

PROFESSIONAL PROGRAMME EXAMINATION

JUNE 2011

**DUE DILIGENCE AND CORPORATE
COMPLIANCE MANAGEMENT**

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) *A company registered under section 25 of the Companies Act, 1956 shall be required to have minimum paid-up capital of ` 5 lakh or such higher paid-up capital as may be prescribed from time-to-time.*
- (ii) *Rematerialisation means the conversion of physical holdings back into the electronic holdings.*
- (iii) *All fees/compensation, if any, paid to non-executive directors can be fixed by the Board of directors without the previous approval of the shareholders in a general meeting.*
- (iv) *The Securities Contracts (Regulation) Act, 1956 states that if a company fails to comply with the listing conditions or delisting conditions or grounds or commits a breach thereof, it shall be liable to a penalty not exceeding ` 20 crore.*
- (v) *A company not eligible to raise funds from the Indian capital market will not be eligible to issue foreign currency convertible bonds.*

(2 marks each)

(b) *Critically examine and comment on the following :*

- (i) *A remuneration committee may be set-up by the Board of directors.*
- (ii) *As per SEBI regulations, every issuer is required to submit audit report on a quarterly basis.*

(5 marks each)

Answer 1(a)(i)

False : According to Section 3(6) of the Companies Act, a Company registered under Section 25 before or after the commencement of Companies(Amendment) Act, 2000, shall not be required to have minimum paid up capital specified under Section 3(6).

Answer 1(a)(ii)

False : Rematerialisation means conversion of dematerialized shares (i.e. electronic holdings) into physical holdings.

Answer 1(a)(iii)

False : As per Clause 49 of the listing agreement, all fees/compensation, if any paid to non-executive directors, including independent directors, shall be fixed by the

Board of Directors and require previous approval of shareholders in general meeting. However, prior approval of shareholders in general meeting shall not apply to payment of sitting fees to non-executive directors, if made within the limits prescribed under the Companies Act, 1956 for payment of sitting fees without approval of the Central Government.

Answer 1(a)(iv)

False : As per clause 23E of Securities Contracts (Regulations) Act, 1956 states that if any company fails to comply with the listing conditions or delisting conditions or grounds or commits a breach thereof, it shall be liable to a penalty not exceeding twenty five crore rupees.

Answer 1(a)(v)

True : An Indian Company, which is not eligible to raise funds from the Indian Capital Market including a company which has been restrained from accessing the securities market by the Securities and Exchange Board of India (SEBI) will not be eligible to issue (i) Foreign Currency Convertible Bonds and (ii) Ordinary Shares through Global Depositary Receipts under the Foreign Currency Convertible Bonds and Ordinary Shares (Through Depositary Receipt Mechanism) Scheme, 1993.

Answer 1(b)(i)

Constitution of Remuneration Committee is the non-mandatory requirement under Clause 49 of the Listing Agreement. Accordingly, the board may set up a remuneration committee to determine on their behalf and on behalf of the shareholders with agreed terms of reference, the company's policy on specific remuneration packages for executive directors including pension rights and any compensation payment. To avoid conflicts of interest, 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 being an independent director.

Answer 1(b)(ii)

Regulation 55A of SEBI (Depositories and Participants) Regulations 1996 provides that every issuer shall submit an audit report on quarterly basis to the concerned stock exchanges, audited by a qualified Chartered Accountant or practising company secretary, for the purposes of reconciliation of total issued capital, listed capital and capital held by depositories in dematerialized form, the details of changes in share capital during the quarter and the in-principle approval obtained by the issuer from all the stock exchanges where it is listed in respect of such further issued capital. The audit report shall also give the updated status of the register of members of the issuer and confirm that securities have been dematerialized as per requests within 21 days from the date of receipt of requests by the issuer and where the dematerialization has not been effected within the stipulated period, the report shall disclose the reason for such delay. The issuer shall immediately bring to the notice of the depositories and the stock exchanges, any differences observed in its issued, listed capital and the capital held by depositories in dematerialized form.

Question 2

- (a) Write the most appropriate answer from the given options in respect of the following :
- (i) Where a company fails to comply with the requirement of filing the compliance certificate with the Registrar of Companies, every officer of the company and the company shall be punishable with fine which may extend to —
- (a) ₹ 250 per day during which the default continues
- (b) 1,000 per day during which the default continues
- (c) 500 per day during which the default continues
- (d) 750 per day during which the default continues.
- (ii) As per clause 49 of the listing agreement, the Board of directors shall meet in a year at least —
- (a) 2 Times
- (b) 3 Times
- (c) 4 Times
- (d) 5 Times.
- (iii) When a charge on the assets of the company is satisfied, which one of the following forms is required to be filed with the Registrar of Companies —
- (a) Form No.10
- (b) Form No.12
- (c) Form No.8
- (d) Form No.17.
- (iv) As per FEMA regulations, an Indian party is permitted to make an investment in overseas joint venture/wholly owned subsidiaries not exceeding —
- (a) 100%
- (b) 200%
- (c) 400%
- (d) 500%
- of its net worth as on the date of the last audited balance sheet.
- (v) The proceedings of each general meeting of the company should be entered within —
- (a) 60 Days of the meeting
- (b) 45 Days of the meeting
- (c) 90 Days of the meeting
- (d) 30 Days of the meeting.

(vi) Which of the following Acts does not come under the purview of the securities laws —

(a) Securities and Exchange Board of India Act, 1992

(b) Foreign Contribution (Regulation) Act, 1976

(c) Securities Contracts (Regulation) Act, 1956

(d) Depositories Act, 1996.

(1 mark each)

(b) Distinguish between the following :

(i) 'Equity shares' and 'sweat equity shares'.

(ii) 'Buy-back of shares' and 'redemption of shares'.

(5 marks each)

Answer 2(a)(i)

(c) Rs. 500 per day during which the default continues.

Answer 2(a)(ii)

(c) 4 Times

Answer 2(a)(iii)

(d) Form No. 17

Answer 2(a)(iv)

(c) 400%

Answer 2(a)(v)

(d) 30 days

Answer 2(a)(vi)

(b) Foreign Contribution (Regulation) Act, 1976

Answer 2(b)(i)

Equity Share

As per Section 85 of the Companies Act 1956, an equity share capital is one which is not a preference share capital. This means that the holders of equity shares do not have any preferential rights of receiving dividends. They will receive dividend only after the preference dividend has been paid. They also do not have any priority over preference shares regarding the repayment of capital at the time of liquidation of the company, Equity shareholders have voting rights.

Sweat Equity Shares

Sweat Equity Shares mean equity shares issued by a company to its employees or director at a discount or for consideration, other than cash for providing know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called. Section 79 A of the Companies Act, permits issue of Sweat equity shares to employees or directors in recognition of their contribution for providing know-how etc.

Answer 2(b)(ii)**Buy-Back of Shares**

As per Section 77 A of the Companies Act, 1956, a company subject to the authorization of its Articles may purchase its own shares (Buy-Back) out of:

(i) its free reserves (ii) the Securities Premium account (iii) the proceeds of any shares or other securities.

The buy-back of shares may be either by purchasing of shares from existing shareholders or purchasing shares from the open market.

Further a special resolution is required to be passed in the General Meeting authorizing Buy-Back and the buy back is to be authorized by the Articles of Association.

Redemption of Shares

As per section 80 of the Companies Act, 1956, if authorized by the Articles, a Public Company may redeem its redeemable Preference Shares out of:

- (i) Proceeds of fresh issue of shares or
- (ii) out of profits available for dividend.

Further, no such shares can be redeemed unless they are fully paid. When the shares are redeemed out of profit, an equal amount is to be transferred to Capital Redemption Reserve Account”.

Question 3

- (a) *You are a Company Secretary holding certificate of practice. While issuing the secretarial compliance certificate to Keya Co. Ltd., you observe that in the calendar year 2010, the following meetings of the Board of directors were held :*

1st meeting	—	26th February, 2010
2nd meeting	—	30th March, 2010
3rd meeting	—	26th May, 2010
4th meeting	—	30th June, 2010
5th meeting	—	1st October, 2010
6th meeting	—	28th December, 2010

Do you feel that there is any violation of the provisions of the Companies Act, 1956 ? Explain. (6 marks)

- (b) *Swadesh has applied for shares under employees stock option scheme (ESOS) and his option was granted by the company. Now, Swadesh wants to transfer his option to his friend, Vinod. Comment on the check points for non-transferability of option under the ESOS.* (5 marks)
- (c) *“MCA-21 offers the facility to view documents and also search and other facilities of public documents online.” Explain the statement and narrate the procedure for examination of records filed by a company with the Registrar of Companies.* (5 marks)

Answer 3(a)

Section 285 of the Companies Act, 1956 prescribes that in the case of every company, a meeting of the Board of Directors shall be held at least once in every three months and at least four such meetings shall be held in every year.

It has been clarified so long as four board meetings are held in a calendar year, one in each quarter; the interval between two meetings may be more than 3 months. For instance, if a meeting is held on January 1, the next meeting may be held on June 30, the third one on 1st July and the fourth one is on the 31st December.

However, it must be ensured that in each quarter of a calendar year a board meeting must be held.

In the given case, it is observed that the board meeting has been held in each quarter of the calendar year 2009 except in the quarter (July 09 to September 09) i.e. there is no board meeting in the 3rd quarter of July 09 to September 09 of the calendar year 2009.

So there is a violation of section 285 of the Companies Act 1956.

Answer 3(b)**Check points for Non-Transferability of Option under ESOS**

- (i) Check that option granted to an employee is not transferable to any person.
- (ii) (a) No person other than the employee to whom the option is granted shall be entitled to exercise the option.
 - (b) under the cashless system of exercise, the company may itself fund or permit the empanelled stock brokers to fund the payment of exercise price which shall be adjusted against the sale proceeds of some or all the shares, subject to the provisions of the Companies Act, 1956.
- (iii) Check that the option granted to the employee is not pledged, hypothecated, mortgaged or otherwise alienated in any other manner.
- (iv) Check that in the event of the death of employee while in employment, all the options granted to him till such date are vested in the legal heirs or nominees of the deceased employee.
- (v) Check that in case the employee suffers a permanent incapacity while in employment, all the option granted to him as on the date of permanent incapacitation, shall vest in him on that day.
- (vi) Check that if an employee resigns or is terminated, all options not vested as on that day expire. However, the employee shall, subject to the terms and conditions formulated by compensation committee, be entitled to retain all the vested options.
- (vii) Check that, the options granted to a director, who is an employee of an institution and has been nominated by the said institution, has not been renounced in favour of institution nominating him.

Answer 3(c)

MCA-21 offers the facility to view documents and also search and other facilities of public documents. This facility is handy for users and banks and financial institutions while sanctioning loans.

This facility enables viewing of public documents of companies for which payment has been made by user. The document can be viewed only within 7 days after the payment has been confirmed. Also, the documents are available for only

3 hours after the user has started viewing the first document of the company.

- (a) User has to access My MCA portal and login to the My MCA portal.
- (b) Click on the 'My Documents' tab after logging into the system.
- (c) List of company names will be displayed, for which user have already paid for public viewing. It also displays
 - (i) Date of request i.e. the date, when user made the request to view the company document.
 - (ii) Status of the request i.e. whether viewed or to view.
- (d) Click on the view link under status field.
- (e) The documents are grouped under five categories i.e. user has to click on the desired category under which the document falls.
- (f) If more than one document is listed, the user can arrange them name wise or date wise.
- (g) On clicking the document name, the document shall be displayed for viewing.

The public documents under this facility are available for viewing by public on payment of requisite fee. Public documents include Incorporation documents, charge documents, annual returns and balance sheet, change in directors and other documents.

Question 4

- (a) *What do you mean by 'persons acting in concert' ? Who will be deemed to be persons acting in concert as per the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 ?* (6 marks)
- (b) *Sunil is a Company Secretary holding certificate of practice. He has accepted the assignment of secretarial audit of XYZ Ltd. for the financial year ended 31st March, 2010. He received the notice of his assignment on 15th April, 2010 and signed the audit report on 30th June, 2010. It is noticed that Sunil ceased to be a Company Secretary in practice from 1st June, 2010. Examine the validity of the report dated 30th June, 2010 signed by Sunil.* (5 marks)
- (c) *Amar Properties Pvt. Ltd. was incorporated by Amar and his three sons. The issued and paid-up capital was 4 lakh comprising 4,000 shares of 100 each. After few years, Amar died in an accident. At that time his name appeared in the following manner in the register of members.*

<i>Name</i>	<i>No. of Shares</i>
<i>Amar</i>	<i>100</i>
<i>Amar and his first son</i>	<i>600</i>
<i>Amar and his second son</i>	<i>600</i>
<i>Amar and his third son</i>	<i>500</i>
<i>Total :</i>	<u><i>1,800</i></u>

On the demise of Amar, his wife claimed that her late husband held 1,800 equity shares jointly and severally. He had left behind a will and she accordingly obtained a probate in her favour in respect of the above mentioned shares from the court and applied to the company for transmission of all the 1,800 shares in her favour. The company transmitted only 100 shares in the name of Amar's wife because of complaints made by the other survivors. Amar's wife has filed a petition under sections 111(2) and 111(4) of the Companies Act, 1956 challenging the action of the company. Prepare a note for the company about the defences it may take.

(5 marks)

Answer 4(a)

According to Regulation 2(e) of SEBI (SAST) Regulations, 1997, "person acting in concert" comprises,—

- (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 or 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:

Provided that sub-clause (ix) shall not apply to a bank whose sole relationship with the acquirer or with any company, which is a holding company or a

subsidiary of the acquirer or with a relative of the acquirer, is by way of providing normal commercial banking services or such activities in connection with the offer such as confirming availability of funds, handling acceptances and other registration work;

- (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.

Answer 4(b)

The Board appointed Mr. Sunil as Secretarial Auditor. He was Company Secretary holding Certificate of Practice. While Sunil received the Notice on 15th April 2010 he was Practising Company Secretary whereas on the date of signing of Audit Report he was not Company Secretary in practice in terms of Company Secretaries Act, 1980. Hence report submitted as Company Secretary in Practice was not valid.

Answer 4(c)

Since the provisions of Companies Act, 1956/Articles are binding on the company as well as every share holder, only the survivors in respect of 1700 (600+600+500) shares would be entitled to the shares held jointly with late Amar. Amar's wife cannot claim any exclusive interest or title to the shares based on her application and probate, since 1700 shares were held jointly and therefore, she is not right in seeking transmission of all 1800 shares in her favour.

Thus, on a strict legal construction, wife of Amar is entitled to only in respect of 100 shares which were held in the sole name of Amar. The company was right in transmitting only the 100 shares to her. The complainant cannot get any relief from Company Law Board in this regard.

This present case is similar to the case in *Smt. Biva Pyne v. Pyne Properties (P) Ltd. and others* [2010] 94 CLA 192 (CLB). In this case CLB held that the petitioner was entitled for transmission only in respect of shares which were held in the sole name of her deceased husband.

Question 5

- (a) Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s) :
 - (i) Promoters' contribution has to be brought in as per the SEBI guidelines before the _____ of public issue.
 - (ii) Indian depository receipt means any _____ in the form of depository receipt created by domestic depository in India.
 - (iii) The depository participant shall redress the grievances of the beneficial owners within _____ of the date of receipt of the complaint.
 - (iv) Form No. _____ is required to be filed with the Registrar of Companies in case any existing director was appointed as managing director or manager.

- (v) *Legal due diligence is a _____ operation through which one can know the strengths and weaknesses of a company.*
- (vi) *Every company accepting deposits from the public has to file with the Registrar of Companies the return of deposits under section 58A of the Companies Act, 1956 on or before _____ every year.*
(1 mark each)
- (b) *Katreena Ltd., a listed company, wants to make an issue of securities through a rights issue and the aggregate value of the securities including premium exceeds 70 lakh. As a Company Secretary of Katreena Ltd., advise the company about the procedures to be followed for making the rights issue.* (5 marks)
- (c) *While conducting the secretarial audit of Rainbow Pharmaceuticals Ltd., it came to notice that a Board meeting held on 24th March, 2011 was convened and conducted by Jagat alone as a director of the company. On enquiry, it was found that except Jagat, all other directors of the company had resigned and in order to constitute the quorum and to carry out the business activities, two additional directors were appointed with immediate effect in the said single director Board meeting. Decide the validity of the Board meeting and the appointment of the two additional directors in the meeting held on 24th March, 2011.*
(5 marks)

Answer 5(a)(i)

At least one day before opening

Answer 5(a)(ii)

Instrument

Answer 5(a)(iii)

30 days

Answer 5(a)(iv)

25 C

Answer 5(a)(v)

Precautionary

Answer 5(a)(vi)

June 30th

Answer 5(b)

SEBI (ICDR) Regulations 2009 are applicable for rights issue where the aggregate value of specified securities offered is fifty lakh rupees or more. The following are the compliances which are to be ensured for issue of rights shares.

1. *Record Date*

- Ensure that the record date has been announced for the purpose of determining the shareholders eligible to apply for specified securities in the proposed rights

issue. It may be noted that the issuer shall not withdraw rights issue after announcement of the record date.

- If the issuer withdraws the rights issue after announcing the record date, it shall not make an application for listing of any of its specified securities on any recognised stock exchange for a period of twelve months from the record date announced. However, the issuer may seek listing of its equity shares allotted pursuant to conversion or exchange of convertible securities issued prior to the announcement of the record date, on the recognised stock exchange where its securities are listed.

2. *Restriction on rights issue*

No issuer shall make a rights issue of equity shares if it has outstanding fully or partly convertible debt instruments at the time of making rights issue, unless it has made reservation of equity shares of the same class in favour of the holders of such outstanding convertible debt instruments in proportion to the convertible part thereof.

The equity shares reserved for the holders of fully or partially convertible debt instruments shall be issued at the time of conversion of such convertible debt instruments on the same terms on which the equity shares offered in the rights issue were issued.

3. *Letter of offer, abridged letter of offer*

The abridged letter of offer, along with application form, shall be dispatched through registered post or speed post to all the existing shareholders at least three days before the date of opening of the issue. The letter of offer shall be given by the issuer or lead merchant banker to any existing shareholder who has made a request in this regard. The shareholders who have not received the application form may apply in writing on a plain paper, along with the requisite application money. The shareholders making application otherwise than on the application form shall not renounce their rights and shall not utilise the application form for any purpose including renunciation even if it is received subsequently. If any shareholder makes an application on application form as well as on plain paper, the application is liable to be rejected.

4. *Pricing*

The issue price shall be decided before determining the record date which shall be determined in consultation with the designated stock exchange.

5. *Period of subscription*

A rights issue shall be open for subscription for a minimum period of fifteen days and for a maximum period of thirty days.

6. *Pre-Issue Advertisement for rights issue*

The issuer shall issue an advertisement for rights issue disclosing the following:

- (a) the date of completion of despatch of abridged letter of offer and the application form;
- (b) the centres other than registered office of the issuer where the shareholders or the persons entitled to receive the rights entitlements may obtain duplicate copies of the application forms in case they do not receive the application form within a reasonable time after opening of the rights issue;

7. *Obligation of issuer/intermediaries*

The obligation of issuer/intermediaries for a rights issuer, with respect to advertisement, appointment of compliance officer, redressal of investor grievances, due diligence, post issue reports, post issue advertisements etc is same as the public issue.

Answer 5(c)

As given in the problem, normally, the quorum for the board meetings of the company is three, which is in accordance with Section 287 of the Companies Act. The meeting in question was held for increasing the strength of board to meet out the criteria prescribed for quorum, whereas, Regulation 75 of Table A of Schedule to the Companies Act, 1956 provides that when the number of directors of the company falls below the requisite quorum, the continuing directors or director present could be the quorum for the purpose of increasing the number of directors required to have a quorum, but for no other purpose.

It was held in *Mannalal Khetan v Kedar Nath Khetan* (1977) 47 Comp Cases 185 (SC) the only proposal that the continuing directors could have considered in the Board Meeting was to increase the number of directors and nothing else and even the Board with the quorum established in that meeting cannot consider any item other than the appointment of directors for the purpose of constituting quorum.

Therefore, the board meeting would be considered valid and the appointment of two additional directors will also be valid. However, decisions if any taken in that board meeting other than the constitutional of the board would be considered null and void, even if it is in the interest of the company.

Question 6

- (a) *Mention the possible hurdles in carrying out a legal due diligence. (6 marks)*
- (b) *MPS Ltd. is an educational institution registered as a society under the Societies Registration Act, 1860. It wishes to make overseas investment in United Kingdom by establishing a wholly owned subsidiary to run schools in that country. Explain the provisions relating to overseas investments by a registered society. (5 marks)*
- (c) *Mention the various records required to be maintained by depository participants under the Depositories Act, 1996. (5 marks)*

Answer 6(a)

Possible Hurdles in carrying out a legal due diligence and remedial actions

1. *Non availability of information*

In many occasions, when a person carries out due diligence, the required information may not be available or insufficient to derive a complete picture.

2. *Unwillingness of target company's personnel in providing the complete information*

Non-co-operation of target company's personnel may also prove to be a major hurdle during due diligence process. Sometimes, the available information would be pretended as not available.

3. *Providing of incorrect information*

Providing of incorrect information by the target personal also acts as a major hurdle in the due diligence process.

4. *Complex tax policies and hidden liabilities*

Complex tax policies & structures may create a number of hidden tax liabilities, which may not be easy to track.

5. *Multiple Regulations and its applicability*

Owing to the new and emerging legislations, it is difficult to interpret whether a specific legislation is applicable for business and getting legal opinion on the same would prove to be very costly.

6. *Process in providing data*

Multiple Layers of review and scrutiny before data is provided for due diligence also hinders and delays the due diligence process.

7. *Absence of proper MIS*

Due diligence process would become difficult if there is no proper MIS in the company.

Actions to break hurdles in due diligence

The following actions may break the afore said hurdles

- Focus follow up questions.
- Ask several people the same questions and utilise appropriate professional skepticism.
- Polite persistence may help to overcome this attitude.
- Independent check with regulatory authorities.

Considering this hurdles, it is advisable to insert the necessary disclaimer clauses in the due diligence report.

Answer 6(b)

Overseas investment by registered society

Registered Trusts and Societies engaged in manufacturing / educational sector / set up hospital in India are allowed make investment in the same sector(s) in a Joint Venture or Wholly Owned Subsidiary outside India, with the prior approval of the Reserve Bank. Trusts/Societies satisfying the eligibility criteria as given below may submit the application/s in Form ODI-Part I, through their AD Category - I bank/s, to the Chief General Manager, Reserve Bank of India, Foreign Exchange Department, Overseas Investment Division, Central Office, Amar Building, 5th Floor, Fort, Mumbai 400 001, for consideration:

- (i) The Society should be registered under the Societies Registration Act, 1860.
- (ii) The Memorandum of Association and rules and regulations permit the Society to make the proposed investment which should also be approved by the governing body / council or a managing / executive committee.

- (iii) The AD Category - I bank is satisfied that the Society is KYC (Know Your Customer) compliant and is engaged in a bonafide activity;
- (iv) The Society has been in existence at least for a period of three years;
- (v) The Society has not come under the adverse notice of any Regulatory / Enforcement agency like the Directorate of Enforcement, CBI etc.

In addition to the registration, the activities which require special license / permission either from the Ministry of Home Affairs, Government of India or from the relevant local authority, as the case may be, the AD Category – I bank should ensure that such special license / permission has been obtained by the applicant.

Answer 6(c)

Depository Participant should maintain the following records for period of five years:

- (a) Form submitted by the client for:
 - Opening of accounts.
 - Closing of accounts.
 - Freezing of accounts.
 - Defreezing of accounts
- (b) Delivery Instructions given by clients.
- (c) Records of all actions taken on the exception reports generated by the system.
- (d) A Register showing details of grievances received from the clients and their present status.
- (e) Instructions received from the clearing member to transfer balances from the Pool Account to the Delivery Account of the Clearing Member in order to enable him to deliver these securities to the clearing corporation for settlement of trades.
- (f) Instructions given by clearing member authorising the transfer of securities from the pool account to the account of its clients.
- (g) Dematerialisation Request Forms (DRFs) and Rematerialisation Request Forms (RRFs) filled by clients.
- (h) Forms received in the case of pledge and transmission of securities.
- (i) Details of certificates sent for dematerialisation.
- (j) Proof of despatch of DRFs and Share Certificates by courier.
- (k) Details of certificates, sent for dematerialisation, received back along with objection memo from various companies.

Question 7

- (a) *Explain the compliances required with regard to any two of the following :*
 - (i) *Removal of a director.*
 - (ii) *Triangular merger.*
 - (iii) *Statutory meeting.*

(4 marks each)

(b) Write notes on any two of the following :

- (i) Sectors where foreign investment is prohibited
- (ii) Eligibility for issuance of Indian depository receipts (IDRs)
- (iii) Closure of register of members. (4 marks each)

Answer 7(a)(i)

A director may be removed from office before the expiry of his term by—

- (a) Shareholders of the Company; (b) Central Government; or (c) Company Law Board.

(a) *Removal by shareholders*

Pursuant to Section 284(1) of the Act, the shareholders of a company may, by passing an ordinary resolution at a general meeting, remove a director before the expiry of the period of his office. However, the following directors cannot be removed by the company unless otherwise stipulated in the terms of their appointment:

- (a) a director appointed by the Central Government under Section 408;
- (b) a director of a private company holding office for life on the first day of April, 1952 whether or not he is subject to retirement under an age limit by virtue of the articles or otherwise;
- (c) where the company has availed itself of the option to appoint not less than two-thirds of the total number of directors according to the principle of proportional representation under Section 265;
- (d) a director appointed by a Financial Institution/Bank under the terms of a loan agreement.

The right given by Section 284 is a statutory right which cannot be taken away by the memorandum, articles or by any contract or any other document and if it is sought to be taken away, such a provision will be void.

(b) *Removal of directors by the Central Government*

Chapter IVA of the Act comprising Section 388B to 388E contains provisions regarding power of the Central Government to remove managerial personnel of a Company from office on the recommendation of the Company Law Board/Tribunal.

(c) *Removal by Company Law Board/Tribunal*

Where on an application to the Company Law Board/Tribunal for prevention of oppression under Section 397 and mismanagement under Section 398 of the Act, the CLB/Tribunal finds that the relief ought to be granted, it may by order, terminate or set aside any agreement of the company with a director or managing director or other personnel on such terms and conditions as it may think just and equitable.

Answer 7(a)(ii)**Triangular Merger**

Triangular Merger means the amalgamation of two companies by which the disappearing company is merged into subsidiary of surviving company and shareholders of the disappearing company receive shares of the surviving company.

Answer 7(a)(iii)**Statutory Meeting**

Every company limited by shares and every company limited by guarantee and having a share capital, shall, within a period not less one month nor more than six months from the date of which the company is entitled to commence business, hold a general meeting of the members of the company which is called as Statutory Meeting. Statutory meeting is held only once in the life time of the company. Private companies are not required to hold statutory meeting.

Answer 7(b)(i)

Foreign investment in India is freely permitted in almost all sectors except for the following prohibited sectors.

- (i) Business of chit fund, or
- (ii) Nidhi Company, or
- (iii) Agricultural or plantation activities, or
- (iv) Real estate business, or construction of farm houses
- (v) Trading in Transferable Development Rights

Real Estate Business does not include development of townships, construction of residential/commercial premises, roads or bridges.

Further, Partnership firms/ proprietorship concerns having investments as per FEMA regulations are not allowed to engage in Print Media sector.

In addition to the above, investment in the form of Foreign Direct Investment is also prohibited in certain sectors such as:

- (i) Retail Trading (except for single brand product retailing)
- (ii) Atomic Energy
- (iii) Lottery Business
- (iv) Gambling and Betting
- (v) Agriculture (excluding Floriculture, Horticulture, Development of seeds, Animal Husbandry, Pisciculture and Cultivation of vegetables, mushrooms etc. under controlled conditions and services related to agro and allied sectors) and Plantations (Other than Tea plantations).

Answer 7(b)(ii)**Eligibility for issue of IDRs**

- (a) Pre-issue paid-up capital and free reserves has to be at least US\$ 50 million and the company has to have a minimum average market capitalization (during the last 3 years) in its parent country of at least US\$ 100 million;
- (b) Continuous trading record or history on a stock exchange in its parent country for at least three immediately preceding years;
- (c) The company has to have a track record of distributable profits in terms of Section 205 of the Companies Act, 1956, for at least three out of immediately preceding five years;
- (d) The company has to fulfil such other eligibility criteria as may be laid down by Securities and Exchange Board of India (SEBI) from time to time in this behalf.

Answer 7(b)(iii)

Section 154 of the Companies Act, 1956 contains procedure for closing the register of members. Accordingly, a company may, after giving not less than seven days previous notice by advertisement in some newspaper circulating in the district in which the registered office of the company is situate, close the register of members or the register of debenture holders for any period or periods not exceeding in the aggregate forty-five days in each year, but not exceeding thirty days at any one time.

Question 8

Critically examine and comment on any four of the following :

- (i) *An Indian company planning to make a public offer in the United States of America need not register its securities.*
- (ii) *The preferential allotment made to any person shall be locked-in for a period of two years.*
- (iii) *It is not the duty of the lead merchant banker to ensure the despatch of share certificates/refund orders.*
- (iv) *The depository system functions very much like the banking system.*
- (v) *Companies may fall a prey to contravention of the provisions of the Companies Act, 1956 in the absence of professional support as compared to companies which have a qualified Company Secretary.* (4 marks each)

Answer 8(i)

This statement is not correct.

Indian Companies planning a public offering in the US and wants to get its securities on US exchange has to register its securities in Form F-1. This form requires certain information to be included in the prospectus such as use of proceeds, summary information, risk factors and ratio of earnings to fixed charges, determination of offering price, dilution, plan of distribution, description of securities to be registered, name of legal counsel and disclosure of commissions etc.

Answer 8(ii)

This statement is not correct.

As per Chapter VII of SEBI(ICDR) Regulations 2009, the specified securities allotted on preferential basis to promoter or promoter group and the equity shares allotted pursuant to exercise of options attached to warrants issued on preferential basis to promoter or promoter group, shall be locked-in for a period of three years from the date of allotment of the specified securities or equity shares allotted pursuant to exercise of the option attached to warrant, as the case may be:

It may be noted that not more than twenty per cent of the total capital of the issuer shall be locked-in for three years from the date of allotment. Equity shares allotted in excess of the twenty per cent. shall be locked-in for one year from the date of their allotment pursuant to exercise of options or otherwise, as the case may be. The specified securities allotted on preferential basis to persons other than promoter and promoter group and the equity shares allotted pursuant to exercise of options attached to warrants issued on preferential basis to such persons shall be locked in for a period of one year from the date of their allotment.

Answer 8(iii)

The statement is not correct.

As per regulation 69 of SEBI(ICDR) Regulation 2009, the post-issue merchant banker shall ensure that the despatch of refund orders, allotment letters and share certificates is done by way of registered post or certificate of posting, as may be applicable. The post-issue merchant banker shall ensure payment of interest to the applicants for delayed dispatch of allotment letters, refund orders, etc. as per the disclosure made in the offer document.

Answer 8(iv)

This statement is correct.

The Depository System functions very much like the banking system. A bank holds funds in accounts whereas a Depository holds securities in accounts for its clients. A Bank transfers funds between accounts whereas a Depository transfers securities between accounts. In both systems, the transfer of funds or securities happens without the actual handling of funds or securities. Both the Banks and the Depository are accountable for the safe keeping of funds and securities respectively.

Answer 8(v)

This statement is correct.

The Ministry of Corporate Affairs institutes every year, a large number of prosecutions against the companies and their officers in default for contravention of various provisions of the Companies Act. Most of the companies against which prosecutions are instituted are private limited companies or small public limited companies which do not have the benefit of expert professional services of qualified Company Secretaries.

Appointment of whole-time company secretary or seeking professional advice from a company secretary in practice relieves the company and its directors from the

consequences of unintended non-compliances of the provisions of the Companies Act. Also, the smaller companies have tendency to short circuit the procedural requirement which primarily occurs due to ignorance or lack of professional support. The company secretary acts as an Advisor to the company and guides a company on various requirements of the Act and how to ensure their compliances. Thus, it can be said that the smaller companies fall prey to violations of the provisions of the Companies Act in the absence of professional support as compared to companies which have a qualified Company Secretary.
