

PROFESSIONAL PROGRAMME EXAMINATION

DECEMBER 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 friendly takeover is with the consent of target company.*
- (ii) *A limited two-way fungibility scheme has been put in place by the Government of India for ADRs/GDRs.*
- (iii) *Companies proposing to issue IDRs need not be listed companies.*
- (iv) *Bonus issue can be made in lieu of dividend.*
- (v) *Foreign investment in India is freely permitted in all sectors.*
(2 marks each)

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

- (i) *Cultural differences are to be addressed at the time of merger/ amalgamation.*
- (ii) *The all-India financial institutions while granting term loans to companies insist on certain formalities to be completed by a company availing such loan.*
(5 marks each)

Answer 1(a)

- (i) **True.** There is an agreement between the management of two companies through negotiations and the takeover bid may be with the consent of majority or all shareholders of the target company, which is referred to as friendly takeover bid.
- (ii) **True.** Under this scheme, a stock broker in India, registered with SEBI, can purchase shares of an Indian company from the market for conversion into ADRs/GDRs based on instructions received from overseas investors. Re-issuance of ADRs/GDRs would be permitted to the extent of ADRs/GDRs which have been redeemed into underlying shares and sold in the Indian market.
- (iii) **False.** Every issuer of an IDR has to comply with the conditions stipulated in the listing agreement for IDRs issued by SEBI.
- (iv) **False.** As per Regulation 94(2) of SEBI (ICDR) Regulations, 2009 Bonus issue shall not be made in lieu of dividend.

- (v) **False.** Consolidated FDI Policy prohibits FDI in certain sectors, limits certain sectors with some sectoral limits. In other sectors FDI is freely permitted.

Answer 1(b)(i)

Cultural differences look like playing both ways. Although distant cultural environments make the integration process harder, the lack of culture-fit or cultural compatibility has often been used to explain M&A failure. Cultural differences have also been considered a source of lower commitment to work, making co-operation more difficult, particularly from employees of the acquired company. In this regard, scholars have largely given account of the lack of co-operation momentum stemming from a “we” versus “them” attitude, resulting in hostility among employees.

The issues of cultural integration and the issues of human behavior need to be addressed. For the purpose, following checks have to be made constantly to ensure that:

- sensitive areas of the company are pinpointed and personnel in these sections carefully monitored;
- serious efforts are made to retain key people;
- a replacement policy is ready to cope with inevitable personnel loss;
- records are kept of everyone who leaves, when, why and to where;
- employees are informed of what is going on, even bad news is systematically delivered. Uncertainty is more dangerous than the clear, logical presentation of unpleasant facts;
- training department is fully geared to provide short, medium and long term training strategy for both production and managerial staff;

Answer 1(b)(ii)

The All-India Financial Institutions while granting term loans to companies insist on certain formalities to be completed by a company availing such loan. These include furnishing of certificates by Company Secretaries in Practice in regard to the following:

- (a) Necessary power of a company and its directors to enter into a loan agreement.
- (b) Borrowing limits of a company under Section 293(1)(d) of the Companies Act, 1956, including details of share capital – authorised, issued, subscribed and paid-up, and the actual borrowing.
- (c) List of members of a company.
- (d) Copies of resolutions passed at company meeting to be furnished to financial institutions.

Question 2

- (a) *Write the most appropriate answer from the given options in respect of the following :*

(i) *An independent audit committee should consist of atleast —*

- (a) *One-fourth of the independent directors*

- (b) *One-third of the independent directors*
 - (c) *One-half of the independent directors*
 - (d) *Two-thirds of the independent directors.*
 - (ii) *The role of a Company Secretary in securities management and compliances does not include —*
 - (a) *Certifications*
 - (b) *Appearances*
 - (c) *Audits*
 - (d) *Book-keeping.*
 - (iii) *Section 284 of the Companies Act, 1956 deals with —*
 - (a) *Removal of the Auditor*
 - (b) *Removal of the Chief Financial Officer*
 - (c) *Removal of Directors*
 - (d) *Removal of the Company Secretary.*
 - (iv) *Compliance certificate issued by a Practising Company Secretary is addressed to —*
 - (a) *The Board of Directors*
 - (b) *The Chief Financial Officer*
 - (c) *The Chief Executive Officer*
 - (d) *The Shareholders.*
 - (v) *Reporting to Reserve Bank of India after completion of a GDR issue has to be made within —*
 - (a) *45 Days*
 - (b) *30 Days*
 - (c) *15 Days*
 - (d) *60 Days.*
 - (vi) *A listed company is required to notify the stock exchange concerned, the date of the Board meeting at which the rights issue is proposed to be considered at least —*
 - (a) *2 Days before the Board meeting*
 - (b) *7 Days before the Board meeting*
 - (c) *10 Days before the Board meeting*
 - (d) *21 Days before the Board meeting.* (1 mark each)
- (b) *Distinguish between the following :*
- (i) *'Legal due diligence' and 'financial due diligence'.*
 - (ii) *'Conglomerate merger' and 'reverse merger'.* (5 marks each)

Answer 2(a)(i)

- (d) Two-thirds of the independent directors

Answer 2(a)(ii)

- (d) Book-keeping

Answer 2(a)(iii)

- (c) Removal of Directors

Answer 2(a)(iv)

- (d) The shareholders

Answer 2(a)(v)

- (b) 30 days

Answer 2(a)(vi)

- (a) 2 days before the Board meeting

Answer 2(b)(i)

A legal due diligence covers the legal aspects of a business transaction, liabilities of the target company, potential legal pitfalls and other related issues. Legal due diligence covers intra-corporate and intercorporate transactions. It includes preparation of regulatory checklists, meeting with personnel, independent check with regulatory authorities etc. apart from document verification.

Financial Due Diligence includes review of accounting policies, review of internal audit procedures, quality and sustainability of earnings and cash flow, condition and value of assets, potential liabilities, tax implications of deal structures, examination of information systems to establish the reliability of financial information, internal control systems etc.

Answer 2(b)(ii)

A conglomerate merger involves coming together of two companies in different industries i.e., the businesses of the two companies are not related to each other, neither horizontally nor vertically. There is nothing common either in their end product, or in the rendering of any specific type of service to the society. This is the type of merger of companies which are neither competitors, nor complementaries nor suppliers of a particular raw material nor consumers of a particular product or consumable. Here, the merging companies operate in unrelated markets having no functional economic relationship.

Reverse merger takes place when a healthy company amalgamates with a financially weak company. In the context of the provisions of the Companies Act, 1956, there is no difference between merger and reverse merger. It is like any other amalgamation. Reverse merger can be carried out through the High Court route, but where one of the merging companies is a sick industrial company under SICA, such merger must take place through BIFR. On the amalgamation becoming effective, the sick company's name may be changed to that of the healthy company and the benefits provided under Income tax Act, 1961, can be availed.

Question 3

- (a) *Aman, Naman and Vansh hold jointly 100 equity shares in Priyanka Ltd. They want to change the order of names in the share certificate as Vansh, Aman and Naman. They make an application to the company for change and lodge the share certificate. The company directed them to execute a proper instrument of transfer to effect the change. Is the company justified? Advise. (5 marks)*
- (b) *List any five instances where resolution can be passed through circulation by the Board. (5 marks)*
- (c) *The Board of directors of Pee Kay Beverages Ltd. at a Board meeting held on 23rd May, 2011 declared an interim dividend to its equity shareholders. In the next Board meeting held on 12th June, 2011, the Board revoked the declaration of the said interim dividend. Some of the shareholders have protested that the Board has no right to revoke the interim dividend. As the Company Secretary, advise the Board taking into account the relevant provisions of the Companies Act, 1956. (6 marks)*

Answer 3(a)

In case of joint shareholdings, the holders may require the company to alter or rearrange the serial order of their names in the register of members of the company. This is called transposition of names.

In this process, there will be need for effecting consequential changes in the share certificates issued to them. Since no transfer of any interest in the shares takes place on such transposition, the question of insisting on filling transfer deed with the company may not arise.

A request signed by all the holders (in the existing order and also proposed order) is sufficient which the Board of directors can consider and effect transposition of names.

So, in the given case, the stand of the company is not justified.

Answer 3(b)

The Companies Act, 1956 prescribes that certain items are to be passed only at the Board Meeting such as :

1. Filing up of casual vacancy in the office of a director appointed in a General Meeting [Section 262(1)].
2. To make calls on members [Section 292(1)(a)].
3. To authorize, the buy-back referred to in the first proviso to clause (b) of sub-section (2) of section 77A [section 292(1)(aa)].
4. To issue debentures [Section 292(1)(b)].
5. To borrow money otherwise than above [Section 292(1)(c)].
6. To invest funds [Section 292(1)(d)].
7. To make loans [section 292(1)(e)].
8. To delegate powers [Section 292(1)(c)(d) and (e)].

9. To approve contracts in which directors are interested [Section 297].
10. To note the general disclosure of directors' interests or the general notice or renewal thereof [Section 299].
11. To note disclosure of shareholdings of directors and manager [Section 307].

Any other items which is not mandatorily to be passed at the Board Meeting can be passed through circulation.

Answer 3 (c)

Section 205 of the Companies Act, 1956 has been amended by the Companies (Amendment) Act, 2000 to provide as follows:

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

In view of the above legal position, the Board of Directors of PEE KAY Beverages Ltd. must have deposited the amount of interim dividend declared on 23rd May, 2011 into a separate bank account on or before 28th May, 2011 i.e. within five days from 23rd May, 2011 the day on which the interim dividend was declared. As stated above, the amount once deposited in to a separate bank account, can be used only for payment of interim dividend.

Thus, the Board of PEE KAY Beverages Ltd. has no power to revoke the interim dividend declared on 23rd May, 2011.

Question 4

- (a) *The Board of directors of Astute Ltd. met thrice in the year 2010 and the fourth meeting, though called yet could not be held in the year 2010 and adjourned twice for lack of quorum. Examine —*
 - (i) *Whether any provisions of the Companies Act, 1956 have been violated.*
 - (ii) *Whether any item of business which has not been included in the agenda can be taken up in the adjourned Board meeting. (5 marks)*
- (b) *Explain the meaning of 'setting-up of wholly owned subsidiary abroad'. State the basic legal enactments to be followed by an Indian company for the establishment of such subsidiary company abroad. (5 marks)*
- (c) *Prompt Finance Ltd. which has issued 1,00,000 non-convertible debentures of ₹100 each is facing financial difficulties and the debentures are due for redemption on 31st March, 2012. The management of the company is contemplating whether the debentures can be rolled over and seeks your*

advice. As a Practising Company Secretary, advise the management in this regard.
(6 marks)

Answer 4(a)(i)

The provisions of the Companies Act have not been violated.

As per Section 285 of the Companies Act, 1956, a company must hold a meeting of its Board of Directors at least once in every three calendar months and there should be at least four Board meetings every year. However, as per Section 288(2), a company shall not be deemed to have contravened the provisions of Section 285 where the meeting had been called but could not be held for want of a quorum.

Answer 4(a)(ii)

If the Board meeting is adjourned sine die, a fresh notice must be given. No new business can be introduced unless notice of such new business is given. R V Grimshaw, (1847) 10 QBD 747. Notice of adjourned meeting is not required if time and place of the adjourned meeting is announced at the original meeting [Section 114(7) of Canada Business Corporation Act].

Answer 4(b)

An Indian party is eligible to make direct investment in Joint Venture or Wholly Owned Subsidiary outside India, as per Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2000. The said Regulations defines wholly owned subsidiary as under :

“Wholly Owned Subsidiary” means a foreign entity formed, registered or incorporated in accordance with the laws and regulations of the host country whose entire capital is held by Indian Party.

According to Regulation 6 of the said Regulations, an Indian party is permitted to make investment in overseas Joint Ventures (JV) / Wholly Owned Subsidiaries (WOS), not exceeding 400 per cent of its net worth as on the date of the last audited balance sheet. The Indian party is required to approach an Authorised Dealer Category - I bank with an application in Form ODI and prescribed enclosures/documents for effecting remittances towards such investments. Such overseas investments will include contribution to the capital of the overseas JV/ WOS, loan granted to the JV/ WOS and 100 per cent of guarantees issued to or on behalf of the JV/WOS.

Answer 4(c)

As per SEBI (Issue and listing of Debt Securities) Regulations 2008, the following are the checklist relating to roll-over of non-convertible instruments.

- Where it is desired to roll-over the debt securities issued, ensure to pass a special resolution of holders of such securities and give twenty one days notice, containing the disclosure with regard to credit rating, rationale for roll-over etc.
- The issuer shall, prior to sending the notice to holders of debt securities, file a

copy of the notice and proposed resolution with the stock exchanges where such securities are listed, for dissemination of the same to public on its website.

- The debt securities issued can be rolled over subject to the following conditions:
 - (a) the roll-over is approved by a special resolution passed by the holders of debt securities through postal ballot having the consent of not less than 75% of the holders by value of such debt securities;
 - (b) atleast one rating is obtained from a credit rating agency within a period of six months prior to the due date of redemption and is disclosed in the notice;
 - (c) fresh trust deed shall be executed at the time of such roll –over or the existing trust deed may be continued if the trust deed provides for such continuation;
 - (d) adequate security shall be created or maintained in respect of such debt securities to be rolled-over.
- Ensure to redeem the debt securities of all the debt securities holders, who have not given their positive consent to the roll-over.

Question 5

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

- (i) *Issue related expenses should not exceed _____ in case of GDRs listed on U.S. stock exchange.*
- (ii) *No approval shall be necessary from _____ for a foreign company to establish a branch/unit in special economic zone to undertake manufacturing and service activities subject to specified conditions.*
- (iii) *All securities which are subject to lock-in period should carry _____ on the face of the certificate.*
- (iv) *In the case of takeover of a target company, the offer to acquire should remain open for a period of minimum _____ days.*
- (v) *A company is required to obtain _____ approval for listing from the stock exchanges having nationwide trading terminals where it is listed, before issuing further shares or securities.*
- (vi) *For issue of sweat equity shares, at least _____ should elapse since the date on which the company was entitled to commence business.*
(1 mark each)

(b) *With a view to ensure that Practising Company Secretary (PCS) shows utmost integrity and independence of judgment in the performance of duties, certain persons have been disqualified for appointment as PCS for giving compliance certificate to a company. Explain the category of persons who have been disqualified to act as such.*
(5 marks)

(c) Describe the role of depository participants under the Depositories Act, 1996.
(5 marks)

Answer 5(a)

- (i) Issue related expenses should not exceed **7%** in case of GDRs listed on U.S. stock exchange.
- (ii) No approval shall be necessary from **RBI** for a foreign company to establish a branch/unit in special economic zone to undertake manufacturing and service activities subject to specified conditions.
- (iii) All securities which are subject to lock-in period should carry '**non-transferable**' on the face of the certificate.
- (iv) In the case of takeover of a target company, the offer to acquire should remain open for a period of minimum **twenty** days.
- (v) A company is required to obtain '**in-principle**' approval for listing from the stock exchanges having nationwide trading terminals where it is listed, before issuing further shares or securities.
- (vi) For issue of sweat equity shares, at least **one year** should elapse since the date on which the company was entitled to commence business.

Answer 5(b)

With a view to ensure that PCS shows utmost integrity and independence of judgment on the performance of his duties, a person referred to in sub-section (3) or sub-section (4) of section 226 of the Act, should not be eligible for appointment or re-appointment for giving compliance certificate to a company.

Accordingly, the following persons shall not be qualified for appointment as secretarial auditor of a company:

- (i) a body corporate;
- (ii) an officer or employee of the company;
- (iii) a person who is a partner, or who is in the employment of an officer or employee of the company;
- (iv) a person who is indebted to the company for an amount exceeding ten thousand rupees, or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for an amount exceeding ten thousand rupees;
- (v) If a secretarial auditor becomes subject, after his appointment, to any of the disqualifications specified hereinabove he shall be deemed to have vacated his office as such.

Answer 5(c)

Just as a brokers act an agent of the investor at the Stock Exchange; a Depository Participant (DP) is the representative (agent) of the investor in the depository system

providing the link between the Company and investor through the Depository. The Depository Participant maintains securities account balances and intimate the status of holding to the account holder from time to time. According to SEBI guidelines, Financial Institutions like banks, custodians, stockbrokers etc. can become participants in the depository. A DP is one with whom an investor needs to open an account to deal in shares in electronic form. While the Depository can be compared to a Bank, DP is like a branch of that bank with which an account can be opened. The Depositories Act, 1996 enables the DP to perform the following functions :

- Acts as an Agent of Depository
- Customer interface of Depository
- Functions like Securities Bank
- Account opening
- Facilitates dematerialisation
- Instant transfer on pay-out
- Credits to investor in IPO, rights, bonus
- Settles trades in electronic segment

Question 6

- (a) *The balance sheet of Chintoo Gold Finance Ltd., a listed company, as on 31st March, 2011 disclosed the following position :*

<i>Liabilities</i>	<i>₹ in Lakhs</i>
<i>Equity share capital (fully paid-up shares of ₹ 10 per share)</i>	<i>3,600</i>
<i>General reserve</i>	<i>1,000</i>
<i>Profit and loss account</i>	<i>900</i>
<i>Securities premium</i>	<i>540</i>
<i>12% Debentures</i>	<i>2,500</i>
<i>Unsecured loans</i>	<i>1,500</i>
<i>Current liabilities</i>	<i>2,650</i>
	<u><i>12,690</i></u>
<i>Assets</i>	
<i>Fixed assets</i>	<i>6,130</i>
<i>Investments</i>	<i>1,800</i>
<i>Current assets</i>	<i>4,560</i>
<i>Goodwill</i>	<i>150</i>
<i>Miscellaneous expenditure</i>	<i>50</i>
	<u><u><i>12,690</i></u></u>

The company is contemplating to buy-back its equity shares in the beginning of the current financial year 2011-12 to the maximum extent as permissible under the law.

The following information has also been furnished to you :

- *Investments of ₹ 1,800 lakh were sold for ₹ 1,300 lakh.*
- *The income-tax authorities imposed an additional tax liability of ₹ 500 lakh for the year 2011.*

You are required to —

- (i) *Prepare a note commenting on the decision of the Board of directors and to compute the maximum amount of equity shares that can be purchased by the company.*
 - (ii) *Test the debt-equity ratio after buy-back of shares. (10 marks)*
- (b) *State the legal provisions contained in the Companies Act, 1956 for registration of charges. Also state the consequences of non-filing of charges. (6 marks)*

Answer 6(a)

To

The Board of Directors
Chintoo Gold Finance Ltd.

Sub: Note on Buy-back of shares

Section 77A(2)(c) of the Companies Act, describes as follows :

- (i) The buy back is or less than 25% of paid-up capital and free reserves of the company. However, the buy-equity shares in any financial year shall not exceed 25% of its total paid-up equity capital in the financial year. Accordingly the calculations as to maximum amount of equity shares that can be purchased by the company is as under :

Free reserve for buy-back:

	<i>₹ in Lakh</i>
General Reserve	1,000
Profit and Loss Account	900
Securities Premium	540
	<u>2,440</u>

<i>Less:</i>	<i>₹ In Lakh</i>
Additional Tax Liability	500
Loss on Sale of Investments	500
Goodwill	150
Miscellaneous	50
	<u>1,200</u>

Free Reserves	1,240
Equity Share Capital	3,600
Share Capital and Free Reserves	4,840
25% of Paid-up Capital & Free Reserves	1,210
25% of the Equity Share Capital	900

Hence,

- (a) Maximum no. of equity shares can be purchased in a financial year is 90 lakhs
- (b) Maximum amount available for buy-back ₹ 1,210 lakhs
- (c) Maximum Price that can be paid for buy-back of a share $1210/90 = ₹ 13.45$ per share :
- (d) Maximum premium payable per equity share $(₹ 13.45 - 10) = ₹ 3.45$
- (e) Total Premium Payable on buy-back $(90 \times 3.45) = ₹ 310$ lakhs
- (f) Amount Payable on face value of Equity Share $(90 \times 10) = ₹ 900$ lakhs

(ii) Debt equity ratio after buy-back

Section 77A (2)(d) prescribes that the ratio of that owed by the company is not more than twice the capital and its free reserves after buy-back

		₹ (Lacs)
Equity Share Capital (3600-900)		2,700
General Reserves		1,000
Profit & Loss Account		900
Securities Premium		540
		<u>5,140</u>
<i>Less:</i>	₹ (Lacs)	
Tax Liability for 2011	500	
Loss on Sale of Investments	500	
Miscellaneous Expenditure	50	
Goodwill	150	
Premium on buy-back	<u>310</u>	1,510
Total Shareholders fund after buy-back		<u>3,630</u>
<i>Debt:</i>	₹ (Lacs)	
12% Debentures	2,500	
Unsecured Loans	1,500	
Current Liabilities	<u>2,650</u>	
Total Debt	<u>6,650</u>	

Ratio of Debt to Equity = $6650 : 3630 = 1.83 : 1$

Hence the ratio of debt to equity is less than 2%.

Answer 6(b)

Sections 124 to 145 in Part V of the Companies Act, 1956 provide for the registration of charges with respect to creation, modification, satisfaction of charges.

Prescribed particulars of the charge together with the instrument, if any, evidencing, creating or modifying the charge (or a certified copy thereof) are required to be filed with the Registrar of Companies within thirty days after the date of creation or modification of the charges. In case of satisfaction of charge, the intimation is required to be given to the Registrar within thirty days from the date of payment or satisfaction of the charge.

The prescribed particulars in e-Form 8 or e-Form 10, as the case may be together with copy of the instrument creating or modifying the charge and those relating to satisfaction of charge in e-Form 17 are required to be filed with the Registrar of Companies.

Consequences of non-registration

If a charge which requires registration under Section 125 is not registered as per Sub-section (1) of Section 125, the consequences are as follows:

- (a) The charge will be void as against the liquidator (if the company goes into liquidation) and against creditors, but against them only.
- (b) The charge is good against the company and the amount becomes payable immediately.
- (c) Until liquidation, the person seeking to enforce such a charge, has available to him all remedies of a mortgage against the company, though not against other creditors.
- (d) The company may give a subsequent valid mortgage to secure the same debt. But if a subsequent creditor, even with notice of the first charge, takes a registered charge before the first said charge is registered, he obtains priority.
- (e) During liquidation the charge-holder (creditor) assumes the status of an unsecured creditor, as the charge is void against liquidator and creditors.
- (f) The holder of an equitable charge whose charge is void on the ground of non-registration, has no lien on the title deeds or documents deposited with him as the deposit is only ancillary to the void charge.
- (g) Although a security becomes void by non-registration, it does not affect the contract or obligation of the company to repay the money thereby secured. In fact, Section 125 provides that where a charge becomes void by non-registration, the money becomes immediately payable and the company cannot repudiate it on the ground of non-registration.
- (h) Omission to register particulars of charges as required is punishable with fine. The company and every officer of the company or other person who is in default shall be punishable with fine which may extend to five thousand rupees for everyday during which the default continues. A further fine of Rs.10,000 may be imposed on the company and every officer of the company for other defaults relating to the registration of charges (Section 142).

Question 7

- (a) *Explain the compliances required with regard to any two of the following:*
- (i) *The company has defaulted in the matter of repayment of deposits to small depositors.*
 - (ii) *Payment of remuneration to directors.*
 - (iii) *Abridged prospectus and application forms.* (4 marks each)
- (b) *Write notes on any two of the following :*
- (i) *Annual general meeting and book closure.*
 - (ii) *Remedial actions to overcome hurdles in carrying out a due diligence.*
 - (iii) *Takeover defenses by the target company in the case of hostile takeover bid.* (4 marks each)

Answer 7(a)(i)

Where the company has accepted deposits from small depositors as defined under Section 58AA and has made any default in repayment of any such deposits or part thereof or interest thereupon check whether:

- (i) the company has sent an intimation of default, if any, in repayment of deposit or part thereof or interest thereupon to the Company Law Board within 60 days from the date of default on monthly basis;
- (ii) the intimation includes the particulars in respect of names and addresses of each small depositor, the principal sum of deposits due to them and interest accrued thereupon;
- (iii) the company has complied with the order of the Company Law Board, if any;
- (iv) the company has not accepted further deposits from small depositors unless each small depositor, whose deposit has matured has been paid the amount of deposit and the interest accrued thereupon. This condition shall not apply if deposit is renewed by the small depositor voluntarily or repayment thereof has become impracticable or been stayed by a competent court or authority;
- (v) the company has stated in every advertisement and application form inviting deposits from the public issued after the default, the total number of small depositors and amount due to them in respect of which such default had been made;
- (vi) the company has mentioned in the advertisement and application form inviting deposits issued by it after the default the fact of waiver of interest accrued on deposits of the small depositors, if any;
- (vii) the company has after default taken a loan for the purpose of working capital from any bank, whether the company has first utilised the funds so obtained in repayment of any deposit or any part thereof or any interest thereupon to the small depositors before applying such funds for any other purpose;
- (viii) the application form, issued by the company to small depositors for accepting

deposits from them, contained a statement that the applicant had been apprised of:

- every past default
- the waiver of interest and reasons therefor.

Answer 7(a)(ii)

Remuneration of Directors

Check whether

- (i) the payment of remuneration to directors was within the limits provided under Sections 198 and 309 of the Act;
- (ii) 'net profit' has been computed in accordance with the provisions of Sections 349 and 350;
- (iii) the remuneration paid to managing director/whole-time director was in accordance with the provisions of the Articles, Schedule XIII to the Companies Act, 1956, resolution passed by the shareholders in general meeting and/or approval of the Central Government;
- (iv) remuneration paid if any has been recovered in case approval by the Central Government was either not obtained or denied;
- (v) special resolution was passed for payment of remuneration by way of commission to directors who are not whole-time/managing directors;
- (vi) increase in the remuneration was effected with Central Governments approval in accordance with Section 310;
- (vii) no other remuneration was paid to a director in any other capacity except as permitted;
- (viii) no tax free payment was made;
- (ix) compensation for loss of office, if any, has been paid within the limits specified in Sub-section (4) of Section 319;

the amount of remuneration by way of fee for each meeting of the Board of directors or a committee thereof has not exceeded the amount as may be prescribed from time to time.

Answer 7(a)(iii)

- (a) Every application form issued by the issuer is to be accompanied by a copy of the abridged prospectus and abridged letter of offer;
- (b) The abridged prospectus and abridged letter of offer should not contain matters which are extraneous to the contents of the prospectus;
- (c) The abridged prospects and abridged letter of offer shall contain the disclosures as prescribed under Regulation 58 of SEBI (ICDR) Regulations, 2009.
- (d) The Issuer should provide the facility of ASBA (Applications supported by Blocked Accounts) in all book built public and rights issue.

Answer 7(b)(i)

The Company is required to close its Transfer Books for purposes of declaration of dividend or issue of right or bonus shares or issue of shares on conversion of debentures or of shares arising out of rights attached to debentures or for such other purposes as the Exchange may agree to or require.

The company has to close its Transfer Books at least once a year at the time of the Annual General Meeting if they have not been otherwise closed at any time during the year and to give to the Exchange the notice in advance of at least 7 days, or of as many days as the Exchange may from time to time reasonably prescribe, stating the dates of closure of its Transfer Books (or, when the Transfer Books are not to be closed, the date fixed for taking a record of its shareholders or debenture holders) and specifying the purpose or purposes for which the Transfer Books are to be closed (or the record is to be taken) and to send copies of such notices to the other recognised stock exchanges in India. The minimum time gap between the two book closures and/or record dates has to be atleast 30 days.

Answer 7(b)(ii)

The following actions may break the hurdles in carrying out a due diligence

- Focus on follow up questions.
- Ask several people the same questions and utilise appropriate professional acumen.
- 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 7(b)(iii)

Hostile takeovers directly made to the shareholders of target company has resulted in a multiple defensive strategies by corporate from being taken over by the company.

Few of the defensive strategies are as follows :

1. *Packman Defense*

Under this strategy target company attempts to purchase the shares of acquirer company provided it has substantial cash flow or liquidable asset.

2. *Shark Repellants*

An increasingly used defense mechanism being used is anti-takeover amendments to the company's Articles of Association which is called shark repellants

3. *Poison pills*

Creation of securities (which is also called poison pills) which provide their holders with special rights exercisable only after a period of time following the occurrences of triggering event.

4. Refusal by the Board to register a transfer is also being adopted as a defensive strategy.

Question 8

Critically examine and comment on any four of the following :

- (i) *Compliance with the requirements of law through a compliance management programme can produce positive results at several levels.*
- (ii) *The Depositories Act, 1996 provides for the establishment of depositories in securities with the objective of ensuring free transferability of securities with speed, accuracy and security.*
- (iii) *The penal provisions for non-compliance of the conditions of the listing agreement are governed by section 23(2) and section 23E of the Securities Contracts (Regulation) Act, 1956.*
- (iv) *The concept of data room and its need in due diligence.*
- (v) *'Promoter group' under SEBI takeover code.* (4 marks each)

Answer 8(i)

Compliance with the requirement of law through a compliance management programme can produce positive results at several levels:

- (a) Companies that go the extra mile with their compliance programme lays the foundation for the control environment.
- (b) Companies effective compliance management programme are more likely to avoid stiff personal penalties, both monetary and imprisonment.
- (c) Companies that enabled positive ethics and affective compliance management programme deep within their culture often enjoy healthy returns through employee and customer loyalty and public respect for their brand, both of which can translate into stronger market capitalization and shareholders returns.

Clearly, the benefits of implementing and maintaining an effective ethics and compliance programme far outweigh its costs. Not only does the compliance management programme protect investors wealth but also helps the business in running successfully with any potential risk being addressed in a timely and accurate manner.

Answer 8(ii)

Depositories Act, 1996 provides for the establishment of depositories in securities with the objective of ensuring free transferability of securities with speed, accuracy and security by –

- (a) making securities of Public Limited Companies freely transferable subject to certain exceptions
- (b) dematerialising the securities in the depository mode; and
- (c) providing for maintenance of ownership records in a book entry form.

In order to streamline the settlement process, the Act envisages transfer of ownership of securities electronically by book entry without making the securities move from person to person. The Act has made the securities of all public limited companies freely transferable, restricting the company's right to use discretion in effecting the transfer of securities, and the transfer deed and other procedural requirements under the Companies Act have been dispensed with. The details have been dealt in the chapter on Depositories.

Answer 8(iii)

The penal provisions for non-compliance of the conditions of the Listing Agreement are governed by Clause 23(2) and Clause 23E of the Securities Contract (Regulation) Act, (SCRA) 1956.

Clause 23(2) states that any person who fails to comply with the provisions of Section 21 (conditions for listing) shall without prejudice to any award of penalty by Adjudicating Officer on conviction be punishable with imprisonment for a term which may extend to ten years or with fine which may extend to twenty five crore rupees or with both.

Clause 23E of SCRA 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 8(iv)

A Data Room provides all important business documents/information which may be on Financial, regulatory, IPR, marketing, Press report or any important material aspect pertaining to a business transaction. Other wise it provides for a common platform/place where all records of important business information are kept for the review by a potential buyer after signing of a Non Disclosure Agreement (NDA). As data room discloses confidential data which is not available for public and may relate to business process, trade secret, technology information etc, the access to data room is made after signing of Non Disclosure Agreement.

In this regard, provisions are also to be made to mitigate the risks of data destruction or data stealing. For this purpose the restrictive provisions are to be made for entry, study, noting and exit from the data room. This includes physical checking of the persons conducting such study in the data room. Installing close circuit camera in the data room and monitoring the activity of the persons on time to time basis is a regular activity. It results in adequate expenditure and prior to that make proper budgeting is required.

Principals are also to be laid down for copying documents to clearly state about the nature of documents which could be copied in the data room. For this purpose also photocopiers and scanning machines are kept, electronic data similarly also monitored for which copies are required to be made.

Need for Data Room

1. Removes ambiguity in the minds of buyer about the profitability, growth prospectus, and sustainability of business that is proposed to be bought.
2. Provides material information that helps in doing a SWOT analysis.

3. It enables the buyer to do a better bargain through the analysis of the data.
4. May expose the weakness of the seller which is not directly provided to the buyer- For example, a material off balance sheet transaction.
5. Provides data that helps in better Valuation of business for both buyer and seller.

Answer 8(v)

As per explanation to Regulation 2(1)(h) of SEBI (SAST) Regulations, 1997, promoter group” shall include:

- (a) in case promoter is a body corporate—
 - (i) a subsidiary or holding company of that body corporate;
 - (ii) any company in which the promoter holds 10 per cent or more of the equity capital or which holds 10 per cent or more of the equity capital of the promoter;
 - (iii) any company in which a group of individuals or companies or combinations thereof who holds 20 per cent or more of the equity capital in that company also holds 20 per cent or more of the equity capital of the target company; and
 - (b) in case the promoter is an individual—
 - (i) the spouse of that person, or any parent, brother, sister or child of that person or of his spouse;
 - (ii) any company in which 10 per cent or more of the share capital is held by the promoter or an immediate relative of the promoter or a firm or HUF in which the promoter or any one or more of his immediate relative is a member;
 - (iii) any company in which a company specified in (i) above, holds 10 per cent or more, of the share capital; and
 - (iv) any HUF or firm in which the aggregate share of the promoter and his immediate relatives is equal to or more than 10 per cent of the total.
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