or other information but does not include the rendering of any service free of charge or under a contract of personal service.

Passengers traveling by train on payment of stipulated fare charged for the ticket are 'consumers' and the facility or transportation by rail provided by the railway administration is a service rendered for consideration as defined in the Act (*General Manager v. Anand Prasad Sinha*, FA 3/1988 decided on 28.7.1989)

Subscribers of telephones would also be 'consumer' under the Act (*Dist. Manager, Telephones Patna v. Lalit Kumar Bajla*, F.A. No. 18/1989 decided on 31.1.1990). It has been held in various other cases that the Telephones Dept./Mahanagar Telephone Nigam Ltd. fall within the provisions of the Consumer Protection Act, 1986 and the subscribers, as consumers of telephone service, are entitled to seek relief from Forums wherever necessary.

Answer 5(ii)

Section 6 of the Patents Act, 1970 provides that an application for a patent for an invention may be made by any of the following persons that is to say :

- (a) any person claiming to be the true and first inventor of the invention
- (b) any person being an assignee of the person claiming to be the true and first inventor in respect of the right to make such an application.
- (c) the legal representative of any deceased person who immediately before his death was entitled to make such an application.

The application may be made by one of the person either alone or jointly with any other person.

Answer 5(iii)**Remedies against Infringement of Copyright**

Section 55 of the Copyright Act provides for the civil remedies for infringement of copyright and entitles the owner of the copyright to all such remedies by way of injunction, damages, accounts and otherwise as may be conferred by law for the infringement of copyright. Section 54 defines the term owner of copyright. Section 58 entitles the owner of the copyright to initiate proceedings for the possession of infringing copies and other materials related thereto. In this context, the section clarifies that all infringing copies of any work in which copyright subsists and all plates used or intended to be used for the production of such infringing copies shall be deemed to be the property of the owner of the copyright.

Answer 5(iv)

Section 30 of the Trade Marks Act, 1999 enumerates certain acts which do not constitute infringement. This section explicitly states that there will be no infringement, if the use of a mark is in accordance with the honest practices in industrial or commercial matters and is not such as to take unfair advantage of or be detrimental to the distinctive character or repute of a trade mark. This section further enumerates the following acts as not constituting an infringement of trade mark—

- (i) where the use is in relation to goods or services to indicate the kind, quality etc. of the goods or of rendering of services or other characteristics of goods or services.
- (ii) Where a trade mark is registered subject to conditions or limitations, the use of the trade mark in a manner outside the scope of registration.
- (iii) Where a person uses the mark in relation to goods or services for which the registered owner had once applied to mark and had not subsequently removed it or impliedly consented to its use.
- (iv) A trade mark registered for any goods may be used in relation to parts and accessories to other goods or services and such use is reasonably necessary and its effect is not likely to deceive as to the origin.

- (v) The use of a registered trade mark being one of more registered trade marks which are identical or nearly resemble each other in exercise of the right to the use of that registered trade mark.

Question 6

Attempt any three of the following :

- (i) *Rajesh made a complaint before the Consumer Disputes Redressal Forum for seeking compensation against the State Electricity Board contending that due to fluctuations and fall in electricity voltage in his small scale industrial unit, he suffered production loss. Will he succeed ?*
- (ii) *Mention the salient features of the Supreme Court judgement in the matter of M.C. Mehta and Another vs. Union of India and Others (1987) relating to liability for pollution.*
- (iii) *After the date of booking for purchase of a car, Rakshit was asked to pay differential amount of increase in the central excise duty at the time of delivery of the car. Rakshit refused to pay the amount and moved the Consumer Disputes Redressal Forum. Will he succeed ?*
- (iv) *Rohit, the insured (since deceased), took out four life insurance policies with double accident benefits, premium payable half-yearly. When the premium fell due, the general agent of the LIC of India met Rohit and took a bearer cheque towards the premium payable by him in respect of the policies. Although the agent had encashed the cheque immediately thereafter, the amount was not deposited with the LIC of India. Meanwhile, the insured met with a fatal accident. The widow of Rohit filed a claim for the payment of the sum assured. Will she succeed ?* (5 marks each)

Answer 6(i)

Rajesh will succeed. The present problem is similar to that of *Kerale State Electricity Board v. Raveendran*. In this case the National Commission considered a complaint relating to falling electricity voltage, damaging the machine in a plastic factory and affecting production. The National Commission awarded compensation to the complainant.

Answer 6(ii)

The Supreme Court in *M.C. Mehta and Another v. Union of India and others* [(1987) 1 Comp. LJ 99 (SC)] ruled that an application for compensation in a pollution case can be maintained under Article 32 of the Constitution, for, such application is for the protection of the fundamental rights of the people and the Court has all incidental and ancillary powers including the power to forge new remedies and fashion new strategies designed to enforce fundamental rights.

On the question of liability of an enterprise engaged in hazardous activities, the Supreme Court laid down for the first time a far-reaching ruling, that an enterprise which is engaged in hazardous or inherently dangerous activities and an industry which poses a potential threat to the health and safety of the persons working in the factory and of those residing in the surrounding area, owes an absolute and non-delegatable duty to the community to ensure that no harm results to any one on account of an hazardous or inherently dangerous nature of the activity which it has undertaken.

The Court further reiterated that the rule in *Rylands v. Fletcher* [(1861-73) All.E.R. 146 HL] of strict liability would apply in India but without any exceptions whatsoever recognised in England. The Court also ruled that the measure of compensation must be correlated to the magnitude and capacity of the enterprise because such compensation must have a deterrent effect.

Answer 6(iii)

Rakshit will succeed. The present problem is similar to that of *Vikas Motors v. Dr. A K Sain*. The Supreme Court held that demand of excess amount when consumer has performed his part of contract making full payment of the car within time, it is not justified on the ground that the manufacturer raised price on account of rise in excise duty after the date of booking.

Answer 6(iv)

Widow of Rohit will not succeed. The present problem is similar to that of *Harshad J. Shah v. Life Insurance Corporation of India* [1997(3) SCALE 423 (SC)]. In this case Supreme Court held that the agent had no express authority to receive the premium on behalf of the Corporation. In his letter of appointment there was a condition expressly prohibiting him from collecting the premium. Nor could it be said that he had an implied authority to collect the premium, as regulation 8(4) expressly prohibited the agents from collecting premiums. Therefore, no case had been set up by the complainant before the State Commission that the Corporation by its conduct had induced the policyholders, including the insured, to believe that the agents were authorised to receive premiums on behalf of the Corporation. Nor was there any material on record that lent support to this contention. In the facts of this case there is no room to invoke the doctrine of apparent authority underlying Section 237 of the Indian Contract Act.

No deficiency of service on the part of the LIC.

Question 7

(a) Discuss any two of the following :

- (i) Persons responsible for the payment of wages under the Payment of Wages Act, 1936.
- (ii) Industrial unrest.
- (iii) Object and scope of the Industrial Disputes Act, 1947. (5 marks each)

(b) Attempt any five of the following stating relevant legal provisions and decided case law, if any :

- (i) The workers in a factory went on sit-down strike resulting in stoppage of work. The management sought the help of the police and removed them forcibly when they refused to vacate the premises and indulged in violence. Later on, the organisation dismissed those workers. The workers claimed immunity from criminal action under the Trade Unions Act, 1926. Will they succeed ?
- (ii) A worker after an accident became partially disabled and could not do his earlier work. However, the employer offered him another kind of job which

he could do without any difficulty. Despite the offer of another job, the worker demanded compensation for partial disablement. Will he succeed ?

- (iii) An electrician, who had to go frequently to a heating room from a cooling plant, contracted pneumonia which resulted in his death. Will it be construed as 'physical injury' ?*
- (iv) A worker was placed under suspension and disciplinary proceedings were initiated against him. The proceedings could not be completed in 90 days after which the suspended worker demanded increase in subsistence allowance under the Industrial Employment (Standing Orders) Act, 1946. Will he succeed ?*
- (v) An employee was suspended, but after an inquiry, he was reinstated with full back wages. He claimed bonus for the period of suspension. Will he succeed ?*
- (vi) A worker went on leave. He continued to remain absent from duty even after the expiry of leave. The employer treated the 'absence from duty without leave' as breach of continuity of service for the purposes of the Payment of Gratuity Act, 1972. Is the employer justified ?*
- (vii) The workers in a factory went on strike. The strike was legal. The employer deducted wages for the strike period on the ground that the legality of strike did not always exempt the workers from deduction of their wages for the period of strike. Was the employer's action justified ? (3 marks each)*

Answer 7(a)(i)

Responsibility for Payment of Wages

As per Section 3 of the Payment of Wages Act, every employer is responsible for the payment to persons employed by him of all wages required to be paid under the Act. In addition, the following persons shall also be responsible for the payment of wages under the Act:

- (i) in a factory, the person named as the manager;
- (ii) in industrial or other establishments, the person if any, who is responsible to the employer for the supervision and control of the industrial or other establishment;
- (iii) upon railways (otherwise than in factories), the person nominated by the railway administration in this behalf for the local area concerned.

Answer 7(a)(ii)

Industrial Unrest

Unrest may be defined as a disturbed state of mind in a human being caused by discontent or dissatisfaction arising out of failure to satisfy certain basic human needs. Industrial unrest, therefore, refers to the discontent or dissatisfaction lurking in the disturbed mind of labourers about certain lapses at the working place or about their wages or security or employment etc. Labourers are always hopeful that their causes of discontent or unrest can be eliminated by their collective strength. Hence they form their own organisations and resort to certain measures with which they try to gain their ends.

Since industrial unrest involves question of right or wrong and also affects every section of society, it thrusts itself upon the attention of the community and becomes a social problem.

Two categories of causes of industrial unrest are: (1) intangible causes and (2) tangible causes.

Intangible causes : These are closely connected with the study of human nature. Man seek to satisfy his wants but the path that he follows in his search for satisfaction is a complex one, governed by reasons, emotions and instincts. Very often the path may appear to be irrational and illogical to the outsider but to the person himself, it is perfectly rational and logical. Different people have different attitudes towards the same fact.

Tangible causes : These include demand for increase in wages, bonus etc.; demand for re-instatement of any dismissed worker; demand for greater facilities; demand for recognition of a trade union; political causes leading to general agitation.

Answer 7(a)(iii)

Object and Scope of the Industrial Disputes Act, 1947

This Industrial Disputes Act, 1947 makes provision for the investigation and settlement of industrial disputes and for certain other purposes. It ensures progress of industry by bringing about harmony and cordial relationship between the employers and employees.

Though the Supreme Court in number of cases has stated the objects of the Industrial Disputes Act, nevertheless the principal objectives of the Act have been laid down by the Supreme Court in the case of *Workmen of Dimakuchi Tea Estate v. Dimakuchi Tea Estate*, AIR 1958 S.C. 353, as follows:

- (i) Promotion of measures of securing and preserving amity and good relations between the employer and workmen.
- (ii) Investigation and settlement of industrial disputes between employers and employees, employers and workmen, or workmen and workmen with a right of representation by registered trade union or federation of trade unions or an association of employers or a federation of associations of employers.
- (iii) Prevention of illegal strikes and lock-outs.
- (iv) Relief to workmen in the matter of lay-off and retrenchment.
- (v) Promotion of collective bargaining.

Subsequently the Supreme Court in *Workmen, Hindustan Lever Limited v. Hindustan Lever Limited*, (1984) 1 SCC 728 held that the Act was designed to provide a self-contained code to compel the parties to resort to industrial arbitration for the resolution of existing or apprehended disputes without prescribing statutory norms for varied and variegated industrial relating norms so that the forums created for resolution of disputes may remain unhampered by any statutory control and devise rational norms keeping pace with improved industrial relations reflecting and imbibing socio-economic justice.

Further the Apex Court held that this being the object of the Act, the court by interpretative process must strive to reduce the field of conflict and expand the area of

agreement and show its preference for upholding agreements sanctified by mutuality and consensus in larger public interest, namely, to eschew industrial strife, confrontation and consequent wastage

Answer 7(b)(i)

The workers will not succeed.

In the case of *National Labour Relations Board v. Fansteel Metallurgical Corporation*, (1939) 306 US 240, it was held that the workers were not entitled to any immunity. Employees had right to strike but no licence to commit acts of violence or seize plant or building. The fact that it is the unfair labour practice committed by the employer which led to this violent situation, the employees cannot be permitted to take law in their hands and resort to force instead of peaceful remedies

In the above mentioned case, workers went on sit-down strike. They took over and occupied two key buildings of the company resulting in stoppage of work in the organisation. The management sought the help of police who told the workers to vacate the buildings. On their refusal to do so, police removed them forcibly. At this, the workers became angry and indulged in violence. Later on, the company dismissed these workers. The workers pleaded immunity from criminal action in furtherance of their trade dispute.

Answer 7(b)(ii)

The worker will succeed. In *General Manager, G.I.P. Rly. v. Shankar*, A.I.R. 1950 Nag. 307, it was held that if after the accident a worker has become disabled, and cannot do a particular job but the employer offers him another kind of job, the worker is entitled to compensation for partial disablement

Answer 7(b)(iii)

The Workmen's Compensation Act contemplates compensation for personal injury. It is not confined to physical or mental injury. It includes psychological and physiological injury as well. Whenever something which is not expected happens and as a result there is an injury, one may not have to look to external injury. Any internal injury in body would also amount to an injury.

The facts of the given problem are similar to the case of *Indian News Chronicle v. Mrs. Lazarus*, AIR 1961, Punj. 102, where a workman, in the course of his duties, had frequently to go into a heating room and from there to a cooling room. One night when he went into the cooling room, he got pneumonia of which he died.

It was held that the death was due to personal injury.

Answer 7(b)(iv)

Subsistence allowance under Section 10A of the Industrial Employment (Standing Orders) Act, 1946 is paid by an employer to a workman who has been suspended by the employer pending investigation or inquiry into complaints or charges of misconduct against him. The subsistence allowance is payable-

- (a) at the rate of fifty per cent of the wages which the workman was entitled to immediately preceding the date of such suspension, for the first ninety days of suspension; and

- (b) at the rate of seventy five per cent of such wages for the remaining period of suspension if the delay in the completion of disciplinary proceedings against such workman is not directly attributable to the conduct of such workman.

An analysis of the legal provisions mentioned above, reveals that if the delay in the completion of disciplinary proceedings is on the part of management, then the workman will succeed. If delay is attributable to the conduct of workman, then he will not succeed.

Apparently from the facts of the given case, it seems that delay is not attributable to the conduct of workman. Delay in the completion of disciplinary proceedings is on the part of management.

Therefore, the workman will succeed.

Answer 7(b)(v)

Under the Payment of Bonus Act, every employee shall be entitled to be paid by his employer in an accounting year, bonus, in accordance with the provisions of this Act, provided he has worked in the establishment for not less than thirty working days in that year. (Section 8)

In the given problem, the employee will succeed. It has been held that an employee suspended but subsequently reinstated with full back wages can not be treated to be ineligible for bonus for the period of suspension. [*Project Manager, Ahmedabad Project, ONGC v. Sham Kumar Sahegal* (1995) 1 LLJ 863]

Answer 7(b)(vi)

Payment of gratuity is a piece of social welfare legislation and deals with matters relating to payment of gratuity which like pension, provident fund etc. is a retrial benefit.

The employer is not justified. He cannot do so without seeking an explanation from the employee when he resumes his duties. After getting the explanation and the documents in support of the explanation, the employer can decide whether the absence from duty can be treated as breach of continuity of service.

Continuous service has been defined under Section 2-A of the Payment of Gratuity Act. Section 2-A of the Act inter-alia an employee shall be said to be in continuous service for a period if he has for that period, been in uninterrupted service, including service which may be interrupted on account of

- sickness,
- accident,
- leave
- absence from duty without leave (not being absence in respect of which an order treating the absence as break in service has been passed in accordance with the standing orders, rules or regulations governing the employees of the establishment),
- layoff
- strike, or
- a lockout, or
- stoppage of work for which the employee is not at fault

It has been held that interrupted service by reason of sickness leave, lay-off, strike,, lock-out, or cessation of work not due to any fault of the employee concerned should not be regarded as a break in continuity of his service. [*Lalappa Lingappa v. Laxmi Vishnu Mills* (1981) 2 SCC 238].

Answer 7(b)(vii)

The employer's action was justified. To be entitled to wages for the strike period, the strike should be both legal and justified.

In *Crompton Greaves Ltd. v. Workmen*, the view taken by the Supreme Court is that the strike must be both legal and justified to entitle the workmen to the wages for the period of strike whereas in *Bank of India v. T.S. Kelawala*, [1990] 4 SCC 744, the Apex Court had taken the view that whether the strike is legal or illegal, the employees are not entitled to wages for the period of strike.

The constitutional bench of the Apex Court in *Syndicate Bank v. K. Umesh Nayak*, [1994] 5 SCC 572, applying the 'no-work no-pay' principle held that wages during the strike period are payable only if the strike is both legal and justified but not payable if the strike is legal but not justified or justified but illegal.

SECURITIES LAWS AND REGULATION OF FINANCIAL MARKETS

Time allowed : 3 hours

Maximum marks : 100

NOTE : Answer SIX questions including Question No. 1 which is **COMPULSORY**.

Question 1

- (a) State, with reasons in brief, whether the following statements are true or false :
- (i) The proceeds of external commercial borrowings (ECB), not brought into India, can be invested abroad by a company.
 - (ii) Appointment of a lead merchant banker is not compulsory for the rights issue by a listed company.
 - (iii) A promoter can transfer his shares during lock-in period, if shares are acquired in a preferential allotment.
 - (iv) A beneficial owner with a depository can claim his loss to be indemnified by the depository.
 - (v) A venture capital fund can get its units listed at a recognised stock exchange in India. (2 marks each)
- (b) Choose the most appropriate answer from the given options in respect of the following :
- (i) Underwriting is the technique used in issue of securities under :
 - (a) Public issue
 - (b) Rights issue
 - (c) Bonus issue
 - (d) All the above.
 - (ii) The money market instrument which is issued in the form of a promissory note is called :
 - (a) Commercial bill
 - (b) Commercial paper
 - (c) Treasury bill
 - (d) Unit issued by a 'money market mutual fund' (MMMF).
 - (iii) In case of an Euro issue, the prospective investors can access to vital information about the issuer company from :
 - (a) Stock research report
 - (b) Offering circular
 - (c) Quarterly results of the issuer company
 - (d) Investor relation programs.

- (iv) *Market capitalisation of a listed company is computed by multiplying number of shares available for trade with :*
- (a) *Face value of a share*
 - (b) *Market price of a share*
 - (c) *Issue price of a share*
 - (d) *Book price of a share.*
- (v) *In case of a public issue, the minimum application value should be in the range of :*
- (a) *Rs. 3,000 – Rs. 5,000*
 - (b) *Rs. 5,000 – Rs. 10,000*
 - (c) *Rs. 7,000 – Rs. 10,000*
 - (d) *Rs. 5,000 – Rs. 7,000.* (1 mark each)
- (c) *Re-write the following sentences after filling-up the blank spaces with the most appropriate word(s)/figure(s) :*
- (i) *Money market instruments are generally financial claims that have _____ risk.*
 - (ii) *Hedge funds are also called _____.*
 - (iii) *Dealing in securities between members outside the official hours of stock exchange is known as _____.*
 - (iv) *Open ended schemes of mutual funds are more _____ than close ended schemes.*
 - (v) *Holders of Global Depository Receipts (GDRs) do not carry _____ rights.* (1 mark each)

Answer 1(a)

- (i) *True :* ECB proceeds parked overseas can be invested in the liquid assets, as given below : (a) deposits or Certificate of Deposit or other products offered by banks rated not less than AA(-) by Standard and Poor/Fitch IBCA or Aa3 by Moody's; (b) deposits with overseas branch of an authorised dealer in India; and (c) Treasury bills and other monetary instruments of one year maturity having minimum rating as indicated above. The funds are required to be invested in such a way that the investments can be liquidated as and when funds are required by the borrower in India.
- (ii) *True :* The body corporate need not appoint a merchant banker if the right issue is made to the existing members and its size is Rs.50 lac or less irrespective of the fact whether the issue is with or without the right of renunciation.
- (iii) *True :* The locked in shares/instruments can not be transferred except to and amongst promoter/promoter group or to a new promoter(s) or person(s) in control of the company subject to the condition that lock in for the transferee(s) shall continue for the remaining period and such transferee shall comply with SEBI (Substantial Acquisition of Shares and Takeover), 1997, if applicable.
- (iv) *False :* The Depository can not indemnify the beneficial owner for all the losses incurred by him. However, if the loss has been caused due to the negligence of

either the Depository or its participant, then such a loss will be indemnified by the Depository.

- (v) *False* : Under SEBI (Venture Capital Fund) Regulations, 1996, the venture capital fund is entitled to get its units listed on any recognized stock exchange after the expiry of three years from the date of issuance of these units.

Answer 1(b)

- (i) Public issue
- (ii) Commercial Paper
- (iii) Offering circular
- (iv) Market price of a share
- (v) Rs. 5000 – Rs. 7,000.

Answer 1(c)

- (i) Default
- (ii) Rich man's mutual funds.
- (iii) Kerb dealing
- (iv) Liquid
- (v) Voting

Question 2

(a) *Write short notes on any four of the following :*

- (i) *Concurrent audit of depository participants*
- (ii) *Asset securitisation*
- (iii) *Demutualisation of stock exchange*
- (iv) *Tracking stocks*
- (v) *Voluntary delisting of securities.*

(3 marks each)

(b) *Expand the following :*

- (i) *OTCEI*
- (ii) *AMC*
- (iii) *FIPB*
- (iv) *IDR.*

(1 mark each)

Answer 2(a)(i)

Concurrent audit of depository participants

National Securities Depository Limited provides for concurrent audit of the Depository Participants. It requires that the process of demat account opening control and verification of Delivery Instruction Slips (DIS) is subject to Concurrent Audit. Depository Participants

have been advised to appoint a firm of qualified Chartered Accountant(s) or Company Secretary(es) holding a certificate of practice for conducting the concurrent audit. However, the participants in case they so desire, may entrust the concurrent audit to their Internal Auditors.

Answer 2(a)(ii)**Asset Securitization**

Securitization is the process through which a distinct loan or discrete pool of receivable is separately packaged and sold to investors as securities (Negotiable Instruments) to be serviced by the cash flows of these loans or receivables. Such securities are secured by the underlying assets and have other credit enhancement. This process, in short, transforms illiquid assets on the balance sheet of a lender into marketable instrument.

The principal risk in this form of financing is the uncertainty of cash flows due to assets becoming defaulting on repayments or turning into loss. As such the main factor taken into account for assessing risk of these securities are :

- (i) Overall risk portfolio of the issuer;
- (ii) Quality of assets being securitized,
- (iii) Process of selection of the receivables pool to be securitized.

Answer 2(a)(iii)**Demutualisation of Stock Exchange**

Demutualisation refers to the transition process of an exchange from a “mutually owned” association to a company “owned by shareholders”. In other words, transforming the legal structure of an exchange from a mutual form to a business corporation form is referred to as demutualisation. The above, in effect means that after demutualisation, the ownership, the management and the trading rights at the exchange are segregated from one another.

Answer 2(a)(iv)**Tracking Stocks**

A Tracking Stock is a type of common stock that “tracks” or depends on the financial performance of a specific business unit or operating division of a company, rather than the operations of the company as a whole. As a result, if the unit or division performs well, the value of the tracking stocks may increase, even if the company's performance as a whole is not upto mark or satisfactory. The opposite may also be true.

A tracking stock is a special type of stock issued by a publicly held company to track the value of one segment of that company. Tracking stocks are generally issued by a parent company in order to create a financial vehicle that tracks the performance of a particular division or subsidiary.

Answer 2(a)(v)**Voluntary Delisting of Securities**

The Securities and Exchange Board of India (Delisting of Securities) Guidelines 2003, issued with the objective to protect the interest of investors in the securities market,

deal with the Voluntary and Compulsory delisting. Eligibility Criteria for Voluntary Delisting include the following :

- (i) The securities of the company have been listed for a minimum of period of three years on any stock exchange.
- (ii) A company, which has a convertible instrument outstanding, shall not be permitted to delist its equity shares, till the exercise of the conversion options.
- (iii) A company may delist one or all of its class of securities. However, if the equity shares of a company are delisted, the fixed income securities may continue to remain listed on the stock exchange.
- (iv) An exit price is required to be determined in accordance with the book building process described in the Delisting Guidelines.

Answer 2(b)

- (i) **OTCEI** : Over the Counter Exchange of India
- (ii) **AMC** : Asset Management Company
- (iii) **FIPB** : Foreign Investment Promotion Board
- (iv) **IDR** : Indian Depository Receipts

Question 3

(a) *Distinguish between any two of the following :*

- (i) *'European option' and 'American option'.*
- (ii) *'Buy and hold' and 'buy and trade'.*
- (iii) *'Commercial bills' and 'commercial papers'.* (4 marks each)

(b) *Explain any two of the following investment strategies :*

- (i) *Straddle*
- (ii) *Strip*
- (iii) *Strap.* (2 marks each)

(c) *State the requirements of 'minimum subscription' in respect of the following :*

- (i) *Public issue*
- (ii) *Composite issue.* (2 marks each)

Answer 3(a)(i)

“European Option” and “American Option”

European Options are Options that can be exercised only on the expiration day.

American Options are options contracts that can be exercised at any time upto the expiration date. Since investors have the freedom to exercise their American options at any point during the life of the contract, they are more valuable than European Options which can be exercised at maturity.

Answer 3(a)(ii)**“Buy and Hold” and “Buy and Trade”**

Buy and Hold strategy implies that instruments once purchased shall be held till maturity. This in short is a passive strategy and its salient features are :

- (i) The return is fixed and locked in the day the investment is made;
- (ii) Price variation risk due to in fluctuations in secondary market is avoided.
- (iii) No risk of default on maturity.

Buy and Trade is quite contrary to Buy and Hold Strategy in as much as under this strategy the instruments purchased are actively traded by the portfolio Manager. This is an active strategy and it helps the Portfolio Manager to optimize the yield by actively trading the instruments in the secondary market before maturity.

Answer 3(a)(iii)**"Commercial Bills" and "Commercial Papers"**

Commercial bills are basically negotiable instruments accepted by buyers for goods or services obtained by them on credit. Such bills being bills of exchange can be kept upto the due date and encashed by the seller or may be endorsed to a third party in payment of dues owing to the latter.

Commercial Paper (CP) is an unsecured money market instrument issued in the form of a promissory note. CP, is a privately placed instrument. It enables highly rated corporate borrowers to diversify their sources of short-term borrowings and provides an additional instrument to investors.

Answer 3(b)

- (i) **Straddle** : Combination of put and identical call holder pays premium equal to premium on put and call. He is insured against any movement on either side and has opportunity to gain from up move and down move.
- (ii) **Strip** : Buyer of strip is confident that scrip price will change. He also feels it is more likely to go down and enters into two puts and one call. Here the premium is equal to the sum of the premia on the two put and one call.
- (iii) **Strap** : The strap buyer feels the market may go either way, but is more likely to go up. He therefore enters into two calls and a put. The buyers recovers cost if there is a slight upswing in the market and chances of profit rise.

Answer 3(c)**(i) Public issue**

For Non-underwritten Public Issues : "If the company does not receive the minimum subscription of 90% of the issued amount on the date of closure of the issue, or if the subscription level falls below 90% after the closure of issue on account of cheques having being returned unpaid or withdrawal of applications, the company shall forthwith refund the entire subscription amount received. If there is a delay beyond 8 days

after the company becomes liable to pay the amount, the company shall pay interest as per Section 73 of the Companies Act, 1956."

For Underwritten Public Issues : "If the company does not receive the minimum subscription of 90% of the net offer to public including devolvement of Underwriters within 60 days from the date of closure of the issue, the company shall forthwith refund the entire subscription amount received. If there is a delay beyond 8 days after the company becomes liable to pay the amount, the company shall pay interest prescribed under Section 73 of the Companies Act, 1956."

(ii) Composite Issue

- (a) The Lead Merchant Banker shall ensure that the requirement of 'minimum subscription' is satisfied both jointly and severally, i.e., independently for both rights and public issues.
- (b) If the issuer company does not receive the minimum subscription in either of the issues the issuer company shall refund the entire subscription received.

Question 4

- (a) *Explain any two of the following terms related to securities market :*
 - (i) *Market abuse*
 - (ii) *Price monitoring*
 - (iii) *On line surveillance.* (2 marks each)
- (b) *"On line trading of corporate securities has originated the depository services in the capital markets." Comment.* (4 marks)
- (c) *Explain the rationality of 'fund of funds' in the Indian financial market.* (4 marks)
- (d) *State the composition of 'remuneration committee' as provided under Clause 49 of the listing agreement.* (4 marks)

Answer 4(a)

- (i) **Market Abuse** : is a broad term which includes abnormal price/volume movement, artificial transactions, false or misleading impressions, insider trading etc. Various actions like imposition of special margin, reduction of circuit filters, trade to trade settlement, suspensions etc. are used to control market abuse.
- (ii) **Price Monitoring** : Price monitoring basically includes following activities :
 - Market surveillance
 - Investigations
 - Rumour verification
 - Pro-active measures.
- (iii) **On line surveillance** : This system was commissioned in 1999 with main objective of detecting potential market abuse at a nascent stage to reduce the volatility of market. It reduces the ability of market participants to unduly influence the price and volumes of scrips traded at the Exchange improve the risk management system, and strengthen the regulatory mechanism at the Exchange.

Answer 4(b)**Depository Services**

The advent of on-line automated trading in securities in India brought with it several associated benefits such as transparency in trading and equal opportunities for market player all over the country. In order to provide safe and efficient system of trading and settlement, Depositories Act, 1996 was enacted. Depositories gave a new dimension and new scope for trading in primary as well as secondary market in a more efficient and effective manner, in a paper less form on an electronic book entry basis.

Answer 4(c)**Fund of Funds**

A Fund of Funds invests in other hedge funds rather than investing in individual securities. Technically any fund that pools capital together, while utilizing two or more sub managers to invest money in equity, commodities, or currencies, is considered a Fund of Funds. Investors are allocating assets to Fund of funds products mainly for diversification amongst the different managers' styles, while keeping an eye on risk exposure. Fund of Funds are structured as limited partnerships, which afford advantages to the investor such as due diligence.

Answer 4(d)**Composition of Remuneration Committee**

The remuneration committee, which would determine the remuneration packages of the executive directors may comprise of at least three directors, all of whom should be non-executive directors. The Chairman of committee would be an independent director.

Question 5

(a) *As on 1st April, 2008, Cash Rich Ltd. has surplus cash for six months. It has following two options under consideration for investing the surplus cash —*

- (i) *to invest in fixed deposit at the interest rate of 8% per annum payable quarterly; and*
- (ii) *to buy treasury bills of the face value of Rs. 100 at Rs. 98.019 with maturity after six months.*

Presuming that the risk involved in both the options is identical, state giving reasons which option should be selected by the company for investing its surplus funds. (6 marks)

(b) *Briefly comment on any three of the following statements :*

- (i) *Mutual fund investments in India are fraught with multiple risks.*
- (ii) *Provision for buy-back of securities/shares has contributed to volatility of stock.*
- (iii) *SEBI has taken a number of steps to improve the working of the stock exchanges.*
- (iv) *Exchange Traded Funds (ETFs) are the new variety of mutual funds.*

(2 marks each)

- (c) *Explain the accounting ratios which are required to be disclosed under the heading 'basis for issue price' in an offer document for an issue under book building process.* (4 marks)

Answer 5(a)

Alternative 1 – invest money in fixed deposits

Rate of interest 8% pa payable quarterly

Quarterly rate of Interest $8/4 = 2\%$

Effective rate of interest for 2 quarters = $[(1.02 \times 1.02) - 1] \times 100 = 4.04\%$

Alternative 2 – Investing money in treasury bills

$$Y \text{ of Treasury Bill} = \frac{(100 - P) \times 365 \times 100}{P \times D}$$

Where

Y = Discounted yield

P = Price of T. Bill = Rs. 98.019

D = Days to maturity = (April - 30 + May - 31 + June - 30 + July - 31 + August - 31 + September - 30) = 183 days

$$\text{Yield} = \frac{(100 - 98.019) \times 365 \times 100}{98.019 \times 183} = 4.03\%$$

Since the effective rate of interest is more than the yield from Treasury Bill, it shall be advantageous to park the money in fixed deposits.

Answer 5(b)(i)

Excessive diversification of portfolio, losing focus on the securities of key segments, Over concentration in investments in high priced blue chip securities, offering less than average returns, Large payments of brokerage and commission due to necessity of effecting high turnover are some of the risks mutual funds in India are confronted with.

Apart from this Mutual Funds also face risk due to Poor planning of investments, unresearched forecast on income, profits and Government policies, failure to identify risks of the scheme *vis-à-vis* the market risk, lack of transparency in functioning. Some Mutual Funds are characterized by secrecy, unwillingness to move towards transparency despite legislation; trades in large block of securities in stock markets leads to volatility and major market movement.

Answer 5(b)(ii)

Buy-back is a process whereby a company purchases its own shares or other specified securities from the holders thereof. A company can resort to buy-back to reduce the number of shares issued and return surplus cash to the shareholders. It is a corporate financial strategy which involves capital restructuring and is prevalent globally with the underlying objectives of increasing earnings per share, averting hostile takeovers, and improving returns to the stakeholders.

Answer 5(b)(iii)

In secondary market, SEBI improved market efficiency, integrity and transparency. Trading infrastructure was modernized in most of the traditional stock exchanges. Mutual funds were reformed drastically so as to provide greater operational flexibility to the fund manager and increase their accountability and supervision. Substantial acquisition of takeover of shares and insider trading was regulated and regulations for foreign institutional investors were liberalized.

Answer 5(b)(iv)

Exchange Traded Funds (ETFs) represent a basket of securities that are traded on an exchange. They are similar to index mutual funds but are traded more like a stock. They are a rapidly growing class of financial product and are typically organized as unit trusts. ETFs can be bought and sold throughout the trading day, allowing for intraday trading—which is rare with mutual funds. Unlike mutual funds, ETFs do not trade necessarily at the net asset values of their underlying holdings, meaning an ETF could potentially trade above or below the value of the underlying portfolios.

Answer 5(c)

The following accounting ratios shall be given under the basis for issue price for each of the accounting periods for which the financial information is given :

1. EPS, pre-issue, for the last three years (as adjusted for changes in capital).
2. P/E pre-issue.
3. Average return on net-worth in the last three years.
4. Net-Asset value per share based on last balance sheet.
5. Comparison of all the accounting ratios of the issuer company as mentioned above with the industry average and with the accounting ratios of the peer group (i.e. companies of comparable size in the same industry. (Indicate the source from which industry average and accounting ratios of the peer group has been taken).

Question 6

- (a) *A unit of Evergrow Equity Fund is redeemed at Rs. 15, the exit load being 2.25%. Calculate the NAV. (4 marks)*
- (b) *Briefly explain the developments in commodity futures market. (4 marks)*
- (c) *Explain 'unique identification number' (UIN) and criteria to determine specified intermediaries, specified listed companies and specified investors. (4 marks)*
- (d) *Discuss briefly the SEBI Guidelines on insider trading. (4 marks)*

Answer 6(a)

NAV = Redemption Price (1 + Exit Load)

NAV = 15 (1 + 0.0225)

NAV = 15.34

Answer 6(b)

A commodity is defined as all kinds of goods, i.e., every kind of movable property other than actionable claims, money and securities. Like a stock exchange, a commodity exchange is an association or a company or any other body corporate organizing futures trading in commodities.

Till 2004, due to certain perceptions about commodities markets concerned people had lost sight of the basic economic function of commodities exchanges, viz., that of price discovery and price risk management. The Government had therefore imposed prolonged prohibition of futures trading in commodity markets. However, afterwards it finally approved futures trading in all commodities through four commodity exchanges leading to national level multi commodity exchange. Having signed WTO agreement and embarked on economic liberalization policies, the government realized the need for futures trading. It was expected to lead to strengthening of competitiveness of India's agricultural products and the commodities trade and industry.

Futures trading is organized in such goods or commodities as are permitted by the Central Government. At present, all goods and products of agriculture (including plantation); mineral and fossil origin are allowed for futures trading under the auspices of commodity exchanges. Commodities futures contracts and the commodity exchanges organizing trading in such contracts are regulated by the Government of India under the Forwards Contracts (Regulation) Act of 1952 [FCRA] and the Rules framed thereunder.

Answer 6(c)**Unique Identification Number**

SEBI (Central Database of Market Participants) Regulations, 2003 requires every specified intermediary, other entity, specified listed company and specified investor to make application for allotment of Unique Identification Number for itself and for its related persons. Unique Identification Number means the Identification Number generated in the Central Database for and allotted to each applicant under the regulations.

Criteria to determine specified intermediaries, specified listed companies and specified investors

For the purposes of specifying the intermediaries, listed companies or investors, SEBI take into consideration the following factors :

- (a) With regard to intermediaries or other entities-their kind and the nature of functions performed by them, their net worth and other similar factors;
- (b) With regard to listed companies or companies which intend to get their securities listed-their paid-up capital, the number of their public shareholders, the volume of trading in their securities, the proposed issue size and other similar factors; and
- (c) With regard to investors—the quantum of investment made by them in the securities of any listed company or their volume of trading in securities in a particular financial year.

Answer 6(d)**SEBI Guidelines on Insider Trading**

SEBI (Insider Trading) Regulations, 1992 govern the conduct of the insiders, connected persons and persons who are deemed to be connected persons on matters relating to Insider Trading.

Directors, officers, designated employees and all connected persons are required to maintain confidentiality of all Price Sensitive Information. They are prohibited from passing on such information to any person directly or indirectly by a recommendation for the purchase or sale of securities of the company.

Every listed company is required to prescribe a threshold limit for dealing in the securities of that company. All directors, officers, designated employees and connected persons would need to obtain pre-clearance from the company for dealing in securities above the threshold limit. Insider Trading Regulations prescribes disclosure of interest or holding to be made by directors, officers and substantial shareholders in case of listed companies. Insider Trading Regulations has prescribed norms to be followed by listed companies, to ensure timely and adequate disclosure of price sensitive information.

Question 7

- (a) *Explain the eligibility criteria for appointment of an 'Ombudsman' under the SEBI Regulations. What are the functions of an Ombudsman ?* (4 marks)
- (b) *Mention the terms and conditions on which non-banking finance companies can accept public deposits under directions issued by the Reserve Bank of India.* (4 marks)
- (c) *List out briefly the general grievances of investors against the companies.* (4 marks)
- (d) *What are the duties of debenture trustees under the SEBI (Debenture Trustees) Regulations, 1993 ?* (4 marks)

Answer 7(a)**Eligibility Criteria for Appointment of an Ombudsman**

In order to be appointed as an Ombudsman, a person is required to be

- (i) a citizen of India;
- (ii) of high moral integrity;
- (iii) not below the age of forty five years; and
- (iv) either a retired District Judge or qualified to be appointed a District Judge, or having at least ten years experience of service in any regulatory body, or having special knowledge and experience in law, finance, corporate matters, economics, management or administration for a period of not less than ten years, or an office bearer of investors' association recognised by the Board having experience in dealing with matters relating to investor protection for a period of not less than 10 years.

However a person is not qualified to hold the office of the Ombudsman if he is an undischarged insolvent; has been convicted of an offence involving moral turpitude; has been found to be of unsound mind and stands so declared by a competent court; has been charge sheeted for any offence including economic offences; or has been a whole-time director in the office of an intermediary or a listed company and a period of at least 3 years has not elapsed.

The Ombudsman has the following functions :

- (i) To receive complaints specified under SEBI (Ombudsman) Regulations against any intermediary or a listed company or both;
- (ii) To consider such complaints and facilitate resolution thereof by amicable settlement;
- (iii) To approve a friendly or amicable settlement of the dispute between the parties;
- (iv) To adjudicate such complaints in the event of failure of settlement thereof by friendly or amicable settlement.

Answer 7(b)

NBFC can accept Public Deposits as per NBFC's Acceptance of Public Deposits (Reserve Bank) Directions, 1998. The conditions stipulated by these guidelines are:

- (i) Net owned fund of the Company should not be less than Rs. 25 lacs.
- (ii) Deposits should be rated at least once a year with minimum investment grade rating and rating certificate to be sent to RBI along with the return on prudential norms.
- (iii) Company shall not accept or renew Public Deposits payable on Demand.
- (iv) Maturity period of deposits should not be less than 12 months or more than 60 months.
- (v) Quantum of Deposits is subject to such Ceilings as may be laid down by RBI for Asset Finance Company, Loan Finance Company and Investment Company.
- (vi) Interest on deposits not to exceed 16% per annum but may be paid or compounded at not less than monthly rests.
- (vii) Brokerage, Commission, incentive for mobilization of Deposits not to exceed 2% of the amount of deposits collected.
- (viii) Interest on over due deposit may be paid if the deposits in full or part thereof is renewed from the date of maturity till some future date.
- (ix) Deposits in joint name may be accepted.
- (x) Premature payment of deposits allowed incase of death.
- (xi) Loan equivalent to 75% of the deposit amount may be allowed after the expiry of three months from the date of deposits and at a rate of 2% above the interest rate payable on deposits.

Answer 7(c)**General Grievances of Investors**

The general grievances the investors have against companies can be listed as under:

- (i) Furnishing inadequate information or making misrepresentation in prospectus, application forms, advertisements and rights offer documents.
- (ii) Delay/non-receipt of refund orders, allotment letters and share certificates/debenture certificates/bonds.
- (iii) Delay/non-receipt of share certificates/debenture certificates after transfer.
- (iv) Delay in listing of securities with stock exchanges.
- (v) Delay/non-receipt of share certificates/bonds/debentures after endorsement of part payment/call money.
- (vi) Delay/non-receipt of share certificates/bonds/debentures after sub-division or consolidation.
- (vii) Delay/non-receipt of letter of offer of rights issue.
- (viii) Delay/non-receipt of bonus shares/right shares.
- (ix) Delay/non-receipt of notices for meetings/annual reports.
- (x) Delay/default in payment of interest and repayment of deposits.

Answer 7(d)

Regulation 15 of SEBI (Debenture Trustee) Regulations, 2003 casts the following duties on the debenture trustees:

- (1) Call for periodical reports from the body corporate;
- (2) Take possession of trust property in accordance with the provisions of the trust deed;
- (3) Enforce security in the interest of the debenture holders;
- (4) Do such acts as necessary in the event the security becomes enforceable;
- (5) Debenture certificates have been despatched to the debenture holders in accordance with provisions of the Companies Act, 1956.
- (6) Exercise due diligence to ensure compliance by the body corporate, with the provisions of the Companies Act, the listing agreement of the stock exchange or the trust deed;
- (7) To take appropriate measures for protecting the interest of the debenture holders as soon as any breach of the trust deed or law comes to his notice;
- (8) To ascertain that the debentures have been converted or redeemed in accordance with the provisions and conditions under which they are offered to the debentureholders;
- (9) Inform SEBI immediately of any breach of trust deed or provision of any law;
- (10) Debenture trustee may inspect books of accounts, records, registers of the body corporate and the trust property to the extent necessary for discharging its obligations.

Question 8

- (a) *What is 'margin trading facility' ? State briefly the essential requirements for providing margin trading facility to the members by a stock exchange. (4 marks)*
- (b) *State briefly whether electronic-holding of securities can be converted into physical form. Also state in brief whether instructions for delivery of securities can be given to a depository participant via internet. (4 marks)*
- (c) *Explain the following credit rating symbols :*
- (i) FA (ii) LAA+
(iii) DA1 (iv) PR 5 (1 mark each)
- (d) *Define 'persons acting in concert' under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997. (4 marks)*

Answer 8(a)**Margin Trading**

Margin trading was introduced by SEBI to curb speculative dealings in shares leading to volatility in the prices of securities. Margin Trading basically means buying stocks without having the money to do so. Margin means the minimum amount to be placed by the client with the broker, before the actual purchase. The broker may advance the balance amount to meet full settlement obligations.

When the balance deposit in the client's margin account falls below the required maintenance margin, the broker shall promptly make margin calls. However, no further exposure can be granted to the client on the basis of any increase in the market value of the securities.

The broker must disclose to the stock exchange details on gross exposure including the name of the client, unique identification number, name of the scrip and if the broker has borrowed funds for the purpose of providing margin trading facilities, name of the lender and amount borrowed, on or before 12 Noon on the following day.

Stock exchanges disclose scripwise gross outstanding in margin accounts with all brokers to the market. Such disclosures regarding margin trading done on any day shall be made available after the trading hours on the following day through the website.

Answer 8(b)

SEBI (Disclosure and investor Protection) Guidelines, 2000 prescribes that no company can make a public or rights issue or an offer for sale unless the company enters into an agreement with a depository for dematerialization of securities already issued or proposed to be issued to the public or existing shareholders and the company gives an option to the subscribers/investors to receive the security certificates or hold securities in dematerialized form with a depository.

Thus dematerialization of securities is compulsory for making the issue of securities. However after getting the shares it is the discretion of the shareholder to either keep it in dematerialized form or rematerialize it in Physical form. If one wishes to get back his securities in the physical form one has to fill in the remat request form and his DP for rematerialisation of the balances in his securities account.

Yes, Both NSDL and CDSL have launched this facility for delivering instructions to your DP over internet called SPEED-e and EASI respectively. The facility can be used by all registered users after paying the applicable charges.

Answer 8(c)

- (i) **FA** : CRISIL rating symbol for Fixed Deposits. Adequate safety—indicates the degree of safety regarding timely payment of interest and principal is satisfactory. Changes in circumstances can affect such issues more than those in the higher rated categories.
- (ii) **LAA+** : Symbol represents long-term funds. This represents High safety. Risk factors are modest and may vary slightly.
- (iii) **DA1** : Excellent : The developer's past track record in executing real estate projects as per specified quality levels and transferring clear title within stipulated time schedule is excellent.
- (iv) **PR 5** : Rating symbol of CARE related to short-term instruments. It provides that the instrument is in default or is likely to be in default on maturity.

Answer 8(d)

SEBI (Substantial Acquisition of Shares & Takeovers) Regulations, 1997 defines person acting in concert' as under :

- (1) Persons who, for a common objective or purpose of substantial acquisition of shares or voting rights or gaining control over the target company, pursuant to an agreement or understanding (formal or informal), directly or indirectly co-operate by acquiring or agreeing to acquire shares or voting rights in the target company or control over the target company.
- (2) Without prejudice to the generality of this definition, the following persons will be deemed to be persons acting in concert with other persons in the same category, unless the contrary is established :
 - (i) A company, its holding company, or subsidiary of such company or company under the same management either individually or together with each other;
 - (ii) A company with any of its directors, or any person entrusted with the management of the funds of the company;
 - (iii) Directors of companies referred to in sub-clause (i) of clause (2) and their associates;
 - (iv) Mutual fund with sponsor or trustee or asset Management Company;
 - (v) foreign institutional investors with sub-account(s);
 - (vi) Merchant bankers with their client(s) as acquirer;
 - (vii) Portfolio managers with their client(s) as acquirer;
 - (viii) Venture capital funds with sponsors;

- (ix) Banks with financial advisers, stock brokers of the acquirer or any company which is a holding company, subsidiary or relative of the acquirer:
 - (x) Any investment company with any person who has an interest as director, fund manager, trustee, or as a shareholder having not less than 2 per cent of the paid-up capital of that company or with any other investment company in which such person or his associate holds not less than 2 per cent of the paid up capital of the latter company.
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