

PROFESSIONAL PROGRAMME EXAMINATION

JUNE 2009

**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 correct or incorrect:*

- (i) *The issuer and merchant banker need not ensure that the security created to secure the debt securities is adequate to ensure 100% asset cover for the debt securities.*
- (ii) *A private placement is an issue of shares or convertible securities by a company to a select group of persons under section 81 of the Companies Act, 1956 which is neither a rights issue nor a public issue.*
- (iii) *A 'takeover bid' is an offer addressed to each shareholder of a company, whose shares are not closely held, to buy his shares in the company at the offered price within the stipulated period of time.*
- (iv) *As per clause 49 of the listing agreement in respect of good corporate governance, a director shall not be member in more than 20 committees or act as chairman of more than 10 committees across all companies in which he is a director.*
- (v) *A company can deliver the share certificate at any time after receiving the application for registration of transfer as per the Companies Act, 1956.*

(2 marks each)

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

- (i) *All preferential issues by the listed companies should be approved by the shareholders' resolution in the meeting of shareholders.*
- (ii) *A depository participant is the agent of the investor in the depository system providing the link between the company and investor through the depository.*

(5 marks each)

Answer 1(a)(i)

The statement is incorrect.

As per SEBI (Issue and Listing of Debt Securities) Regulations, 2008, it is the duty of the issuer & merchant banker to ensure that the security created to secure the debt securities is adequate for ensuring 100% asset cover for the debt securities.

Answer 1(a)(ii)

The statement is correct.

A Private Placement of Securities is not like that of Public Offerings of Securities.

Instead offering the securities to the public, these are being offered to select group persons under the Section 81 of the Companies Act, 1956. Private placement is a faster way for a company to raise capital. It is generally known by the name preferential allotment, which has to comply with Chapter XIII of SEBI (DIP) Guidelines, 2000, in case, the issuer is a listed company.

Answer 1(a)(iii)

The statement is correct.

A “takeover bid” is an offer addressed to each shareholder of a company, whose shares are not closely held, to buy his shares in the company at the offered price within the stipulated period of time. It is addressed to the shareholders with a view to acquire sufficient number of shares that gives the offerer company, the voting control of the target company.

Answer 1(a)(iv)

The statement is incorrect.

As per Clause 49 of the listing agreement, a director shall not be member in more than 10 committees or act as Chairman of more than 5 committees across all companies in which he is a director.

Answer 1(a)(v)

The statement is incorrect.

Under Section 113 of the Companies Act 1956, a Company is required to deliver the share certificate within 3 months after the allotment of any securities and within 2 months after the application for registration of transfer of any such securities.

Answer 1(b)(i)

Preferential issues are governed under Section 81(1A) of the Companies Act, 1956 and Chapter XIII of the SEBI(DIP) Guidelines, 2000. While Section 81(1A) requires the company to obtain shareholders approval through special resolution, Chapter XIII of SEBI(DIP)Guidelines, 2000 stipulates that allotment pursuant to any resolution passed at a meeting of shareholders of a company granting consent for preferential issues of any financial instrument, shall be completed within a period of 15(fifteen days) from the date of passing of the resolution. If, the allotment on preferential basis is pending on account of pendency of any approval of such allotment by any regulatory authority or the Central Government, the allotment shall be completed within 15 days from the date of such approval. If SEBI has granted relaxation to the issuer in terms of regulation 29A of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, the preferential allotment of shares, fully convertible debentures and partly convertible debentures, shall be made by it within such time as may be specified by the Board in its order granting relaxation.

Answer 1(b)(ii)

Just as brokers act as 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 companies and investor through the depository. The depository participant maintains securities account balance and intimate the status of holding to the account holder from time to time. According to SEBI guidelines, financial institutions like banks, custodians, stockbroker etc. can become participants with 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 main characteristics of a depository participant are as under:

- Acts as an agent of depository
- Customer interface of depository
- Demat Account opening
- Facilitates dematerialization
- Instant transfer on pay-out
- Credits to investor in IPO, rights, bonus etc.
- Settles trades in electronic segment etc.

Question 2

(a) Choose the most appropriate answer from the given options in respect of the following :

(i) Public issue is not governed by the —

- (a) Companies Act, 1956
- (b) Foreign Exchange Management Act, 1999
- (c) Payment of Bonus Act, 1965
- (d) Securities Contracts (Regulation) Act, 1956.

(ii) In case of underwriting of rights issue, if minimum subscription is not received, the entire subscription should be refunded within —

- (a) 45 days
- (b) 60 days
- (c) 42 days
- (d) 30 days.

(iii) A downstream merger occurs when —

- (a) There is a merger of parent company into its subsidiary company
- (b) There is a merger of subsidiary company into its parent company
- (c) There is a merger of a healthy company with a financially weak company
- (d) There is a merger of a subsidiary company into its parent company where the parent company owns substantially all of the shares of the subsidiary company.

- (iv) 'Overseas Custodian Bank' means a banking company which is established in a country —
- Inside India
 - Outside India
 - Inside as well as outside India
 - Either inside or outside India.
- (v) If a company or any other person contravenes any provision of the rules for which no punishment is provided under the Companies (Issue of Indian Depository Receipts) Rules, 2004, the company and every officer in default shall be punishable with fine which may extend to —
- Equal the amount of IDR issue
 - Twice the amount of IDR issue
 - Thrice the amount of IDR issue
 - Four times the amount of IDR issue.
- (vi) Payment of foreign technology collaboration by Indian companies under the FEMA regulations are allowed under automatic route subject to the limitation of the lump sum payments not exceeding —
- US \$5 million
 - US \$10 million
 - US \$2 million
 - US \$3 million. (1 mark each)
- (b) Write a note on 'intellectual property due diligence'. (4 marks)
- (c) Distinguish between the following :
- 'Due diligence' and 'audit'.
 - 'American depository receipts (ADRs)' and 'global depository receipts (GDRs)'. (3 marks each)

Answer 2(a)(i)

- (c) Payment of Bonus Act, 1965

Answer 2(a)(ii)

- (c) 42 days.

It may be noted that, this period has been reduced to 15 days vide SEBI Circular dated August 28, 2008.

Answer 2(a)(iii)

- (a) There is a merger of parent company into its subsidiary company

Answer 2(a)(iv)

- (b) Outside India

Answer 2(a)(v)

- (b) Twice the amount of IDR issue

Answer 2(a)(vi)

- (c) US \$2 million

Answer 2(b)**Intellectual Property due diligence**

The recent concept of valuation of intangible assets related to Intellectual Property like Patents, Copyrights, Design, Trademarks, Brands etc., also getting greater importance as these Intellectual Properties of the business are now often sold and purchased in the market by itself, like any other tangible asset. The main objective of intellectual property due diligence is to ascertain the nature and scope of target company's right over the intellectual property, to evaluate the validity of the same and to ensure whether there are no infringement claims.

Answer 2(c)(i)

<i>Particulars</i>	<i>Audit</i>	<i>Due diligence</i>
Scope	Limited to financial analysis	Includes not only analysis of financial statements, but also business plan, sustainability of business, future aspects, corporate and management structure, legal issues etc.
Data	Based on historical data	Covers future growth prospects in addition to historical data.
Mandatory	Mandatory	Mandatory based on the transaction.
Assurance	Positive assurance i.e. true and fairness of the financial statements	Negative assurance. i.e. identification of risks if any.
Type	Post mortem analysis	It is required for future decision.
Nature	Always uniform	Varies according to the nature of transaction
Repetitiveness	Recurring event	Occasional event

Answer 2(c)(ii)**American Depositary Receipts (ADR)**

An American Depositary Receipt (ADR) is a dollar denominated form of equity ownership in the form of depository receipts in a non-US Company. It represents the foreign shares of the company held on deposit by a custodian bank in the company's home country and carries the corporate and economic rights of the foreign shares.

Global Depository Receipts (GDR)

Global Depository Receipts means any instrument in the form of a Depository receipts or certificate created by the Overseas Depository Bank outside India and issued to non-resident investors against the issue of ordinary shares or foreign currency convertible bonds of issuing company.

Question 3

- (a) *As a Practising Company Secretary, you have been asked to carry out the due diligence of XYZ Ltd. for a possible acquisition of the controlling interest from the owners of the said company. Explain briefly the possible hurdles that may occur while carrying out the due diligence and the steps needed to overcome such hurdles.* (6 marks)
- (b) *Anshul Power Generation Ltd. is contemplating setting-up an audit committee as part of good corporate governance. As a Company Secretary of the company, advise the company on the constitution, composition, quorum and the role of audit committee.* (6 marks)
- (c) *Explain the following terms used in due diligence report —*
 - (i) *Deal breakers*
 - (ii) *Deal diluters.* (2 marks each)

Answer 3(a)**Possible Hurdles in Carrying out a Due Diligence and Remedial Actions**

1. *Non availability of in formation*
In many occasions, when a person carries out due diligence, the required information may not be available or sufficient to drive a complete picture.
2. *Unwillingness of Target Company's personal in providing the complete information*
Non- co-operation of Target Company's personal 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 in correct 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 & structure 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, may 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

- Follow up questions/actions
- Ask several people the same questions
- Polite persistence
- Independent check with regulatory authorities
- Developing an MIS.

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

Answer 3(b)

Constitution/Composition of Audit Committee

1. All listed companies shall have qualified and independent audit committee.
2. The audit committee shall have minimum three directors as members.
3. Two-thirds of the members of audit committee shall be independent directors.
4. All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.
5. The Chairman of the Audit Committee shall be an independent director;
6. The Company Secretary shall act as the secretary to the committee.

Quorum of the meeting of Audit Committee

The audit committee should meet at least four times in a year and not more than four months shall elapse between two meetings and the quorum shall be either two members or one third of the members of the audit committee whichever is greater, but there should be a minimum of two independent members present.

Role of Audit Committee

The role of the audit committee shall include the following:

1. Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.
2. Recommending to the Board, the appointment, re-appointment and, if required, the replacement or removal of the statutory auditor and the fixation of audit fees.
3. Approval of payment to statutory auditors for any other services rendered by the statutory auditors.
4. Reviewing, with the management, the Quarterly/annual financial statements before submission to the board for approval.

5. Reviewing, with the management, the statement of uses / application of funds raised through an issue, the statement of funds utilized for purposes other than those stated in the offer document/prospectus/notice and the report submitted by the monitoring agency monitoring the utilisation of proceeds of a public or rights issue, and making appropriate recommendations to the Board to take up steps in this matter.
6. Reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems.
7. Reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit.
8. Discussion with internal auditors any significant findings and follow up there on.
9. Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board.
10. Discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern.
11. To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non payment of declared dividends) and creditors.
12. To review the functioning of the Whistle Blower Mechanism, in case the same is existing.
13. Carrying out any other function as is mentioned in the terms of reference of the Audit Committee.

Answer 3(c)(i)

After completion of Due Diligence, the professionals submit a report which is in general called 'Due Diligence Report'. The findings mentioned the reports are very significant and the outcome of the report may be deal-makers, Deal-Breakers, Deal-Diluters, Deal-cautioners.

Deal Breakers - In this report the findings can be very glaring and may expose various non-compliance that may arise any criminal proceedings or known liabilities.

Answer 3(c)(ii)

Deal Diluters – The findings arising out a diligence may contain violations which may have an impact in the form of quantifiable penalties and in turn may result in diminishing the value of company.

Question 4

- (a) *Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s) :*
 - (i) *Shares issued under an Employee Stock Purchase Scheme (ESPS) are subject to lock-in for a minimum period of _____ year from the date of allotment.*

- (ii) *The credit rating is required to be obtained from atleast _____ registered credit rating agencies under the SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008.*
- (iii) *A public limited company is required to appoint the Company Secretary to act as compliance officer under clause _____ of the listing agreement.*
- (iv) *As per clause 49 of listing agreement, at least _____ of the Board should include independent directors where chairman of the Board is a non-executive director.*
- (v) *An American Depository Receipt (ADR) is a _____ denominated form of equity ownership in the form of depository receipts in a non-US company.*
- (vi) *Pre-issue paid-up capital and free reserves of the issuing company should be at least _____ under the Companies (Issue of Indian Depository Receipts) Rules, 2004 for the issue of IDRs. (1 mark each)*
- (b) *As a Practising Company Secretary, you have been appointed as secretarial auditor of Lilly Ltd. Explain briefly how you would undertake the process of secretarial audit. (10 marks)*

Answer 4(a)

- (i) Shares issued under an Employee Stock Purchase Scheme (ESPS) are subject to lock-in for a minimum period of **One** year from the date of allotment.
- (ii) The credit rating is required to be obtained from atleast **Two** registered credit rating agencies under the SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008.
- (iii) A public limited company is required to appoint the Company Secretary to act as compliance officer under clause **47(a)** of the listing agreement.
- (iv) As per clause 49 of listing agreement, at least **1/3** of the Board should include independent directors where chairman of the Board is a non-executive director.
- (v) An American Depository Receipt (ADR) is a **Dollar** denominated form of equity ownership in the form of depository receipts in a non-US company.
- (vi) Pre-issue paid-up capital and free reserves of the issuing company should be at least **US\$ 50 millions** under the Companies (Issue of Indian Depository Receipts) Rules, 2004 for the issue of IDRs.

Answer 4(b)

A Practising Company Secretary should follow the following process for conducting Secretarial Audit :

1. Before embarking on a assignment one should familiarize himself thoroughly with relevant Acts, Rules, Regulations, Orders, Notifications, Guidelines, Circulars by the Government from time to time.

2. Where the position of law is not clear, he should request the company to obtain legal opinion in order to be doubly sure about the compliances.
3. Where certain facts cannot be personally checked, he should obtain a certificate from the Company in order assure himself that proper compliance have been made.
4. He should also keep himself abreast of latest judicial pronouncements on all import issues.
5. Private Companies, Government Companies and Section 25 Companies are exempt from some provisions of Companies Act. These should be kept in view by the Secretarial Auditor.
6. The Secretarial Auditor should preserve the working sheets and other papers, the details of the documents instead prepared etc. for future references and queries if any.
7. While undertaking Secretarial Audit/Consultancy, as required, the following should be examined carefully:
 - Memorandum and Articles of Association (Extent of applicability of Table A).
 - Certificate of Incorporation.
 - Certificate of Commencement of Business.
 - Annual Reports.
 - Minutes Books of Board/Committee/General Meeting.
 - Register of Members/Debentureholders.
 - Register of Directors.
 - Register of Loans, Guarantee, Security and Investments.
 - Register of Charges.
 - Foreign Register of Members and Debentureholders, if any.
 - Copies of Annual Returns.
 - Register of Contracts.
 - Register of Directors' Shareholdings.
 - Share Transfer Books.
 - Correspondence with the Ministry of Corporate Affairs, Registrar of Companies, MRTP Commission, Ministry of Industry, Ministry of inance, Stock Exchanges etc.
 - Listing Agreement with the Stock Exchange.
 - Register of investments of the company not held in its name.

- Register of Buy-back of Securities under Section 77A(9).
 - Copies of various e-forms filed under Section 610B of the Companies Act, 1956.
 - Various advertisements/press release issued by the company during the year.
 - Other registers as may be notified from time to time under various rules.
8. As soon as the assignment is over the Secretarial Auditor should submit his report to the Board of Directors. He may also submit interim report also from time to time if necessary. The report should set out in detail the scope of the work, his observations on irregularities noticed, weakness in the policies and procedures etc.

Question 5

- (a) *Sanjay is a Practising Company Secretary and has been engaged as internal auditor of the operations of depository participants. Do you feel it is mandatory on the part of the depository participants to appoint an internal auditor ? What should be the contents of the internal audit report ?* (8 marks)
- (b) *As a Practising Company Secretary, you have been assigned to work out preliminary considerations for setting-up a joint venture. State the preliminary considerations to be taken care of in this regard.* (4 marks)
- (c) *A depository participant is required to enter into two important agreements in the course of trading in dematerialised securities. Explain.* (4 marks)

Answer 5(a)

Yes it is mandatory on the part of the Depository Participant to appoint an internal auditor.

As per Circular issued by the two Depository Service providers in India i.e. NSDL & CSDL every depository participant shall ensure that an internal audit in respect of the operations Depository is to be conducted either by a qualified Company Secretary or a Chartered Accountant holding a Certificate of Practice and a copy of the internal audit report shall be submitted to the Depository.

The 'Internal Audit' report should contain the following aspects:-

1. Comments on the maintenance of records.
2. Observations about discrepancies or weakness in the internal control system.
3. Comments on the used authorization and data security systems.
4. Instances of non-adherence to the operational procedures prescribed relating to functions of participant.
5. Instances of non-compliance with the relevant legislations governing the depository operations.
6. General observations & recommendations.

7. Competence with the provisions of SEBI Act, Regulations, Bye Laws, Business Rules, Agreements.

Answer 5(b)

Preliminary considerations

- *Selection* : Selection of an appropriate co-venturer can have long lasting implications for the operation and success of the venture as the ability of the co-managing parties to co-exist and make unanimous decisions is essential to the success of a joint venture.
- *Setting out the objectives and expectations* : Setting out the objectives and expectations of the venture is pre-requisite. It is essential that the nature, scope and duration of the joint venture be identified.
- *Employ competent professionals* : Competent professional like CS, Legal experts experienced in drafting joint venture and strategic alliance agreements should be retained as consultants, to structure the deal with proper legal advice.
- *Negotiation* : It is appropriate that negotiations be conducted at the level of more senior management.
- *Attitude* : Negotiations for alliances should not be entered into with an adverse approach to the opposing party.
- *MOU* : The next step is to prepare memorandum of understanding, setting out the objectives of the joint venture prior to finalising the joint venture agreement. The MOU may set out the key features of the proposed joint venture arrangements and can represent a broad outline of the definitive agreement.
- *Due Diligence* : After the parties have agreed on the basic terms of the joint venture arrangement a fixed period of time is often set in which to conduct a detailed and comprehensive review of all information pertinent to the proposed business venture prior to the execution of the joint venture agreement. This process is referred to as “due diligence”.

Answer 5(c)

The two important agreements to be entered into by Depository Participants (DP) are :

1. *Standard Agreement with the Depository (NSDL)/(CDSL)*

Important clauses needing compliance on part of the DP are :-

- (a) Adherence to the SEBI Act 1992, the SEBI (Depositories and Participants) Regulations 1996, Byelaws and the Business Rules of the Depository.
- (b) Payment of requisite fees and charges as prescribed.
- (c) Compliance with valid instructions of the investor.
- (d) DP to reconcile its own records with the Depository on a daily basis, to maintain systems to comply with insurance mechanism to contribute to

Investors Protection Fund, to comply with accounting requirements, to resolve grievances etc.

2. Standard agreement with the Investor

Important clauses needing compliance by DP are as under:

- (a) The DP shall strictly adhere to the instructions of the client with regard to transfer to and from the Accounts of the Client.
- (b) The DP shall provide a statement of Accounts to the client at regular intervals unless otherwise agreed.
- (c) The DP shall resolve all legitimate grievances of the client within a stipulated period of time.

Question 6

- (a) *Anmol Milk Products Ltd. is planning to expand its operation by financing Rs.75 crore through a term loan from the IDBI Bank Ltd. The company has applied for a term loan and the assets of the company will be mortgaged to the lending bank as security.*

The bank has approached you, being a Practising Company Secretary, to furnish a certificate in respect of necessary powers of the company and its directors to enter into an agreement. State the general points to be kept in mind for furnishing such a certificate. (6 marks)

- (b) *Enumerate the points to be checked by a Secretarial Auditor in respect of the Air (Prevention and Control of Pollution) Act, 1981.* (6 marks)

- (c) *Describe the role of a Company Secretary in Practice in securities management and compliances under the SEBI Act, 1992 and its regulations.* (4 marks)

Answer 6(a)

Requirement of Industrial Development Bank of India

The following points would be kept in mind by the company Secretary in Practice while furnishing of such certificate –

The Memorandum and Articles of Association of the Company has to be examined for this purpose. Particularly the objects clause of the Memorandum of Association has a specified recital pertaining to borrowing powers of the company. The standard clause pertaining to borrowing powers included in the incidental or ancillary objects read as follows-

“To borrow or raise money or to receive money on deposit for the purposes of the company, in such manner and upon such terms as may seem expedient, and to secure the repayment thereof and of moneys owing or obligations incurred by the company and to create, issue and allot redeemable or irredeemable bonds, mortgages or other instruments, mortgage debentures (such bonds or debentures being made payable to bearer or otherwise and issuable or payable either at par, premium, discount or as 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.”

Compliance of the provisions of Section 149 of the Companies Act, 1956, in respect of public limited companies has to be ensured. Exercise of borrowing powers in contravention of Section 149 attracts levy of fine.

Resolutions passed at the meeting of the board/ general meeting for exercising the power of borrowing have to be checked;

Section 292 of the Companies Act requires inter alia, that the power to borrow moneys can be exercised by the Board of Directors only by means of resolution passed at meetings of the Board. This power of borrowings may also be delegated to any committee of directors, managing director, manager or any other principal officer. The delegation should be only by means of resolution passed at board meeting and not by circulation. Every resolution delegating this power should specify the total amount up to which moneys may be borrowed by the delegate.

The certificate will have to refer to the relevant clause(s) of the Memorandum of Association of the company, which gives specific powers to the company, and secure the repayment of the same by mortgage, charge, lien etc. The opinion will also have to refer to the relevant articles of the Association and the general body resolution, if any, under which the Board of Directors are authorized to borrow or raise moneys, secure the repayment thereof and execute on behalf of the company, bonds deeds, documents etc. The opinion should also spell out the limitations and restrictions, if any, on the powers of the Board of directors to borrow or raise money.

Answer 6(b)

Checklist : Air (Prevention and control of Pollution) Act, 1981

The Secretarial auditor has to check the following points in respect of Air (Prevention and Control of Pollution) Act, 1981:-

1. *Prohibition on use of certain appliances in declared areas (Section 19)*
 - (i) Whether any notification has been issued under Section 19 declaring the area in which the premises of the factory of the company is situated, as air pollution control area.
 - (ii) If so, whether directions, if any, of the state Government concerned regarding use of approved appliances have been complied with
2. *Previous consent of the State Board for operating industrial plants (Section 21)*
 - (i) Whether previous consent of the State Board has been obtained for establishing or operating any new industrial plant set up by the Company.
 - (ii) Whether the conditions of consent have been complied with.
 - (iii) Whether consent given has been cancelled. If yes, what action has been taken by the company in the matter.
3. *Whether the air pollutants conform to the standards (section 22) prescribed by the State Government*
4. *Restraints on causing air pollution (section 22A)—*
 - (i) Whether any court has been made orders restraining the company in regard to emission of any air pollutant

- (ii) Whether the state board has been authorized to implement the court's direction in a specified manner.
- 5. *Information to be furnished to the State Board etc. (Section 23, 24, 25 & 26)*
 - (i) Whether information, if any, has been given to the State Board regarding emission or apprehended emission of any air pollutant in excess of the standard laid down.
 - (ii) Whether any inspection has been carried/information called or samples have been taken by the state board or any officer empowered by it.
- 6. *Whether any appeal has been preferred by an aggrieved person against the orders of State Board. (Section 31)*
- 7. *Compliance with directions issued by the Central/State Board (s)–(Section 31-A)*

Whether any directions have been issued by the central/state board(s) particularly in regard to—

 - Closure, prohibition or regulation of any industry operation of process; or
 - The stoppage or regulation of supply of electricity, water or any other service.
 - (ii) If so, whether such directions have been complied with.
- 8. *Prosecution of company and its directors (Chapter VI)*
 - (i) Whether prosecution proceedings have been initiated against the company and its directors for violation of any provisions of the Act.
 - (ii) If yes, what is the State/result of such proceedings?

Answer 6(c)

Role of Company Secretary in Practice

The Securities and Exchange Board of India Act, 1992/rules/regulations/ guidelines/ circulars

1. SEBI has authorized the practicing company secretary to appear before the Securities Appellate Tribunal as an authorized representative of an appellant
2. Practicing Company Secretary can, certify non-promoter holdings as per clause 35 of Listing Agreement in demat mode in case of the companies which have established connectivity with both the depositories.
3. PCS is authorized to o issue certificate of compliance of conditions of corporate governance for companies who have listed their equity shares, debt instruments and Indian Depositories in stock exchanges. .
4. PCS can issue certificate regarding maintenance of adequate security cover in respect of listed debentures every quarter.
5. PCS can conduct Internal Audit of Portfolio Managers.

6. PCS can issue a certificate to listed companies to the effect that all refund orders/certificates to allottees of the previous issues were dispatched within prescribed time and manner and securities were listed on the stock exchanges specified in the offer document.
7. PCS is authorized to issue a certificate to the effect that provisions of SEBI Guidelines, 2000 relating to Bonus Shares have been complied with.
8. PCS is authorised to conduct Internal Audit of sub-brokers.

Question 7

- (a) Write short notes on any two of the following :
- (i) Takeover defences
 - (ii) Appraisal of register of members/debentureholders
 - (iii) Risks on trading in debt securities. (4 marks each)
- (b) Distinguish between **any two** of the following:
- (i) 'Dematerialisation' and 'rematerialisation'.
 - (ii) 'Financial collaboration' and 'technical collaboration',
 - (iii) 'Depository' and 'depository participant'. (4 marks each)

Answer 7(a)(i)

Take Over Defenses

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.

Answer 7(a)(ii)

While conducting share transfer Audit, the following issues are to be considered with respect to appraisal of Register of members/ debentures.

Check whether a company has properly maintained its register of members and register of debenture holders with respect of following aspects:

- (a) Whether the registers are maintained in the form prescribed under the companies (Issue of Share Certificates) Rules, 1960 or as near there to as circumstances admit.
- (b) Whether the details of the transfers have been posted in the proper folios in the register of members. In case of transferee being a new member whether new folio has been allotted to him. In case after recording the transfer the holding of a member becomes nil whether the folio has been properly closed.
- (c) Whether entries in the register are authenticated by the Secretary or any other person authorized by the Board.
- (d) Whether in case of Company having more than 50 members, an index of members is maintained.
- (e) Whether every change in the register of members has been recorded in the index within stipulated time.

Answer 7(a)(iii)

The risk on Trading Debt Securities may be :

- 1. *Default Risk* is the risk that an issuer of a bond may be unable to make timely payment of interest or principal on a debt security.
- 2. *Interest Rate Risk* is the risk emerging from an adverse change in the interest rate prevalent in the market so as to affect the yield on the existing instruments.
- 3. *Reinvestment Rate Risk* is the probability of a fall in the interest rate resulting in a lack of options to invest the interest received at regular intervals at higher rates at comparable rates in the market.
- 4. *Counter Party Risk* refers to the failure or inability of the opposite party to the contract to deliver either the promised security or the sale-value at the time of settlement.
- 5. *Price Risk* refers to the possibility of not being able to receive the expected price on any order due to a adverse movement in this price.

Answer 7(b)(i)

Dematerialisation

Dematerialisation is a process of conversion of physical certificates into electronic balances. Before the process of dematerialisation is set in motion some essential prerequisites need to be considered as under:

- (a) An investor must open an Account with a DP.
- (b) The securities must be in the name of the account holder and owned by him.
- (c) A separate demat requisition form (DRF) is required for each issuer.
- (d) The DRF form must be signed by all the joint holders.

Rematerialisation

Rematerialisation means the conversion of dematerialised holdings back into the physical certificates.

In a simplified form the process of Rematerialisation could be explained hereunder:

- (a) Investor to submit the Rematerialisation Request Form (RRF) to the DP.
- (b) DP to electronically intimate the Depository.
- (c) DP to submit RRF to the Registrar/Issuer Company.
- (d) Depository confirms rematerialisation request to the Registrar/Issuer Company.
- (e) Registrar/Issuer Company verifies particulars, prints certificates and intimates the Depository.
- (f) Depository updates Accounts and downloads details to DP.
- (g) Registrar/issuer dispatches certificates to the investors.

Answer 7(b)(ii)***Financial Collaboration v. Technical Collaboration***

Financial collaboration involves Foreign Direct Investments in the form of Equity, FCCBs, etc., and in Technical collaboration in involves payment of royalty, technical know-how fee etc. Both forms of investment may take place under automatic route where post facto approval of RBI is obtained when the investment / payments are within the limits. When it exceeds the specified limits, it requires prior approval of central government.

Answer 7(b)(iii)**Depository**

A depository is to securities as a bank is to cash. A depository holds securities of investors in electronic form. It facilitates settlement of trades in, and transfer, transmission, lending, borrowing and pledging of, securities by way of book-entry, as and when instructed by investors.

Depository Participant

A participant is assigned the role to act as the agent of a Depository under the Act and cannot act unless registered with SEBI. The primary function of depository participants, as the agent of the depository, is to provide securities' related services offered by the depository to the clients.

Question 8

Critically examine and comment on any four of the following :

- (i) *A key step in any due diligence exercise is to develop an understanding of the purpose for the transaction.*
- (ii) *In case of preferential issue of shares by listed companies, valuation is to be done by an independent qualified valuer.*

- (iii) *Under the Employee Stock Option Scheme, the companies have freedom to determine the exercise price.*
- (iv) *A conglomerate merger involves coming together of two companies in different industries.*
- (v) *Securities held in a depository account can be pledged or hypothecated against a loan, credit or guarantee availed of by the beneficial owner of such securities.*
(4 marks each)

Answer 8(i)

A key step in any due diligence exercise is to develop an understanding of the purpose for the transaction as the nature of due diligence varies from the type of transaction, its volume, the motive and objective of parties to a transaction. The nature and the extent of due diligence depends upon the risk perceived by parties to a transaction. The scope of due diligence is transaction-based and is depending on the needs of the people who is involved in the potential investments, in addressing key uncovered issues, areas of concern/threat and in identifying additional opportunities.

The goal of due diligence is to provide the party proposing the transaction with sufficient information to make a reasoned decision provide a basis for determining or validating the appropriate terms and price for the transaction incorporating consideration of the risks inherent in the proposed transaction.

Answer 8(ii)

As per Chapter XIII of SEBI (DIP) Guidelines 2000, in case of preferential allotment of shares to promoters, their relatives, associated and related entities, for consideration other than cash, valuation of assets in consideration for which the shares are proposed to be issued, should be done by an independent qualified valuer. The word valuer shall mean Chartered Accountant or Merchant Banker appointed to determine the value of intellectual property rights or other addition. This is defined under SEBI (Issue of Sweat Equity) Regulations 2002.

Answer 8(iii)

The companies granting option to it is employees pursuant to the Employees Stock Option Scheme is having the freedom to determine the exercise price subject to adherence to the accounting policies, specified in Schedule I of SEBI (ESOP &ESPS) Guidelines, 1999.

Accounting Policies for ESOS

- (a) In respect of options granted during any accounting period, the accounting value of the options shall be treated as another form of employee compensation in the financial statements of the company.
- (b) The accounting value of options shall be equal to the aggregate, over all employee stock options granted during the accounting period, of the intrinsic value of the option or, if the company so chooses, the fair value of the option.
- (c) Where the accounting value is accounted for as employee compensation in

accordance with clause (b), the amount shall be amortised as specified under the schedule.

- (d) When an unvested option lapses by virtue of the employee not conforming to the vesting conditions after the accounting value of the option has already been accounted for as employee compensation, this accounting treatment shall be reversed by a credit to employee compensation expense equal to the amortized portion of the accounting value of the lapsed options and a credit to deferred employee compensation expense equal to the unamortized portion.

When a vested option lapses on expiry of the exercise period, after the fair value of the option has already been accounted for as employee compensation, this accounting treatment shall be reversed by a credit to employee compensation expenses.

Answer 8(iv)

Conglomerate Merger

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. They lack any commonality 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. A conglomerate merger is one which is neither horizontal nor vertical. In this the merging companies operate in unrelated markets having no functional economic relationship.

Answer 8(v)

Securities held in a depository account can be pledged or hypothecated against a loan, credit, guarantee etc, availed by the beneficial owner of such securities. For this, it is imperative that both the parties to the agreement, to have a beneficiary account with a depository. It is however not necessary that both of them have their depository account with the same participant or same depository. If a beneficial owner intends to create a pledge on a security, owned by him, Regulation 58 of SEBI (Depositories and Participants) Regulations, 1998 have to be borne in mind, which prescribes the procedure to be followed such as making of application to depository through Depository Participant, creation of charge, invocation of pledge etc.

PROFESSIONAL PROGRAMME EXAMINATION

DECEMBER 2009

**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 correct or incorrect :*

- (i) *Private companies are not required to employ the whole-time Company Secretary.*
- (ii) *A member of the Institute of Company Secretaries of India (ICSI) in whole-time practice can issue compliance certificate in respect of any number of companies without any ceiling whatsoever.*
- (iii) *Unlisted companies cannot float global depository receipts (GDRs) in India under the Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993.*
- (iv) *The provisions regarding number of Board meetings and periodicity of Board meetings contained in clause 49 of the listing agreement and section 285 of the Companies Act, 1956 are identical.*
- (v) *Investment in Indian depository receipts (IDRs) is an investment opportunity for foreign investors to invest in Indian companies.*

(2 marks each)

(b) *Suraj, a Practising Company Secretary ignored some material discrepancies while issuing compliance certificate to a company. Explain the professional responsibility involved and state whether any penal provisions are prescribed for taking action in such circumstances.*

(5 marks)

(c) *Explain the significance of securities management and compliances by a Company Secretary under the Companies Act, 1956.*

(5 marks)

Answer 1(a)(i)

Incorrect

As per section 383A(1) of the Companies Act 1956 every company having paid up capital exceeding a prescribed amount is required to appoint a whole-time company secretary. This is applicable to a private companies also if the paid up capital exceeds the prescribed amount.

Answer 1(a)(ii)

Incorrect

A member of the Institute in practice who is entitled to issue compliance certificate pursuant to the proviso to sub-section (1) of section 383A of the Companies Act,

1956 (1 of 1956) shall be deemed to be guilty of professional misconduct if he issues compliance certificates and/or signs Annual Return for more than eighty companies in aggregate i.e. (total number of companies in respect of which compliance certificate is issued or Annual Return is signed) in a calendar year. However, in the case of a firm of Company Secretaries, the ceiling of eighty companies aforesaid would apply to each partner therein who is entitled to sign the compliance certificate.

Answer 1(a)(iii)**Correct**

Unlisted companies, which have not yet accessed the Global Depository Receipt / Foreign Currency Convertible Bond route for raising capital in the international market would require prior or simultaneous listing in the domestic market, while seeking to issue (i) Foreign Currency Convertible Bonds and (ii) Ordinary Shares through Global Depository Receipts under the Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993.

Answer 1(a)(iv)**Incorrect**

As per Clause 49 of the listing agreement, the Board shall meet at least four times a year with a maximum time gap of four months between any two meetings.

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

Hence Section 285 of the Companies Act, 1956 and provisions of clause 49 pertaining to Board Meeting are not identical, as the Companies Act does not specify the maximum gap between two Board Meetings.

Answer 1(a)(v)**Incorrect**

Indian Depository Receipts provide an investing opportunity for Indian investors to invest in foreign equity. They are meant for foreign companies who intend to raise money in India.

Answer 1(b)

Company Secretaries must take adequate care while issuing Compliance Certificate. It is based on this certificate that confidence of the company, Government and trade and industry will build-up vis-a-vis our profession. Any failure or lapse on the part of a Practising Company Secretary in issuing a Compliance Certificate may not only attract penalty for false statement under Section 628 and disciplinary action for professional or other misconduct under the provisions of the Company Secretaries Act, 1980 but also make him liable for any injury caused to any person due to his negligence in issuing the Compliance Certificate. Therefore, it becomes imperative for the Practising Company Secretary that he exercises great care and caution while issuing the Compliance Certificate and also adheres to the highest standards of professional ethics and excellence in providing his services.

Section 628 of the Companies Act, 1956 deals with penalty for false statements. According to said Section, if in any return, report, certificate, balance sheet, prospectus, statement or other document, required by or for the purpose of any of the provisions of the Act, any person makes a statement

- (a) which is false in any material particular, knowing it to be false, or
- (b) which omits any material fact, knowing it to be material;

he shall, except as otherwise expressly provided in the Act, be punishable with imprisonment for a term which may extend to two years and shall also be liable to fine.

In view of this, a Practising Company Secretary will be attracting the penal provisions of Section 628, for any false statement in any material particular or omission of any material fact in the Compliance Certificate. However, a person will be penalised under Section 628 in case he makes a statement, which is false in any material particular, knowing it to be false, or which omits any material fact knowing it to be material.

Answer 1(c)

The company has to issue various types of securities to meet its requirement of funds. The issuance of any kind of security is again subject to the compliances of various Acts, Rules, Regulations and Guidelines. Once the securities have come into existence, the transactions in the securities are also governed by various Acts, Rules, and Regulations. Not only the issuer of the securities but also the holder of the securities are required to comply with the statutory provisions to transact in the securities of the company.

The concept of securities management and compliances thus signifies and includes in its ambit examination, verification or checking of registers, records, forms, returns and documents relating to securities issued by a company and certification of timely and proper compliance of all statutory provisions related to securities applicable to a company.

Thus, securities management and compliances, can provide an umbrella mechanism to ensure better compliances of all the statutory provisions relating to securities by the companies.

The company secretary has a big role to play because it is he who has to ensure the management of securities issued by the company, timely compliance of relevant provision of law applicable to the securities so issued and maintain all records and documents relating to securities issued by the company under the Companies Act, 1956 and other regulations.

Question 2

- (a) *Choose the most appropriate answer from the given options in respect of the following :*
 - (i) *According to SEBI guidelines relating to issue of capital, the draft prospectus is required to be filed with SEBI at least —*
 - (a) *30 days prior to the filing of prospectus with the Registrar of Companies*

- (b) 45 days prior to the filing of prospectus with the Registrar of Companies
 - (c) 60 days prior to the filing of prospectus with the Registrar of Companies
 - (d) 90 days prior to the filing of prospectus with the Registrar of Companies.
- (ii) Retail individual shareholder means a shareholder whose shareholding is not more than —
 - (a) Rs. 1,000
 - (b) Rs.10,000
 - (c) Rs.1,00,000
 - (d) Rs.99,000.
- (iii) Under the Employees' Stock Option Scheme, a director is not eligible to participate in the scheme if he is directly or indirectly holding the equity shares in that company more than —
 - (a) 1% of the issued capital of the company at the time of issuance
 - (b) 2% of the issued capital of the company at the time of issuance
 - (c) 5% of the issued capital of the company at the time of issuance
 - (d) 10% of the issued capital of the company at the time of issuance.
- (iv) The stock exchange may delist such companies which have been suspended for non-compliance with the listing agreement for a minimum period of —
 - (a) 1 month
 - (b) 2 months
 - (c) 3 months
 - (d) 6 months.
- (v) Out of the following, which is not required to be credited to the Investor Education and Protection Fund —
 - (a) Application money received by the company for allotment of any securities and due for refund
 - (b) Matured deposits with the company
 - (c) Matured debentures with the company
 - (d) Matured loans with the company.
- (vi) Section 295 of the Companies Act, 1956 deals with —
 - (a) Appointment of sole selling agents
 - (b) Loans to directors
 - (c) Remuneration to directors
 - (d) Disclosure of interest by directors.

(1 mark each)

(b) *State the circumstances when a company is —*

(i) *required to file the return of allotment with the Registrar of Companies; and*

(ii) *not required to file the return of allotment.* (2 marks each)

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

(i) *'Compliance certificate' and 'secretarial audit'.*

(ii) *'Technical collaboration' and 'financial collaboration' involving foreign investment in India.*

(iii) *'Global depository receipts' (GDRs) and 'Indian depository receipts' (IDRs).*
(3 marks each)

Answer 2(a)(i)

(a) 30 days prior to the filing of prospectus with the Registrar of Companies

Answer 2(a)(ii)

(c) Rs. 1,00,000

Answer 2(a)(iii)

(d) 10% of the issued capital of the company at the time of issuance.

Answer 2(a)(iv)

(d) 6 Months

Answer 2(a)(v)

(d) Matured loans with the company

Answer 2(a)(vi)

(b) Loans to director

Answer 2(b)(i)

The return of allotment in e-Form No. 2 has to be filed with the Registrar of Companies within 30 days from the date of allotment in the following cases:

(a) The company has made any allotment of its shares. If shares were allotted at a discount then relevant documents also to be attached.

(b) Shares were issued for consideration other than cash.

(c) Issue of bonus shares

(d) Allotment in pursuance of the order of the court under section 391/394.

Answer 2(b)(ii)

The return of allotment is not required to be filed:

(a) In case the allotment of forfeited shares

- (b) Allotment to the subscribers to the Memorandum & Articles of Association.
- (c) Issue of debentures.

Answer 2(c)(i)**Compliance Certificate and Secretarial Audit**

As per Section 383A read with Rule 2 of the Companies (Appointment and Qualifications of Secretary) Rules, 1988, every company having a paid up share capital of rupees 10 lakhs or more and not required to appoint a whole-time Secretary is required to file with the Registrar of Companies, a compliance certificate from a company secretary in practice and also attach a copy of that certificate with the Board's Report. In terms of proviso to Section 383A(1), the Central Government has prescribed the Companies (Compliance Certificate) Rules, 2001 for issue of Compliance Certificate by a practicing company secretary.

Secretarial Audit is wider in ambit and denotes a check on numerous legal compliances and also the process carried out by concerned company. The scope of Compliance Certificate would comprise of certification of the compliance of various requirements under the Companies Act, 1956 whereas Secretarial Audit is a much wider term. Secretarial Audit Report should set out in detail the scope of the work, his observations on irregularities noticed, weakness in the policies and procedures etc. Secretarial audit is voluntarily adopted by companies, as a good governance practice.

Answer 2(c)(ii)**Technical collaboration and financial collaboration**

Foreign investment can be taken in the form of technical collaboration/financial collaboration. Financial Collaboration involves Foreign Direct investments in the form of Equity, FCCBs etc. Technical collaboration involves transfer of technology and payment of royalty, technical know-how fee etc. Both forms of investment may take place under automatic route where post facto approval of RBI is obtained when the investment/ payments are within the limits. When it exceeds the specified limits, it requires prior approval of central government.

Answer 2(c)(iii)

Indian Depository Receipt means any instrument in the form of a depository receipt created by Domestic Depository in India against the underlying equity shares of issuing company which is located outside India. The Indian IDR holders would thus indirectly own the equity shares of overseas issuer company. IDRs are to be listed and denominated in Indian Currency. An issuing company cannot raise funds in India by issuing IDRs unless it has obtained prior permission from SEBI.

Global Depository Receipts (GDRs) are negotiable securities issued outside India by a Depository Bank, on behalf of an Indian company, which represent the local Rupee denominated equity shares of the company held as deposit by a Custodian Bank in India.

Question 3

- (a) *You are working as the whole-time Company Secretary in a large listed company.*

Draft a note to the Audit Committee of the Board highlighting the need for the appointment of Secretarial Auditor in the company. (6 marks)

(b) A foreign company engaged in automobile manufacturing activities is interested in setting-up a branch office in India. As a Company Secretary, advise the foreign company the purposes for which a branch office can be set-up under the Foreign Exchange Management Act, 1999. (6 marks)

(c) Explain the following terms used in takeovers and acquisitions :

(i) Conglomerate merger.

(ii) Reverse merger. (2 marks each)

Answer 3(a)

To

The Audit Committee of the Board of Directors
XYZ Ltd

Need for appointment of Secretarial Auditor

Secretarial audit not only acts as an effective mechanism to ensure that the legal and procedural requirements are duly complied with but also instills professional discipline in the working of the company besides building up the necessary confidence in the state of affairs of the company.

Several industrial and corporate laws need to be complied with by companies, non-compliance of which attracts prosecution. Secretarial Audit has a capability to provide an in-built mechanism for ensuring corporate compliance generally and will specifically help restore this confidence of investors through greater transparency.

Secretarial audit extends professional help to the company in carrying out effective compliances and establishment of proper systems with appropriate checks and balances. Secretarial Audit is inherently useful, especially to small and medium sized companies and in particular, to the professional/nominee directors.

It relieves the company and its directors including the independent/nominee directors, from the consequences of unintended non-compliances of the provisions of the Companies Act and other important corporate laws. It further curbs the tendency on the part of the smaller companies to short cut the procedural requirements which is primarily due to ignorance or lack of professional support. Secretarial audit essentially acts as a pre-emptive check to monitor compliance with requirements of the Companies Act and other important corporate laws.

Secretarial audit also assists the government in ensuring better compliance of law and reduces litigation.

Further, with the growing reliance of companies on institutional finance/working capital from All-India and State level financial corporations and banks, it has become imperative for such agencies to know that the company has complied with the core legislations. Secretarial audit provides the much needed case due to proper maintenance of statutory records and compliance with the legal and procedural requirements.

Secretarial audit not only ensures that the company has complied with the provisions of various laws but also extends professional help to the company in carrying out effective compliance and establishment of proper systems with appropriate checks and balances.

In order to ensure better self-regulation on the part of companies and due compliance with the provision of law, secretarial audit of those companies which are not subject to the production of compliance certificate, is an imperative necessity.

Considering the above facts, it is felt that the appointment of Secretarial auditor is necessary as it would be an effective mitigation measure of regulatory risks.

Answer 3(b)**Purposes for which a branch office can be set up.**

Foreign companies engaged in manufacturing and trading activities abroad are allowed to set up Branch Offices in India for the following purposes:

- Export/Import of goods
- Rendering professional or consultancy services
- Carrying out research work, in which the parent company is engaged.
- Promoting technical or financial collaborations between Indian companies and parent or overseas group company.
- Representing the parent company in India and acting as buying/selling agents in India.
- Rendering services in Information Technology and development of software in India.
- Rendering technical support to the products supplied by the parent/ group companies.
- Foreign Airline/Shipping Company

It may be noted that retail trading activities of any nature is not allowed for a branch office in India.

Answer 3(c)(i)

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. They lack any uniformity 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.

Answer 3(c)(ii)

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 regular merger and reverse merger. It is like any other amalgamation.

Question 4

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

- (i) _____ is a process of conversion of physical certificates into electronic balances.
- (ii) The orders of SEBI under the securities laws are appealable before _____ .
- (iii) A _____ is a product whose value is derived from the value of underlying asset, index, etc.
- (iv) When a charge on the assets of the company is satisfied, the fact is intimated in Form No. _____ to the Registrar of Companies.
- (v) At the time of opening of a new demat account, the _____ should ensure that the application form has been filled in all respects and the client has been introduced by a well-known person.
- (vi) A company cannot register a transfer unless _____ duly stamped and executed by both the transferor and transferee is delivered to the company. (1 mark each)

(b) *While carrying out the secretarial audit of Daisy Ltd., you have found that a resolution was passed by the shareholders authorising the company to buy-back its shares. Intimation regarding the buy-back was also given to the recognised stock exchange in due course. However, no further steps were taken by the company in this regard. Meanwhile, a notice has been received by the company from the Securities and Exchange Board of India holding it guilty for not implementing the resolution of buy-back. Decide whether the company is bound to implement the resolution of buy-back of its shares.*
(5 marks)

(c) *What do you mean by an 'independent director' ? Mention the criteria for considering a director as an independent director ?*
(5 marks)

Answer 4(a)

- (i) **Dematerialization** is a process of conversion of physical certificates into electronic balances.
- (ii) The orders of SEBI under the securities laws are appealable before **Securities Appellate Tribunal** .
- (iii) A **Derivative** is a product whose value is derived from the value of underlying asset, index, etc.
- (iv) When a charge on the assets of the company is satisfied, the fact is intimated in Form No. **17/e form 17** to the Registrar of Companies.
- (v) At the time of opening of a new demat account, the **Depository Participant** should ensure that the application form has been filled in all respects and the client has been introduced by a well-known person.

- (vi) A company cannot register a transfer unless **Proper instrument of transfer** duly stamped and executed by both the transferor and transferee is delivered to the company.

Answer 4(b)

As per the provisions of Section 77 A and the relevant provisions of the buy-back regulations, it is clear that a company is under no obligation to buy-back its securities even if its shareholders have passed a special resolution authorizing it to buy-back on the terms and conditions mentioned in the resolution. Section 77 A is only an enabling provision and all that it mandates is that no company shall buy-back its own securities unless it is authorized by its Articles and also by its share holders. The next step on the part of the company is to make a public announcement if it wanted to buy-back and the public announcement would then have been the offer which the company would have made to its shareholders. From the Question it seems that it did not come out with a public announcement and consequently, no offer to buy-back was made to the shareholders. It may be noted that failure if any to complete buy-back has to be reported in the Board's report with reasons thereof. Accordingly the same has to be reported in Directors' Report.

Answer 4(c)

Independent Directors are known to bring an objective view in board deliberations. They bring a valuable outside perspective to the deliberations.

'Independent director' means 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 directors, its senior management or its holding company, its subsidiaries and associates which may affect independence of the director;
- (b) is not related to promoters or persons occupying management positions 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 an executive or was not partner or an executive during the preceding three years, of any of the following:
 - (i) the statutory audit firm or the internal audit firm that is associated with the company, and
 - (ii) the legal firm(s) and consulting firm(s) that have a material association with the company.
- (e) is not a material supplier, service provider or customer or a lessor or lessee of the company, which may affect independence of the director;
- (f) is not a substantial shareholder of the company i.e. owning two percent or more of the block of voting shares.
- (g) is not less than twenty one years of age.

Question 5

- (a) *Jai Hind Ltd. made a public issue of 12 crore shares @ Rs.260 per share. 3 crore shares were offered to retail category of investors. Response of public to the issue was overwhelming and the entire issue was oversubscribed by 4.5 times whereas for the retail category the oversubscription was 6 times. The allotment procedure was finalised as per the SEBI guidelines. Three retail investors Ramesh, Suresh and Tushar who applied for 80 shares, 64 shares and 40 shares respectively, are interested in ascertaining the number of shares likely to be allotted to them. As per the issue document, applications could be made for a minimum of 8 shares and in multiples thereof. What will be their respective actual entitlements ? Explain with reasons. (5 marks)*
- (b) *State the compliances required under the listing agreement regarding publication of financial results in newspapers. (5 marks)*
- (c) *As a Practising Company Secretary, prepare a check-list for the purpose of compliance certificate under section 383A of the Companies Act, 1956 with regard to declaration, payment and transfer of dividend. (6 marks)*

Answer 5(a)

As per allotment procedure, the allotment to retail individual investors would be on proportionate basis i.e. at 1/6 of the total number of shares applied for. The actual entitlement shall be as follows:

<i>Name of Investor</i>	<i>Number of shares applied</i>	<i>Total number of shares eligible to be allotted (No. of shares applied for/6)</i>
R	80	$80/6 = 13.33 = \text{rounded off to 13 shares}$
S	64	$64/6 = 10.66 \text{ rounded off to 11 shares}$
T	40	$40/6 = 6.66 \text{ rounded off to 7 shares (application of T is liable to be rejected because the entitlement is less than the minimum application size)}$

Allotment shall be on proportionate basis within specified categories, rounded off to the nearest integer subject to a minimum allotment being equal to the minimum application size as fixed and disclosed by the issuer.

Answer 5(b)

The company shall, within 48 hours of conclusion of the Board or Committee meeting at which the financial results were approved, publish a copy of the financial results which were submitted to the stock exchange in at least in one English daily newspaper circulating in the whole or substantially the whole of India and in one daily newspaper published in the language of the region, where the registered office of the company is situated.

Where the company has opted to submit audited financial results, it shall also publish the qualifications or reservations, if any, expressed by the auditor together with the audited results.

Where the company has submitted consolidated financial results in addition to stand-alone financial results, it shall have an option to publish either stand-alone financial results or consolidated financial results in the newspapers, subject to the following:

- (i) It shall intimate the stock exchange in the first quarter of the financial year or within such extended period as may be specified by SEBI in this regard and shall not change the same during the financial year;
- (ii) In case the company changes its option in any subsequent year, it shall furnish comparable figures for the previous year in accordance with the option exercised for the current year;
- (iii) It shall give a reference in the newspaper publication, to the places, such as the company's website and stock exchanges' websites, where the standalone results of the company are available.

Answer 5(c)

Checklist for Declaration, payment and transfer of dividend

Check whether:

- (i) dividends were declared out of profits after providing for depreciation according to the provisions of Section 205(2) (unless an exemption in this regard was obtained);
- (ii) specified minimum amount has been transferred to reserves according to the Companies (Transfer of Profits to Reserves) Rules, 1975;
- (iii) board resolution recommending dividend has been passed;
- (iv) the Board has authorised the opening of a separate Bank Account for payment of dividend;
- (v) the amount of dividend including interim dividend was deposited in the separate Bank Account within 5 days from the date of declaration of such dividend;
- (vi) register of members was closed as per the provisions of Section 154;
- (vii) interim dividend, if any, declared by the Board of directors has been confirmed/ noted at the annual general meeting;
- (viii) dividend recommended by the Board was declared at the annual general meeting;
- (ix) dividend warrants were printed, signed and despatched to the registered shareholders within 30 days of declaration;
- (x) permission of Reserve Bank of India, if required was obtained before dividend was remitted to foreigners/non resident Indians;
- (xi) stock exchanges were duly intimated, in case of listed company;
- (xii) voluntary transfer to reserves, if any, was made according to the Companies (Transfer of Profits to Reserves) Rules, 1975;
- (xiii) in case of inadequacy of profits, the Companies (Declaration of Dividends out of Reserves) Rules, 1975, were complied with or previous approval of the

Central Government was obtained, before such declaration by (e-filing) of form pursuant to such rules, duly precertified;

- (xiv) dividends were paid in accordance with Section 206 only to the registered shareholder or his order or to his bankers. In case of a share warrant, dividend has been paid to the bearer of such warrant or to his bankers;
- (xv) unpaid or unclaimed dividend was transferred to the unpaid dividend account within 7 days after the expiry of 30 days from the date of declaration (Section 205A);
- (xvi) amount of dividend remaining unpaid and unclaimed for seven years from the date they became due for payment has been transferred to the Investor Education and Protection Fund, established by the Central Government pursuant to Section 205C and while transferring the amount, the company furnished a statement in the prescribed form under Section 205A(6).
- (xvii) where duplicate dividend warrants were issued, whether indemnity in lieu of dividend warrants lost/defaced were obtained.

Question 6

- (a) *A member of Rosy Ltd. is interested in inspecting and taking copies of minutes of Board meetings and of the annual general meeting held in the year 2008. Draft a suitable reply to be sent to the member. (6 marks)*
- (b) *You are in the process of preparing compliance certificate of Koncept Ltd. You find that a Board resolution has been passed to grant a loan of Rs.80 lakh to another company, Rocket Ltd. The information about Koncept Ltd. as on 31st March, 2009 is as under :*

	<i>Rs. in Lakhs</i>
<i>Paid-up share capital :</i>	
— Equity	50
— Preference	10
<i>General reserves</i>	100
<i>Debentures redemption reserve</i>	5
<i>Loans already given to :</i>	
— Xel Ltd.	5
— Yetin Ltd.	10

Koncept Ltd. has already given a guarantee of Rs.10 lakh to Zohar Ltd.

Prepare a note commenting on the decision of the Board and indicating whether it has complied with the relevant provisions of the Companies Act, 1956. (6 marks)

- (c) *Janta Power Ltd. was incorporated on 30th November, 2008. The certificate of commencement of business was issued by the Registrar of Companies on 31st December, 2008. Explain the provisions of the Companies Act, 1956 regarding holding of statutory meeting by the company. (4 marks)*

Answer 6(a)

The reply would be in the following lines:

The shareholders have no right to see and seek copies of minutes of Board Meeting. However, they can have access to the minutes of general meetings.

Minutes book of general meetings are kept open at the registered office of company during business hours for inspection of members that too without any charge, subject to such reasonable restrictions as the company may by Articles or in general meeting impose.

The copies of minutes of general meetings are to be furnished within 7 days of the receipt of request on payment of Re. 1 for every 100 words or fractional part thereof or such other fee as may be prescribed.

Answer 6(b)

According to Section 372 A of the Companies Act, 1956, a company cannot grant any loans or inter-corporate investment exceeding 60% of its paid up capital and free reserves or 100% of its free reserves, whichever is more.

In the given situation, the position is as under:

Paid up Capital (50+10)	60 Lakh
General Reserves	100 Lakh
Total	<u>160 Lakh</u>
60% of Rs. 160 lakh	= Rs. 96 Lakh
100% of Reserves & surplus	= 100 Lakh

Therefore, higher of the two i.e. Rs. 100 Lakh will be the overall limit of inter-corporate loans.

The existing loans of the company amount to Rs. 25 lakh (Xel Ltd. 5 lakh, Yetin Ltd. 10 Lakh and Konzept Ltd. Rs. 10 Lakh for guarantee). Hence only upto 75 lakh (100-25 Lakh) can be granted as loan by the company.

If the company wants to give loan as proposed i.e. of Rs. 80 Lakh to another company, it has to pass special resolution in company's general meeting as required under Section 372 A of the Companies Act.

Thus Board of Directors should have complied with the said provisions for grant of loan to another company by passing special resolution.

Answer 6(c)

A company limited by shares and a company 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 of obtaining certificate of commencement of business hold a

general meeting of the members of the company. This meeting is called the statutory meeting.

The Board of directors shall, at least twenty-one days before the day on which the meeting is held, forward the statutory report to every member of the company. The Act obligatory that the Statutory Report be certified by at least two directors, including the managing director, if there is one, and also by the company's auditors in so far as the report relates to the shares allotted by the company, cash received in respect of the shares and the receipts and payments of the company. The Board of directors must file a copy of the Statutory Report duly certified, with the Registrar of Companies for registration, after copies thereof have been sent to the shareholders of the company.

Further, in accordance with the provisions of Section 171 of the Act, notice for calling every general meeting of a company, including a statutory meeting, must be given at least twenty-one clear days before the meeting unless consent is accorded to a shorter notice by members, holding not less than 95% of such paid-up capital as gives right to vote or not less than 95% of the total voting power exercisable at the meeting. The notice convening the meeting should state it to be the statutory meeting. The Board shall cause a list showing the names, addresses and occupations of the members of the company and the number of shares held by them respectively, to be produced at the commencement of the Statutory meeting. The list shall remain open and accessible to any member of the company during the continuance of the meeting

Failure to hold such a meeting renders the company liable to be wound up under Section 433 (b)

Question 7

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

- (i) *CEO/CFO certification under listing agreement.*
- (ii) *Pledge of shares held in dematerialised form and the role of depository participant.*
- (iii) *Search and status report on the position of borrowings made by a company.* (4 marks each)

(b) Distinguish between any two of the following :

- (i) *'Friendly takeover' and 'hostile takeover',*
- (ii) *'Share transfer audit' and 'statutory audit',*
- (iii) *'Audit committee' and 'remuneration committee'.* (4 marks each)

Answer 7(a)(i)

As per clause 49(IV)(F) of the listing agreement details the following provisions regarding 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 discharging that function shall certify to the Board that:

- (a) They have reviewed financial statements and the cash flow statement for the year and that to the best of their knowledge and belief :
 - (i) these statements do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading;
 - (ii) these statements together present a true and fair view of the company's affairs and are in compliance with existing accounting standards, applicable laws and regulations.
- (b) There are, to the best of their knowledge and belief, no transactions entered into by the company during the year which are fraudulent, illegal or violative of the company's code of conduct.
- (c) They accept responsibility for establishing and maintaining internal controls for financial reporting and that they have evaluated the effectiveness of internal control systems of the company pertaining to financial reporting and they have disclosed to the auditors and the Audit Committee, deficiencies in the design or operation of such internal controls, if any, of which they are aware and the steps they have taken or propose to take to rectify these deficiencies.
- (d) They have indicated to the auditors and the Audit committee
 - (i) significant changes in internal control over financial reporting during the year;
 - (ii) significant changes in accounting policies during the year and that the same have been disclosed in the notes to the financial statements; and
 - (iii) instances of significant fraud of which they have become aware and the involvement therein, if any, of the management or an employee having a significant role in the company's internal control system over financial reporting.

Answer 7(a)(ii)

The shares held in dematerialized form can be pledged by clients for the purpose of obtaining loans from banks. For the purpose of creating pledge the Depository Participant should ensure that: (a) an application is submitted by the client (b) notice of pledge should be noted in the records if sufficient balances are available for pledge and forward the application to Depository (c) Depository Participants should inform the pledger as well as pledgee about creation of pledge, on intimation from the depository and (d) The participant shall make note in its records about invocation of pledge.

Answer 7(a)(iii)

Search involves physical inspection of documents and status comprises of reporting of the information as made available by the search. A search report prepared by the company secretary in practice enables the Bank/Financial Institution to evaluate

the extent up to which the company has already borrowed moneys and created charges on the security of its movable and immoveable properties. This information is very vital for considering the company's request for grant of loans and other credit facilities. The search report enables the Bank/Financial Institution to study the credit-worthiness of the borrowing company.

Answer 7(b)(i)

A friendly take over is with the consent of taken over company. There is an agreement between the management of two companies through negotiations and the take over bid may be with the consent of majority or all shareholders of the target company. On the other hand when an acquirer company does not offer the target company the proposal to acquire its undertaking but silently and unilaterally pursues its efforts to gain control against the wishes of existing management, such acts of acquirer are known as take over raids or hostile take over bids.

The main distinction between a friendly take over and hostile take over is whether there is a mutual understanding between the acquirer and the taken over company. Where there is mutual understanding, it is friendly take over otherwise it is termed as hostile take over.

Answer 7(b)(ii)

Registration of transfer of shares is one area where investors have interaction with the company and also judge its functioning. A company cannot register a transfer unless a proper instrument of transfer duly stamped and executed both by the transferor and transferee is delivered to the company within the time limit laid down in Section 108 of the Companies Act, 1956. SEBI has laid down guidelines to be followed by the listed companies in the matter of processing of transfers and norms for objection to transfer the shares. Share transfer audit involves checking of all the said Acts and guidelines and the said work can be performed by a secretarial auditor who need not be a statutory auditor. On the other hand statutory audit can only be performed by a statutory auditor appointed by the company in the general meeting as provided in Section 224 of the Companies Act, 1956. The statutory auditor has to submit his report to the shareholders of the company in the manner provided in Section 227 of the Act.

Answer 7(b)(iii)

As per clause 49 of the listing agreement, all listed companies shall have a qualified and independent audit committee. The said committee shall meet at least four times in a year and not more than four months shall elapse between two meetings. The audit committee shall have minimum of three directors as members. Two thirds of the members of audit committee shall be independent directors. The Chairman of the Audit Committee shall be an independent director and shall be present at annual general meeting to answer shareholders queries. The company secretary shall act as the secretary to the audit committee. The audit committee shall have powers to investigate any activity within its terms of reference and review the financial statements of the company.

The Board of Directors may set up a remuneration committee to determine on behalf of the board and the shareholders about the remuneration package payable to

the executive directors. The remuneration committee should normally consist of at least three directors all of whom should be non-executive directors. The constitution of remuneration committee is recommendatory under Clause 49.

Question 8

Critically examine and comment on any four of the following :

- (i) *All listed companies are required to ensure minimum level of public shareholding of 25% of the total number of issued shares of a class/kind for the purpose of continuous listing on a recognised stock exchange.*
- (ii) *While the newly inserted provision under section 383A(1) has opened much awaited area of practice for Company Secretaries, it casts onerous responsibility and poses a great challenge to the profession.*
- (iii) *Company Secretary of a listed company, in addition to complying with the provisions of Companies Act, 1956, is also expected to perform certain activities relating to securities laws and compliances.*
- (iv) *Public announcement is not required for inter-se transfers.*
- (v) *The objectives of a legal due diligence exercise may vary from case to case.*
(4 marks each)

Answer 8(i)

All listed company are required to ensure minimum level of public shareholding at 25% of the total member of issued shares of a class or kind for the purpose of continuous listing. However, where the company offers or has in the past offered a particular class or kind of its shares to the public to the extent of at least 10% of the issue size in terms of Rule 19(2)(b) of the Securities Contracts (Regulations) Rules, 1957, it has to maintain on a continuous basis, public shareholding of at least 10% of the total number of issued shares of such class or kind. Further, where the number of outstanding listed shares of any class or kind of the company are two crore or more and the market capitalization of such company in respect of shares of such class or kind is Rs. 1000 crore or more, it has to maintain on a continuous basis, public shareholding of at least 10% of the total number of issued shares of such class or kind

Answer 8(ii)

As per Section 383 (A)(1) Companies having paid up capital of 10 lacs or more are not required to appoint whole time secretary should obtain compliance certificate as to compliance of provisions of the Companies Act from a Practising Company Secretary.

While issuing the certificate the Company Secretary should exercise great diligence and care. Any failure or lapse on the part of the company secretary will:

- (a) attract penalty under Section 628 of the Companies Act for false statement omission of material particulars involve imprisonment which may extend to 2 years and fine.
- (b) attract disciplinary action for professional misconduct under Company Secretaries Act 1980
- (c) make him liable to third parties for injury caused to them due to negligence.

Answer 8(iii)

As Compliance Officer, the company secretary of a listed Company is liable to perform certain activities relating to securities laws and compliances in addition to the Companies Act, 1956, as a Compliance officer. It includes maintenance, examination, verification of registers, records, returns and other documents relating to securities issued by a company and ensuring of timely and proper compliance various Acts and Regulations. Company Secretary has to do certain activities like:

- Publication of financial results
- Compliance with SEBI & Listing Agreement
- Intimations/Disclosures to Stock Exchanges/SEBI.
- Implementation of Employees Stock Option Scheme
- Cautious about takeovers
- Watch on Stock Price Movements
- Watch on Insider Trading
- Take steps to prevent money laundering
- As Compliance Officer certify to stock exchanges.

Answer 8(iv)

SEBI (SAST) Regulations, 1997 requires the acquirer to make a public announcement and a public offer on acquisition of a certain percentage of shares or voting rights in a company. However, certain circumstances have been provided in regulation 3, subject to which if an acquirer acquires the specified percentage of shares or voting rights, he would be exempted from the requirement of making an open offer to the existing shareholders of the company. It exempts inter se transfer of shares amongst certain specified groups.

Answer 8(v)

A legal due diligence is scrutiny of all, or specific parts, of the legal affairs of the target company depending on the purpose of legal due diligence which may be mergers, acquisition or any major investment decision, with a view of uncovering any legal risks and provide the buyer with an extensive insight into the company's legal matters. It also improves the buyer's bargaining position and ensures that necessary precautions are taken in relation to the transaction proposed.

The objectives of a legal due diligence exercise may vary from case to case. However some of the common objectives in most of the cases would be as follows:

1. Gathering of information from the target company.
 2. Uncovering of the risks of target company through a SWOT analysis.
 3. Improving the bargaining position.
 4. Cost benefit analysis.
 5. Effect of risk and liability on the cost of the transaction.
 6. Mapping of compliance requirements of the target company and the actual status.
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PROFESSIONAL PROGRAMME EXAMINATION

JUNE 2010

DUE DILIGENCE AND CORPORATE COMPLIANCE MANAGEMENT

Time allowed: 3 hours

Maximum marks: 100

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

PART—A

Question 1

- (a) State, with reasons in brief, whether the following statements are correct or incorrect:
- (i) In the case of takeover, public announcement is required to be made by the acquirer either in all editions of an English national daily or in the Hindi national daily with wide circulation at the place where the registered office of the target company is situated.
 - (ii) Indian companies issuing Global Depository Receipts (GDRs) in America and Europe have to comply with the Securities and Exchange Board of India (SEBI) requirements.
 - (iii) A branch office of a foreign company is not allowed to carry out manufacturing activities on its own, but is permitted to sub-contract these to an Indian manufacturer. Branch office established with the approval of RBI may remit its profits outside India.
 - (iv) The stamp duty payable on transfer of shares varies from State to State.
 - (v) A company having a paid-up capital of Rs.2.5 crore is required to submit secretarial compliance certificate. (2 marks each)
- (b) Critically examine and comment on the following :
- (i) It is not the duty of the lead merchant bankers to ensure the despatch of share certificates/refund orders.
 - (ii) A remuneration committee may be set-up by the Board of directors as per clause 49 of the listing agreement relating to good corporate governance. (5 marks each)

Answer 1(a)(i)

Incorrect

Public announcement with respect to takeover is required to be made in

- all editions of one English national daily with wide circulation;
- one Hindi national daily with wide circulation and
- a regional language daily with wide circulation at the place where the registered office of the target company is situated and at the place of the stock exchange where the shares of the target company are mostly traded.

Answer 1(a)(ii)

Correct

FCCB and Ordinary Shares (Through Depository Receipt Mechanism) Scheme 2003 requires unlisted companies floating GDRs, to get its shares simultaneously

listed in Indian exchanges, with respect to underlying shares of the company issuing GDR. Thus the companies issuing GDRs are required to comply with SEBI Requirements also in addition to SEC requirements and EU directives.

Answer 1(a)(iii)

Correct

A branch office is not allowed to carry out manufacturing activities on its own but is permitted to sub-contact these to an Indian manufacturer. It may be noted that foreign companies engaged in manufacturing and trading activities abroad are allowed to set up Branch Offices in India only for the purposes specified under FEM (Establishment in India or branch or office or other place of business) Regulations 2000.

Branch Offices established with the approval of RBI, may remit outside India profit of the branch, net of applicable Indian taxes and subject to RBI Regulations, permission for setting up branch offices is granted by the Reserve Bank of India (RBI).

Answer 1(a)(iv)

Incorrect

In the case of transfer of shares the stamp duty is uniform throughout the country. In case of transfer of debentures or other securities the stamp duty payable on transfer thereof vary from state to state.

Answer 1(a)(v)

Correct

The Central Government in exercise of the powers conferred under Section 642 and Section 383A of the Companies Act, 1956 has amended the COMPANIES (APPOINTMENT AND QUALIFICATIONS OF SECRETARY) RULES, 1988. The amendment seeks to enhance the paid-up capital requirements for companies compulsorily required to appoint a whole time secretary to "five crore rupees". Under the amended rules a company having a paid up share capital of two crore rupees or more but less than five crore rupees may appoint any individual who is a member of the Institute of Company Secretaries of India as a whole-time secretary to perform the duties of a secretary under the Companies Act, 1956. Further, where a company has appointed a whole-time company secretary, possessing the qualification of membership of the Institute of Company Secretaries of India, such a company is not required to obtain a certificate from a secretary in whole-time practice under rule 3 of the Companies (Compliance Certificate) Rules, 2001. Hence, in the given case the paid up capital of the company being Rs.2.5 crores, the company is required to obtain compliance certificate unless it appoints a whole time company secretary possessing the qualification of membership of the Institute of Company Secretaries of India.

Answer 1(b)(i)

The statement is not correct.

As per SEBI (ICDR) Regulations 2009, the post-issue merchant banker is required to 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 also 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. If the issue is managed by more than one merchant banker, the rights, obligations and responsibilities, relating inter alia to disclosures, allotment, refund and underwriting obligations, if any, of each merchant banker shall be predetermined and disclosed in the offer document

Answer 1(b)(ii)

The state is correct.

As per clause 49 of the listing agreement it is recommendatory for the company to have a remuneration committee. 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. This committee may comprise of at least three directors, all of whom should be non-executive directors, the Chairman of committee being an independent director.

Question 2

- (a) Choose the most appropriate answer from the given options in respect of the following:
- (i) When a charge on the assets of a company is created or modified, which one of the following forms is required to be filed with the Registrar of Companies—
 - (a) Form No.21
 - (b) Form No.12
 - (c) Form No. 8
 - (d) Form No.15.
 - (ii) All companies to which Companies (Compliance Certificate) Rules, 2001 apply are required to file with the Registrar of Companies the compliance certificate within —
 - (a) 60 Days from the date on which its AGM is held
 - (b) 45 Days from the date on which its AGM is held
 - (c) 30 Days from the date on which its AGM is held
 - (d) 90 Days from the date on which its AGM is held.
 - (iii) Which one of the following Acts does not come under the purview of 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.
 - (iv) Foreign investment which does not qualify under automatic route —
 - (a) Will have to be cancelled and refunded
 - (b) Is prohibited
 - (c) Has to go for government approval

- (d) *None of the above.*
- (v) *As per compliances under the listing agreement, the Audit Committee shall meet in a year atleast —*
 - (a) *Two times*
 - (b) *Three times*
 - (c) *Four times*
 - (d) *Five times.*
- (vi) *Maximum period of imprisonment for non-compliance of listing agreement is —*
 - (a) *One year*
 - (b) *Three years*
 - (c) *Five years*
 - (d) *Ten years.* (1 mark each)
- (b) *Distinguish between the following :*
 - (i) *'Horizontal merger' and 'vertical merger'; and*
 - (ii) *'Friendly takeover' and 'hostile takeover'. (3 marks each)*
- (c) *Write a note on 'pre-issue due diligence' and 'post-issue due diligence'. (4 marks)*

Answer 2(a)(i)

- (c) Form No. 8

Answer 2(a)(ii)

- (c) 30 days from the date on which its AGM is held.

Answer 2(a)(iii)

- (b) Foreign Contribution Regulations Act, 1976

Answer 2(a)(iv)

- (c) Has to go for government approval

Answer 2(a)(v)

- (c) Four Times

Answer 2(a)(vi)

- (d) Ten years

Answer 2(b)(i)

Horizontal Merger

This class of merger is a merger between business competitors who are manufacturers or distributors of the same type of products or who render similar or same type of services for profit. It involves joining together of two or more companies which are producing essentially the same products or rendering same or similar services or their products and services directly to compete in the market with each other. Horizontal mergers result into a reduction in the number of competing companies in an industry and increase the scope for economies of scale and elimination of duplicate facilities. However, their main drawback is that they promote

monopolistic trend in the industrial sector.

Vertical Merger

In a vertical merger two or more companies are complementary to each other e.g. one of the companies is engaged in the manufacture of a particular product, the other is established and expert in the marketing of that product. In this merger the two companies merge and control the production and marketing of the same product. A vertical merger may result into smooth and efficient flow of production and distribution of a particular product and reduction in handling and stockholding costs. It also poses a risk of monopolistic trend in the industry.

Answer 2(b)(ii)

Friendly Takeover

A friendly takeover is with the consent of taken over company. 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.

Hostile Takeover

When an acquirer company does not offer the target company the proposal to acquire its undertaking but silently and unilaterally pursues efforts to gain control against the wishes of existing management such acts of acquirer are known as 'takeover raids' or hostile 'takeover bids'.

The main distinction between a friendly takeover and hostile takeover is whether there is a mutual understanding between the acquirer and the taken over company. When there is a mutual understanding, it is friendly takeover otherwise it is termed as hostile takeover.

Answer 2(c)

Due diligence spans the entire public issue process. Pre-IPO due diligence process will result in a gap analysis between the present status of the company and the company that should be floated i.e., a gap is an expectations gap, created as a result of how the market expects a listed company to conduct its affairs. In this scenario, once these gaps have been highlighted, the due diligence exercise should extend in advising the company on the processes and activities which are required to fill the gaps identified. The due diligence process aspires to achieve the following:

- to assess the reasonableness of historical and projected earnings and cash flows;
- to identify key vulnerabilities, risk and opportunities;
- to gain an intimate understanding of the company and the market in which the company operates such that the company's management can anticipate and manage change;
- to set in motion the planning for the post-IPO operations.

The scope of pre-issue due diligence includes compliance with regard to eligibility, pricing, disclosure, lock in requirements etc as prescribed under SEBI(ICDR) Regulations 2009.

Post issue due diligence includes post issue requirements like dispatch of share certificates, refund orders, basis of allotment, post issue monitoring reports, redressal of investor grievances, co-ordination with depositories, registrars, bankers etc.

Question 3

- (a) *Ambitious Constructions Ltd., a listed company, is planning to acquire controlling interest in Fine Cements Ltd. As a Practising Company Secretary, you are required to advise the managing director of the acquirer company about the meaning of 'trigger point' and the different trigger points to be followed under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997. (10 marks)*
- (b) *Gokul Financial Services Ltd. has made a public issue for 25 crore shares of Rs.10 each at a premium of Rs.370 per share. The following information has been provided to you:*
- (i) The company has reserved 25% shares for retail category.*
 - (ii) The total issue was over-subscribed 3.5 times whereas the retail category was over-subscribed by 7.20 times.*
 - (iii) The company has fixed a minimum application/bid size as 15 shares. Applications can be made for a minimum of 15 shares and in multiples thereof.*
 - (iv) Three retail investors Ankur, Bobby and Varsha have applied for 225 shares, 105 shares and 90 shares respectively.*
- On the basis of above information, calculate the actual entitlement of shares by Ankur, Bobby and Varsha, if the company has finalised the allotment on proportionate basis. (6 marks)*

Answer 3(a)

Trigger points

Trigger point is a point where provisions of SEBI (SAST) Regulations, 1997 i.e takeover code gets triggered and the acquirer is required to follow public announcement and other requirements as mentioned in the regulations in respect of further acquisition. Following are the trigger points where an acquirer is required to follow SEBI(SAST) Regulations, 1997.

(i) 15% shares or voting rights:

An acquirer who intends to acquire shares which alongwith his existing shareholding would entitle him to exercise 15% or more voting rights, can acquire such additional shares only after making a public announcement (PA) to acquire atleast additional 20% of the voting capital of Target Company from the shareholders through an open offer.

(ii) Creeping acquisition limit:

An acquirer together with persons acting in concert who holds 15% or more but less than 55% of shares or voting rights of a target company, can acquire such additional shares as would entitle him to exercise more than 5% of the voting rights in any financial year ending March 31 only after making a public announcement to acquire atleast additional 20% shares of target company from the shareholders through an open offer.

(iii). Consolidation of holding:

An acquirer who holds 55% or more but less than 75% shares or voting rights of a target company, can acquire further shares or voting rights only after making a public announcement to acquire atleast additional 20% shares of target company from the shareholders through an open offer.

Answer 3(b)

Calculation of allotment of shares on the basis of proportionate basis:

<i>Sr. No.</i>	<i>Name of Investor</i>	<i>Total number of shares applied for</i>	<i>Total number of shares eligible to be allotted (No. of shares applied for/7.20)</i>
1.	Ankur	225 shares	$225/7.20 = 31.25$ shares rounded off to 31 shares
2.	Booby	105 shares	$105/7.20 = 14.58$ shares rounded off to 15 shares i.e. minimum application size.
3.	Varsha	90 Shares	$90/7.20 = 12.5$ i.e. 13 shares application liable to be rejected as the entitlement is less than the minimum application size. However, the successful applicants out of the total applicants shall be determined by drawal of lots.

Question 4

- Priyanka Ltd., a listed company wants to make an issue of securities through a rights issue where the aggregate value of securities including premium exceeds Rs.70 lakh. As the Company Secretary of Priyanka Ltd., how will you advise your company in respect of procedures to be followed? (6 marks)*
- Anjan has applied for shares under the Employees Stock Option Scheme and his option is granted. Now, Anjan wants to transfer his option to one of his friends, Sanjay. Examine the request of Anjan in the light of the SEBI Guidelines, 1999. (5 marks)*
- The managing director of Cautious Bank Ltd. invites you as a Practising Company Secretary to explain him about compilation and preparation of search report before lending funds to a private company. Explain briefly the issues involved in this regard. (5 marks)*

Answer 4(a)

SEBI (ICDR) Regulations 2009 are applicable to a rights issue, where the aggregate value of specified securities offered is fifty lakh rupees or more. Accordingly an issuer making a rights issue, where the aggregate value of the specified securities offered is fifty lakh rupees or more, is required to file a draft offer document, along with fees as specified with SEBI through the lead merchant banker, at least thirty days prior to registering the prospectus, red herring prospectus or shelf prospectus with the Registrar of Companies or filing the letter of offer with the designated stock exchange, as the case may be. The following are important procedures to be followed with respect to a rights issue.

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.

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.

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.

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 4(b)

As per Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999, there shall be a minimum period of one year between the grant of options and vesting of option. However, in a case where options are granted by a company under an ESOS in lieu of options held by the same person under an ESOS in another company which has merged or amalgamated with the first mentioned company, the period during which the options granted by the transferor company were held by him shall be adjusted against the minimum vesting period required. Further, the company shall have the freedom to specify the lock-in period for the shares issued pursuant to exercise of option. The employee shall not have right to receive any dividend or to vote or in any manner enjoy the benefits of a shareholder in respect of option granted to him, till shares are issued on exercise of option. No person other than the employee to whom the option is granted shall be entitled to exercise the option. The option granted to the employee shall not be pledged, hypothecated, mortgaged or otherwise alienated in any other manner. Hence Anjan cannot transfer his options to his friend Sanjay.

Answer 4(c)

MCA-21 enables viewing of public documents of companies for which payment has been made by user. Form 8, Form 10, Form 17 and copies of certificates of registration thereof are available for inspection at the website. Before proceeding with the inspection it would be advisable to ensure that the format in which the search report is required.

Meticulous care will have to be taken in noting down the following particulars from the Register of Charges:

- (a) Date of registration (preferably with the serial number) of the document
- (b) Date and nature of the document creating the charge
- (c) Amount of the charge
- (d) Brief particulars of the property charged
- (e) Name and address of the person in whose favour the charge is created.

In respect of each of the charges created, it would be essential to identify the modifications effected from time to time by noting down carefully the following particulars:

- (a) Date of registration of the document (preferably with the serial number)
- (b) Nature and date of the instrument modifying the charge
- (c) Effect of Modification.

Each modification should be noted in chronological order and the above particulars should be compiled together for each charge.

As and when the charge is satisfied, fool-proof identification of the exact charge which is satisfied is of paramount necessity. The following particulars can be noted chronologically by way of modification by the Search Report.

- (a) Date of registration (preferably with the serial number) of the document
- (b) Date of satisfaction.

Non-essential particulars of charges comprise of the gist of terms and conditions with regard to (a) mode of repayment (b) rate of interest and (c) margin; these need not be given in the Search Report unless specifically so required by the client.

If the client requires particulars of the charges pending registration, it is advisable to give a separate report based on the verification of the registers and records maintained by or available with the company.

Question 5

- (a) *The Board of directors of National Food Corporation Ltd., a listed company decides to go for issue of shares through the Employees Stock Purchase Scheme (ESPS). As a professional, the Board has asked you to draft a due diligence check-list on the following issues :*
- (i) *Eligibility to participate in the scheme;*
 - (ii) *Shareholders approval; and*
 - (iii) *Pricing and lock-in period. (10 marks)*
- (b) *State the procedure for viewing of public documents of companies on MCA portal. (6 marks)*

Answer 5 (a)(i)

Eligibility to Participate in the Scheme

- (i) An employee eligible to participate in the scheme should be:
 - (a) a permanent employee of the company working in India or out of India; or
 - (b) a director of the company, whether a whole time director or not;
 - (c) an employee as defined in sub-clauses (a) or (b) of a subsidiary, in India or out of India, or of a holding company of the company.
- (ii) Check that the employee is not a promoter nor belongs to the promoter group.
- (iii) Ensure that a director who either by himself or through his relatives or through any body corporate, directly or indirectly holds more than 10% of the outstanding equity shares of the company is not participating, as he is not eligible to participate in the scheme.

Answer 5 (a)(ii)

Shareholder Approval

- (i) Check that the Scheme has been approved by the shareholders by passing a special resolution in the meeting of the general body of shareholders.
- (ii) Check that the explanatory statement to the notice has been sent to the shareholders and it specifies—
 - (a) the price of the shares and also the number of shares to be offered to each employee;
 - (b) the appraisal for determining the eligibility of employee for the scheme;
 - (c) total number of shares to be issued.
- (iii) The number of shares offered may be different for different categories of employees.
- (iv) Check that special resolution states that the company shall conform to the

accounting policies as specified in Schedule II of the SEBI (Employee Stock Option Scheme and Stock Purchase Scheme) Guidelines, 1999.

- (v) Check that approval of shareholders have been obtained by way of separate resolution in the general meeting in case of—
 - (a) allotment of shares to employees of subsidiary or holding company and;
 - (b) allotment of shares to identified employees, during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions) of the company at the time of allotment of shares.

Answer 5(a)(iii)

Pricing and Lock-in-period

- (i) The company has the freedom to determine price of shares to be issued under an ESPS, provided they comply with the accounting policies specified.
- (ii) Check that the shares issued under an ESPS are subject to lock-in for a minimum period of one year from the date of allotment.

Also ensure that in a case where shares are allotted by a company under a ESPS in lieu of shares acquired by the same person under an ESPS in another company which has merged or amalgamated with the first mentioned company, the lock-in-period already undergone in respect of shares of the transferor company shall be adjusted against the lock-in required under this clause.

- (iii) If the scheme is part of a public issue and the shares are issued to employees at the same price as in the public issue, the shares issued to employees under the scheme are not subject to any lock-in-period.

Answer 5(b)

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 6

- (a) *Draft a note to the Board of directors on the major compliances for public issue/listing of securitised debt instruments on the recognised stock exchange under the SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008. (8 marks)*
- (b) *Draft a check-list for an issue of Indian Depository Receipts (IDRs) under Chapter VI-A of the SEBI (Disclosure of Investor Protection) Guidelines, 2000 with respect to the following:*
- (i) *Eligibility for issue of IDRs;*
 - (ii) *Investors; and*
 - (iii) *Minimum subscription. (8 marks)*

Answer 6(a)

Major compliances for public issue and/or listing of securitized debt instruments on the recognized stock exchange under SEBI(Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008:

1. Ensure that special purpose distinct entity files draft offer document with SEBI at least 15 days before proposed opening the issue;
2. Ensure that special purpose distinct entity has made arrangements with Registered Depositories for dematerialisation of the securitised debt instruments.
3. Ensure that special purpose distinct entity has made an application for listing to one or more recognized exchanges in terms of 17A (2) of SCRA.
4. Ensure that credit rating is obtained from at least two registered credit rating agencies and the same is disclosed in the offer document.
5. Ensure that the contents of offer document has the required details and does not contain any misleading information.
6. Ensure to file necessary information/reports post issue as directed by SEBI from time to time.
7. Ensure that the special purpose distinct entity complies with its obligation relating to Minimum public offering for listing, continuous listing conditions etc

Answer 6 (b)(i)

Eligibility for issue of IDRs

Check whether the issuer of IDR

- (a) fulfils the eligibility criteria as specified in rule 4 of the IDR Rules;
- (b) is listed in its home country;
- (c) has not been prohibited to issue securities by any Regulatory Body; and
- (d) has good track record with respect to compliance with securities market

regulations.

Answer 6 (b)(ii)

Investors

- (a) Check that at least 50% of the IDRs issued has been subscribed to by QIBs; and
- (b) The balance 50% has been made available for subscription by non-institutional investors (i.e., investors other than QIBs and retail individual investors) and retail individual investors, including employees. IDRs shall be allocated among non institutional investors, retail individual investors and employees at the discretion of the issuer. The manner of allocation shall be disclosed in the prospectus for IDRs.
- (c) Check that application amount in an IDR is not less than Rs. 20,000.
- (d) Check that Procedure to be followed by each class of applicant for applying has been mentioned in the prospectus

Answer 6 (b)(iii)

Minimum subscription

For non-underwritten IDR issues:

"If the issuing company does not receive the minimum subscription of 90 per cent of the issued amount on the date of closure of the issue, or if the subscription level falls below 90 per cent. after the closure of issue on account of cheques having being returned unpaid or withdrawal of applications, the issuing company shall forthwith refund the entire subscription amount received. If the issuing company fails to refund the entire subscription amount within 15 days from the date of the closure of the issue, it is liable to pay the amount with interest to the subscribers at the rate of 15 per cent per annum for the period of the delay"

For underwritten IDR issues:

"If the issuing company does not receive the minimum subscription of 90 per cent of the net offer to public including devolvement of Underwriters within 60 days from the date of closure of the issue, the issuing company shall forthwith refund the entire subscription amount received with interest to the subscribers at the rate of 15 per cent per annum for the period of the delay beyond 60 days."

Question 7

- (a) Write notes on **any two** of the following :
 - (i) Escrow account
 - (ii) Foreign direct investment
 - (iii) Compliance management. (4 marks each)
- (b) Distinguish between **any two** of the following :
 - (i) 'Operational due diligence' and 'strategic due diligence'.
 - (ii) 'Transposition of shares' and 'transmission of shares'.
 - (iii) 'Level-I ADR' and 'Level-II ADR'. (4 marks each)

Answer 7(a)(i)

Escrow Account

The escrow amount shall be calculated in the following manner, as specified in the sub-regulation 2 of regulation 28 of SEBI(SAST) Regulations 1997,—

- (a) For consideration payable under the public offer,—
- | | |
|------------------------------------|--|
| up to and including Rs. 100 crores | 25 per cent; |
| exceeding Rs. 100 crores | 25 per cent up to Rs. 100 crores and 10 per cent thereafter. |

(b) For offers which are subject to a minimum level of acceptance, and the acquirer does not want to acquire a minimum of 20 per cent, then 50 per cent of the consideration payable under the public offer in cash shall be deposited in the escrow account.

The escrow account referred to in sub-regulation (1) shall consist of,—

- (a) cash deposited with a scheduled commercial bank; or
- (b) bank guarantee in favour of the merchant banker; or
- (c) deposit of acceptable securities with appropriate margin, with the merchant banker; or
- (d) cash deposited with a scheduled commercial bank in case of clause (b) of sub-regulation (2) of regulation 28, as mentioned in the abovesaid paragraphs.

In case the escrow account consists of deposit with a scheduled commercial bank, the acquirer has to ensure while opening the account that the merchant banker appointed for the offer is empowered to instruct the bank to issue a banker's cheque or demand draft for the amount lying to the credit of the escrow account, as provided in the regulations.

If the escrow account consists of bank guarantee, such bank guarantee must be in favour of the merchant banker and shall be valid at least for a period commencing from the date of public announcement until twenty days after the closure of the offer.

In case there is any upward revision of offer, consequent upon a competitive bid or otherwise, the value of the escrow account must be increased to equal at least 10 per cent of the consideration payable upon such revision.

Answer 7(a)(ii)

Investment in Indian companies can be made both by non-resident as well as resident Indian entities. Any non-resident investment in an Indian company is direct foreign investment. Investment by resident Indian entities could again comprise of both resident and non-resident investment. Thus, such an Indian company would have indirect foreign investment if the Indian investing company has foreign investment in it. The indirect investment can be a cascading investment i.e. through multi-layered structure also. Foreign Direct Investments (FDI) can be made under the following two routes

1. Automatic Route and
2. Government Route/Approval Route.

Answer 7(a)(iii)

A compliance management system is the method by which corporate manage the entire compliance process. It includes the compliance program, compliance audit, compliance report etc. and in other words it is called compliance solution.

Corporate compliance management involves a full process of research and analysis as well as investigation and evaluation. Such an exercise is undertaken in order to determine the potential issues and get a realistic view about how the entity is performing and how it is likely to perform in the future. Company Secretaries with core competence in compliance and corporate governance play a crucial role in the corporate compliance management. Installing proper compliance process is a must for the success of compliance programme. Systematic approach helps in chalking out a plan of action in right direction. Installing a process presupposes planning for the activity, identification of desired objective and resources, detailed plan of action with provision for eventualities and continuous monitoring and corrective measures.

Answer 7 (b)(i)*(i) Operational due diligence*

Operational due diligence aims at the assessment of the functional operations of the target company, connectivity between operations, technological upgradation in operational process, financial impact on operational efficiency etc. It also uncovers aspects on operational weakness, inadequacy of control mechanisms etc.

(ii) Strategic due diligence

Strategic due diligence tests the strategic rationale behind a proposed transaction and analyses whether the deal is commercially viable, whether the targeted value would be realized. It considers factors such as value creation opportunities, competitive position, critical capabilities.

Answer 7(b)(ii)**Transposition**

In the case of joint-shareholders, one or more of them may require the company to alter or rearrange the serial order of their names in the register of members of the company. In this process, there will be need for effecting consequential changes in the share certificates issued to them. If the company provides in its articles that the senior-most among the joint-holders will be recognised for all purposes like service of notice, a copy of balance sheet, profit and loss account, voting at a meeting etc., the request of transposition may be duly considered and approved by the Board or other authorised officer of the company. 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. Transposition does not also require stamp duty.

Transmission

'Transmission by operation of law' is not a transfer. It refers to those cases where a person acquires an interest in property by operation of any provision of law, such as by right of inheritance or succession or by reason of the insolvency or lunacy of the shareholder or by purchase in a Court-sale, while a transfer is effected by act of parties. This is known as transmission or transfer by operation of law, or involuntary

assignment. Thus, transmission of shares takes place when the registered shareholder dies or is adjudicated as an insolvent, or if the shareholder is a company, it goes into liquidation.

Answer 7(b)(iii)

Level I ADR(unlisted/OTC Traded/pink Sheets) This is the least expensive level to provide for issuance of shares in ADR form in the US. The company issuing ADRs has to comply with the Securities and Exchange Commission (SEC) registration requirements but can be exempted from full SEC reporting requirements under certain circumstances. It can only be traded over the counter and cannot be listed on a national exchange in the US. The electronic OTC markets are also called pink sheets which is a centralized quotation service that collects and publishes market maker quotes for OTC securities in real time.

Level II ADR (US Listed Non capital raising transaction. i.e., without going for public issue): This programme gives more liquidity and marketability as it enables listing of ADRs in one or more of the US exchange. Under this programmes the company has to comply with registration requirements reporting requirements of SEC.

Question 8

*Critically examine and comment on **any four** of the following:*

- (i) Indian companies are allowed to make payments for foreign technology collaboration under automatic route subject to certain limits under the FEMA Regulations.*
- (ii) As part of good corporate governance practices under clause 49 of the listing agreement, a company is required to make disclosures on certain aspects.*
- (iii) Securities audit is a mechanism relieving the company and its directors from the consequences of unintended non-compliance by timely corrective actions.*
- (iv) The legal due diligence process varies depending upon the scope of work dictated by the client, the focus, special areas of weakness, the type of business, etc.*
- (v) Where a company desires to roll over the debentures issued by it, a copy of the notice of the resolution is to be filed with SEBI. (4 marks each)*

Answer 8(i)

Indian Companies are allowed to make the payment for foreign technology collaboration under automatic route subject to the following limits under the FEMA Regulations:

- (a) The lump sum payments not exceeding US\$ 2 million.
- (b) Royalty payable is being limited to 5% for domestic sales and 8% for exports, without restriction on duration of royalty payments. The royalty limits are net of taxes and are calculated according to standard conditions;
- (c) Payment of royalty upto 2% for exports and 1% for domestic sales is allowed under automatic route for use of trade marks and brand name of the foreign collaborator without technology transfer.

Answer 8(ii)

Disclosures under the Clause 49 of Listing Agreement

Basis of related party transactions;

Details of material individual transactions with related parties or others, which are not on an arm's length basis should be placed before the audit committee, together with Management's justification for the same.

Disclosure of Accounting Treatment.

Where in the preparation of financial statements, a treatment different from that prescribed in an Accounting Standard has been followed, the fact shall be disclosed in the financial statements, together with the management's explanation as to why it believes such alternative treatment is more representative of the true and fair view of the underlying business transaction in the Corporate Governance Report

Board disclosures on risk management

The company shall lay down procedures to inform Board members about the risk assessment and minimization procedures. These procedures shall be periodically reviewed to ensure that executive management controls risk through means of a properly defined framework.

Proceeds from public issues, rights issues, preferential issues etc.

When money is raised through an issue (public issues, rights issues, preferential issues etc.), it shall disclose to the Audit Committee, the uses / applications of funds by major category (capital expenditure, sales and marketing, working capital, etc), on a quarterly basis as a part of their quarterly declaration of financial results. Further, on an annual basis, the company shall prepare a statement of funds utilized for purposes other than those stated in the offer document/prospectus/notice and place it before the audit committee.

Remuneration of Directors.

All pecuniary relationship or transactions of the non-executive directors vis-à-vis the company shall be disclosed in the Annual Report.

Management

As part of the directors' report or as an addition thereto, a Management Discussion and Analysis report should form part of the Annual Report to the shareholders. This Management Discussion & Analysis should include discussion on certain matters Industry structure and developments, Opportunities and Threats, Risks and concerns etc.

Disclosures to shareholders.

Disclosures to directors pertains to information like resume of director with respect to his appointment, Disclosure of relationships between directors inter-se etc

Answer 8(iii)

Securities Audit is a mechanism relieving the company and its directors from the consequences of unintended non-compliance by timely corrective actions. There are several penal provisions in the Companies Act, 1956, Securities and Exchange Board of India Act, 1992, Foreign Exchange Management Act, 1999, Securities Contracts

(Regulations) Act, 1956 and other securities related laws. As securities audit ensures the timely and proper compliances of all statutory provisions and early detection of errors and frauds, it provides trustworthy mechanism relieving the company and its directors from the consequences of unintended non-compliances of statutory provisions. Securities Audit is also a powerful tool for proper compliance of all obligations and also for investors' protection.

Answer 8(iv)

A legal due diligence is scrutiny of all, or specific parts, of the legal affairs of the target company depending on the purpose of legal due diligence which may be mergers, acquisition or any major investment decision, with a view of uncovering any legal risks and provide the buyer with an extensive insight into the company's legal matters. It also improves the buyer's bargaining position and ensures that necessary precautions are taken in relation to the transaction proposed.

The scope of due diligence depends on the purpose and objectives of due diligence and may vary from case to case. The scope of due diligence by a large institutional investor will vary from the scope of due diligence by the company which proposes to acquire a target company. Thus it is not possible to define the scope of due diligence specifically. However, certain mandatory issues that should be covered in any type of legal due diligence are as follows:

1. Regulatory compliance
2. Contractual compliance
3. Compliance under intra-corporate aspects
4. Financial aspects
5. Non financial aspects
6. Cultural aspects

Especially in case of cross border transactions, compatibility and adaptability of corporate cultures are to be analysed to eliminate the problems that may arise out of cultural differences.

Answer 8(v)

As per the chapter X of erstwhile SEBI(DIP) Guidelines, 2000, if the company desires to roll over the debentures issued by it, it has to file with SEBI a copy of the notice of the resolution to be sent to the debenture-holders for the purpose, through a merchant banker prior to dispatching the same to the debenture-holders. The notice shall contain disclosures with regard to credit rating, necessity for debenture-holders resolution and such other terms which SEBI may specify.

As per SEBI(ICDR) Regulations 2009, the non-convertible portion of partly convertible debt instruments issued by a listed issuer, the value of which exceeds fifty lakh rupees, may be rolled over without change in the interest rate, subject to compliance with the provisions of section 121 of the Companies Act, 1956 and the following conditions:

- (a) seventy five per cent. of the holders of the convertible debt instruments of the issuer have, through a resolution, approved the rollover through postal ballot;
- (b) the issuer has, along with the notice for passing the resolution, sent to all

holders of the convertible debt instruments, an auditors' certificate on the cash flow of the issuer and with comments on the liquidity position of the issuer;

(c) the issuer has undertaken to redeem the non-convertible portion of the partly convertible debt instruments of all the holders of the convertible debt instruments who have not agreed to the resolution;

(d) credit rating has been obtained from at least one credit rating agency registered with the Board within a period of six months prior to the due date of redemption and has been communicated to the holders of the convertible debt instruments, before the roll over;

PROFESSIONAL PROGRAMME EXAMINATION

DECEMBER 2010

**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 Practising Company Secretary will be attracting the penal provisions of the Companies Act, 1956 for any false statement in the compliance certificate.*
- (ii) *Normally, the register of members or of debentureholders of an unlisted company is closed before the annual general meeting.*
- (iii) *Each due diligence review is unique but the overall aim is to provide an investor with sufficient, relevant and timely information in order to assist in the investment decision.*
- (iv) *Foreign investment can be taken in the form of technical collaboration but not in the form of financial collaboration.*
- (v) *Under the takeover regulations, once the public announcement has been made, the Board of directors of the target company can appoint an additional director or fill in any casual vacancy. (2 marks each)*

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

- (i) *The proportionate allotment of securities in an issue that is oversubscribed shall be subject to reservation for retail individual investors.*
- (ii) *Payment of royalty by Indian companies is allowed under automatic route under the FEMA regulations. (5 marks each)*

Answer 1(a)(i)

True

Section 628 deals with penalty for false statements. According to said Section, if in any return, report, certificate, balance sheet, prospectus, statement or other document, required by or for the purpose of any of the provisions of the Act, any person makes a statement

- (a) *which is false in any material particular, knowing it to be false, or*
- (b) *which omits any material fact, knowing it to be material;*

he shall, except as otherwise expressly provided in the Act, be punishable with imprisonment for a term which may extend to two years and shall also be liable to fine. Accordingly, a Practising Company Secretary will be attracting the penal provisions of Section 628, for any false statement in any material particular or omission of any material fact in the Compliance Certificate.

Answer 1(a)(ii)**False**

Normally, the Register is closed before the Annual General Meeting and for other purposes record dates may be fixed by listed companies. This requirement will not normally apply to a private limited company/unlisted company.

Answer 1(a)(iii)**True**

Due diligence exercise is transaction based and not simply a number crunching exercise. It involves collation of strategic non financial information which is likely to be crucial in the overall investment decision.

Answer 1(a)(iv)**False**

Foreign investment can be taken in the form of technical collaboration as well as financial collaboration. Technical collaboration involves payment of royalty, technical know-how fee etc. and in financial collaboration it involves foreign direct investments in the form of equity, FCCB's etc.

Answer 1(a)(v)**False**

Once the public announcement has been made, the Board of Directors of the target company cannot appoint any additional director or fill in any casual vacancy on the Board of Directors, by any person(s) representing or having interest in the acquirer, till the date of certification by the merchant banker on fulfillment of obligations by acquirer.

However, upon closure of the offer and the full amount of consideration payable to the shareholders being deposited in the special account, changes as would give the acquirer representation on the board on control over the company can be made by the target company;

Answer 1(b)(i)

The proportionate allotment of shares to retail individual investors would be equivalent to the number of shares applied for divided by the oversubscription rate of retail individual investor category, subject to minimum application size. For example the retail individual investors' category is over subscribed 8.25 times and the minimum application size is 9. A has applied for 81 specified Securities, B has applied for 72 specified securities and C has applied for 45 specified securities. As per allotment procedure, the allotment to retail individual investors shall be on proportionate basis i.e., at $1/8.25$ th of the total number of specified securities applied for. The actual entitlement shall be as follows:

1. For A- $81/8.25 = 9.82$ specified securities rounded off to 10 specified securities.
2. For B- $72/8.25 = 8.73$ specified securities rounded off to 9 specified securities (i.e. minimum application size).

3. For C- 45/8.25=5.45 specified securities. Application liable to be rejected. (as the entitlement is less than the minimum application size).

It may be noted that as per SEBI (ICDR) Regulations 2009 not less than 35% of net offer in case of issue through book building process and not less than 50% of net offer in case of issue other than book building process, shall be allocated to retail individual investors.

Answer 1(b)(ii)

Earlier, the payment of royalties under Foreign Technology Collaboration was provided for automatic approval for foreign technology transfers involving payment of lumpsum fee not exceeding US\$ 2 million and payment of royalty limited to 5% on domestic sales and 8% on exports. The said limits have been removed and payments for royalty, lumpsum fee for transfer of technology and payments for use of trademark/brand name is permitted under the automatic route i.e. without any approval of the Government of India. However, all such payments are subject to Foreign Exchange Management (Current Account Transactions) Rules, 2000 as amended from time to time.

Question 2

- (a) Choose the most appropriate answer from the given options in respect of the following :
- (i) The merger of subsidiary company into its parent company is called —
 - (a) De facto merger
 - (b) Up stream merger
 - (c) Down stream merger
 - (d) Reverse merger.
 - (ii) Which of the following committees is a non-mandatory under the listing agreement —
 - (a) Remuneration committee
 - (b) Share transfer committee
 - (c) Shareholders/investors grievance committee
 - (d) Audit committee.
 - (iii) The circular of National Securities Depository Limited (NSDL) providing for the process of demat account opening, control and verification of Delivery Instruction Slips (DIS) is subject to —
 - (a) Statutory audit
 - (b) Concurrent audit
 - (c) Internal audit
 - (d) Continuous audit.
 - (iv) Which of the following sources is not allowed to Indian companies to raise resources from the international market —
 - (a) Global depository receipts
 - (b) American depository receipts

- (c) *Indian depository receipts*
- (d) *Foreign currency convertible bonds.*
- (v) *Which of the following is not involved in the issue of Indian depository receipts —*
 - (a) *Foreign company*
 - (b) *Overseas custodian bank*
 - (c) *Domestic depository*
 - (d) *Foreign investors.*
- (vi) *Under the approval route, the foreign investor or the Indian company requires prior approval from —*
 - (a) *Securities and Exchange Board of India*
 - (b) *Reserve Bank of India*
 - (c) *Company Law Board*
 - (d) *Foreign Investment Promotion Board.* (1 mark each)
- (b) *Distinguish between the following :*
 - (i) *'Amalgamation' and 'takeover',*
 - (ii) *'Liaison office' and 'project office'.* (3 mark each)
- (c) *Mention the sectors which are prohibited for foreign investment in India.* (4 marks)

Answer 2(a)(i)

- (b) Up stream merger

Answer 2(a)(ii)

- (a) Remuneration Committee

Answer 2(a)(iii)

- (b) Concurrent audit

Answer 2(a)(iv)

- (c) Indian depository receipts

Answer 2(a)(v)

- (d) Foreign investors

Answer 2(a)(vi)

- (d) Foreign Investment Promotion Board

Answer 2(b)(i)

Amalgamation is a legal process by which two or more companies are joined together to form a new entity or one or more companies are absorbed or blended with another and as a consequence the amalgamating company loses its existence and

its shareholders become the shareholders of new company or the amalgamated company. In case of amalgamation, a new company may come into existence or an old company may survive while amalgamating company may lose its existence.

Takeover means acquisition by one company of control over another, usually by buying all or a majority of its shares. A transaction or a series of transactions by which a person acquires control over the assets of a company is generally known as takeover of the company. Takeover may be 'friendly take over' or 'hostile take over'

Answer 2(b)(ii)

Liaison Office acts as a channel of communication between the principal place of business or head office and Indian activities. Liaison office cannot undertake any commercial activity directly or indirectly and cannot, therefore, earn any income in India. The role of Liaison Office is limited to collecting information about possible market opportunities and providing information about the company and its products to prospective Indian customers.

Reserve Bank has granted general permission to foreign companies to establish Project Offices in India, provided they have secured a contract from an Indian company to execute a project in India, and

- (i) the project is funded directly by inward remittance from abroad; or
- (ii) the project is funded by a bilateral or multilateral International Financing Agency; or
- (iii) the project has been cleared by an appropriate authority; or
- (iv) a company or entity in India awarding the contract has been granted Term Loan by a Public Financial Institution or a bank in India for the project.

Answer 2(c)

Prohibition on Investment in India

FDI is prohibited in the following activities/sectors:

- (a) Retail Trading (except single brand product retailing)
- (b) Lottery Business including Government /private lottery, online lotteries, etc.
- (c) Gambling and Betting including casinos etc.
- (d) Business of chit fund
- (e) Nidhi company
- (f) Trading in Transferable Development Rights (TDRs)
- (g) Real Estate Business or Construction of Farm Houses
- (h) Manufacturing of Cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes

- (i) Activities / sectors not opened to private sector investment including Atomic Energy and Railway Transport (other than Mass Rapid Transport Systems). Besides foreign investment in any form, foreign technology collaboration in any form including licensing for franchise, trademark, brand name, management contract is also completely prohibited for Lottery Business and Gambling and Betting activities.

Question 3

- (a) *Rosy Trading Ltd. borrowed a sum of Rs.20 lakh from a bank on the mortgage of entire assets of the company and on execution of personal guarantee by all its directors, who stood as sureties for the loan. After one year, the company went into liquidation. For paying off the bank loan, on passing a Board resolution, the directors advanced money to the company to discharge the liability towards the bank loan. However, no action for satisfaction of charge against the property of the company with the Registrar of Companies was taken. Directors claimed that they were subrogated to the position of mortgagee bank on paying off the debt and thus wanted to claim the money in priority to others. You have been engaged to decide their claim. Decide giving reasons and citing case law. (6 marks)*
- (b) *Ankur, a shareholder of Radha Financial Services Ltd., requested for copies of the register under section 301 of the Companies Act, 1956. His request was turned down stating that the register contains details about interest of directors and contracts in which they are interested, it is therefore confidential and copies thereof cannot be given. As a Practising Company Secretary, advise Ankur whether the refusal is valid. (5 marks)*
- (c) *Sonia Enterprises Ltd. is having a good track record for payment of dividend in past five years. The company has paid dividend in the last five years as follows:*

<i>Year Ended</i>	<i>Rate of Dividend Paid</i>
<i>31st March, 2005</i>	<i>12.0%</i>
<i>31st March, 2006</i>	<i>12.5%</i>
<i>31st March, 2007</i>	<i>12.5%</i>
<i>31st March, 2008</i>	<i>15.0%</i>
<i>31st March, 2009</i>	<i>18.0%</i>

It is apparent from the annual accounts for the year ended 31st March, 2010 that the profits are inadequate to declare dividend for the year ended 31st March, 2010 but the Board of directors of the company wants to declare a dividend @ 14% on the equity shares so as to maintain the image of the company. The company has some accumulated profits earned in the previous years which were not transferred to reserves.

The company seeks your advice as to how it can pay dividend at the rate of 14% on the equity shares. (5 marks)

Answer 3(a)

The directors of Rosy Limited are not entitled to claim money in priority to others. Although, the directors advanced money on passing the board resolution, yet the particulars of charge under Section 125 of the Company Act, 1956 not got registered in their favour

in the records of the Registrar of Companies. Accordingly, their position was of an ordinary unsecured creditor. Hence, the directors are not entitled to get payment in priority over the secured creditor.

In case of, *Prabhu v. Official Liquidator* (2008) 146, Com cases 157(ker), the Appellant was one of the directors of M/s. Mittal Steel Re-rolling and Allied Industries Ltd., which was under liquidation. The company, earlier applied for and availed of financial facilities from Canara Bank, to a limit of Rs.75 lakhs out of which an amount of Rs.22 lakhs and odd was outstanding as payable in June, 1981. The entire assets of the company including the land and machinery were mortgaged to the Canara Bank and directors of the company including the appellant had executed personal guarantee bonds and stood as sureties for the said loan. On account of the failure of the company to pay back the dues in proper time by 1981 the Canara Bank had expressed its inability to make further advances for the functioning of the company. In view of the above, the director advanced some money to the company and the company cleared the liabilities of the Canara Bank. The company filed winding up petition in 1987. It was observed in the judgement that there was no registered deed crediting mortgage in favour of appellant. But, the appellant advanced money to the company. The company paid the amount due to the bank using the money advanced by the appellant's group. At the time when winding up application was filed in 1987, he has no case that there is a charge for the property. So, he was not subrogated to the position of the Canara Bank.

Answer 3(b)

No, the stand taken by Radha Financial Services Limited is untenable.

The refusal is not valid and binding on the company. As per Section 301 of the Companies Act, 1956, every company shall keep one or more registers in which shall be entered separately particulars of all contracts entered into by the company in which any of the directors is interested. Such register shall be kept at the registered office of the company and shall also be open to the inspection of any member of the company and extracts may be taken therefrom and copies thereof may be required by any member of the company, to the same extent, in the same manner and on the payment of the same fee, as in case of the register of members of the company.

In view of this provision, Mr. Ankur a shareholder of the Radha Financial Services Limited had a right to take the copies of the register u/s 301 of the Companies Act, 1956. Here, the company can be directed to give the copies of the register as per his request.

Answer 3(c)

In the event of inadequacy or absence of profits in any year, dividend may be declared by a company for that year out of the accumulated profits earned by it in previous years and transferred it to the reserves. As per Companies (Declaration of Dividend out of Reserves) Rules, 1975, dividends out of past profits/reserves shall not exceed average of dividends declared during the last 5 years or 10% of its paid up capital whichever is less. Since, in the given problem, it is proposed to declare dividend @ 14% it shall not be possible without previous approval of the Central Government as per section 205 A (3) if the accumulated profits earned in the previous years which were not transferred to reserves is inadequate.

Here, in such situation the company is advised to make an application to the Central Government seeking approval for payment of dividend at 14%.

Question 4

- (a) *Mention any six cases where approval from shareholders is mandatory by way of special resolution.* (6 marks)
- (b) *Prepare a check-list of takeover process in India when there is no competitive bid.* (5 marks)
- (c) *Ash Ltd. and Cash Ltd. are contemplating setting-up a project in joint venture. To guide them, you are required to state the advantages and disadvantages of joint ventures.* (5 marks)

Answer 4(a)

Instances where the approval of shareholders is mandatory by way of special resolution

1. Change of name of the Company under Section 21
2. Alteration of Articles of association of the company under Section 31
3. Buy-back of shares under Section 77A
4. Issue of sweat equity shares under Section 79A
5. Appointment of Auditor under Section 224A
6. Appointment of sole selling agents under Section 294AA(3)
7. Appointment of director/relative etc to hold office or place of profit under Section 314.
8. Winding up of company by Tribunal under Section 433(a)
9. For Keeping of register or index of members etc at a place other than registered office, but within the city in which the registered office is situated. (Section 163)

Answer 4(b)**Takeover Process in India**

The following chart gives an overview of takeover process in India, when there is no competitive bid.

- Check whether the company has conducted Board meeting for considering public offer.
- Check whether the company has appointed Merchant Banker.
- Check whether the company has Opened Escrow Account.
- Check whether the company has made Public Announcement (PA).
- It may be noted that PA has to be made within 4 days of agreement with Merchant Banker. PA has to contain specified details and not contain misleading

information. Copy of PA has to be filed with SEBI, Target Company and Stock Exchanges where the shares are listed.

- Check whether the company has filed Letter of Offer (LOO) with SEBI.

It may be noted that LOO has to be filed with SEBI within 14 days of PA. Draft LOO has to be sent to the target company also within 14 days of PA.

- Check whether the company has carried out the modifications recommended by SEBI.
- Check whether the company has dispatched LOO to Shareholders, which has to be dispatched not earlier than 21 days from the date of filing LOO with SEBI.
- Opening of Offer has to be made not later than 55th day of PA and to be opened for atleast 20 days.
- Ensure the payment of consideration as required.

Answer 4(c)

Benefit of Joint Venture

- Sharing of risks;
- Access to technology/R&D/markets;
- Access to foreign capital;
- Reduction of manufacturing costs and other overheads including expenditure on R&D;
- Complimentary skills/resources;
- New technology or products or capital;

Disadvantages of a Joint Venture

- Potentially high capital cost plus ongoing financial support are required;
- Profitable returns may take some time to achieve;
- High level of commitment of staff and management takes time;
- Time consuming (especially where a new venture is involved);
- Potential for conflict between joint venture partners;
- Cultural differences and communications difficulties;
- A minority equity position may work against partner;
- Difficult to get out of it quickly, if desired;
- Working in a different legal and commercial system;
- Political risks in the country where the joint venture is based.

Question 5

- (a) *Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s) :*
- (i) _____ covers those findings in a diligence which may not impact the financials but there exist certain non-compliances which though rectifiable require the investor to tread a cautious path.
 - (ii) _____ is a mechanism for subscribing to an issue containing an authorisation to block the application money in a bank account.
 - (iii) _____ instruments help in reducing the risk of investing in fixed income instruments.
 - (iv) A _____ is a technique which is adopted by a company for taking over control of the management and affairs of another company by acquiring its controlling shares.
 - (v) The aggregate of foreign investment made either directly or indirectly (through depository receipts mechanism) shall not exceed _____ of the issued and subscribed capital of the issuing company.
 - (vi) Under section 113 of the Companies Act, 1956, a company is required to deliver the certificate within _____ after the allotment of any of its securities. (1 mark each)
- (b) *Nalini, a Practising Company Secretary, was engaged to perform secretarial audit of Hindustan Fibres Ltd. Draft the audit report to be submitted by her, assuming at least three qualifications. (10 marks)*

Answer 5(a)

- (i) **Deal Cautioners** covers those findings in a diligence which may not impact the financials but there exist certain non-compliances which though rectifiable require the investor to tread a cautious path.
- (ii) **Applications supported by blocked account (ASBA)** is a mechanism for subscribing to an issue containing an authorisation to block the application money in a bank account.
- (iii) **Hedging** instruments help in reducing the risk of investing in fixed income instruments.
- (iv) A **Takeover bid** is a technique which is adopted by a company for taking over control of the management and affairs of another company by acquiring its controlling shares.
- (v) The aggregate of foreign investment made either directly or indirectly (through depository receipts mechanism) shall not exceed **51%** of the issued and subscribed capital of the issuing company.
- (vi) Under section 113 of the Companies Act, 1956, a company is required to deliver the certificate within **three months** after the allotment of any of its securities.

Answer 5(b)

To

The Board of Directors
Hindustan Fibres Ltd.

I have examined the registers, records and documents of Hindustan Fibres Ltd ("the Company") for the financial year ended on March 31, 2010 according to the provisions of-

1. The Companies Act, 1956 and the Rules made under that Act;
 2. The Depositories Act, 1996 and the Regulations and Bye-laws framed under that Act;
 3. The following Regulations and Guidelines prescribed under the Securities and Exchange Board of India Act, 1992 ('SEBI Act');
 - (a) The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997;
 - (b) The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992;
 - (c) The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;
 - (d) The Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999 and
 4. The Securities Contracts (Regulation) Act, 1956 ('SCRA') and the Rules made under that Act; and
 5. The Equity Listing Agreements with Bombay Stock Exchange Limited and National Stock Exchange of India Limited.
- A. Based on my examination and verification of the registers, records and documents produced to me and according to the information and explanations given to me by the Company, I report that the Company has, in my opinion, complied with the provisions of the Companies Act, 1956 ("the Act") and the Rules made under the Act and the Memorandum and Articles of Association of the Company, with regard to:
- (a) maintenance of various statutory registers and documents and making necessary entries therein;
 - (b) closure of the Register of Members;
 - (c) forms, returns, documents and resolutions required to be filed with the Registrar of Companies and Central Government;
 - (d) service of documents by the Company on its Members, and the Registrar of companies;
 - (e) notice of Board meetings and Committee meetings of Directors;
 - (f) the meetings of Directors and Committees of Directors including passing of resolutions by circulation;

- (g) the 17th Annual General Meeting held on June 20, 2009;
 - (h) requirements under section 391-394 of the Act read with Companies (Court) Rules, and the Order of the Hon'ble High Court of Delhi with regard to amalgamation of XYZ Private Limited with the Company.
 - (i) minutes of proceedings of General Meetings and of Board and other meetings;
 - (j) approvals of the Members, the Board of Directors, the Committees of Directors and government authorities, wherever required;
 - (k) constitution of the Board of Directors / Committee(s) of directors and appointment, retirement and re-appointment of Directors including the Managing Director and Wholetime Directors;
 - (l) payment of remuneration to the Directors including the Managing Director and Wholetime Directors;
 - (m) appointment and remuneration of Auditors and Cost Auditors;
 - (n) transfers and transmissions of the Company's shares, issue and allotment of shares and issue and delivery of original and duplicate certificates of shares;
 - (o) declaration and payment of dividends;
 - (p) transfer of certain amounts as required under the Act to the Investor Education and Protection Fund;
 - (q) borrowings and registration, modification and satisfaction of charges;
 - (r) investment of the Company's funds including inter corporate loans and investments and loans to others;
 - (s) giving guarantees in connection with loans taken by subsidiaries and associate companies;
 - (t) form of balance sheet as prescribed under Part I of Schedule VI to the Act and requirements as to Profit & Loss Account as per Part II of the said Schedule;
 - (u) contracts, common seal, registered office and publication of name of the Company; and
 - (v) generally, all other applicable provisions of the Act and the Rules made under that Act.
- B. I further report that:
- (a) the Directors have not complied with the requirements as to disclosure of interests and concerns in contracts and arrangements, shareholdings / debenture holdings and directorships in other companies and interests in other entities;**
 - (b) the Directors have not complied with the disclosure requirements in respect of their eligibility of appointment, their being Independent and compliance with the Company's Code of Business Conduct & Ethics (COBE) for Directors and Management Personnel;**
 - (c) the Company has obtained all necessary approvals under the various provisions of the Act;
 - (d) there was no prosecution initiated against or show cause notice received by the

Company and no fines or penalties were imposed on the Company during the year under review under the Companies Act, SEBI Act, SCRA, Depositories Act, Listing Agreement and Rules, Regulations and Guidelines framed under these Acts against the Company, its Directors and Officers.

C. I further report that the Company has not complied with the certain provisions of the Depositories Act, 1996 and the Bye-laws framed under that Act by the Depositories with regard to dematerialisation / rematerialisation of securities and reconciliation of records of dematerialised securities with all securities issued by the Company.

D. I further report that:

- (a) the Company has complied with the requirements under the Equity Listing Agreements entered into with the Bombay Stock Exchange Limited and the National Stock Exchange of India Limited;
- (b) the Company has complied with the provisions of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;
- (c) the Company has complied with the provisions of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 including the provisions with regard to disclosures and maintenance of records required under the Regulations;
- (d) the Company has complied with the provisions of the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992 including the provisions with regard to disclosures and maintenance of records required under the Regulations; and
- (e) the Company has not complied with the provisions of the Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999 with regard to implementation of Employee Stock Option Scheme, grant of Options and other aspects.**

Signature of Company Secretary

C.P. No.

DECLARATION

I _____ a member of the Institute of Company Secretaries of India, do declare that I am a Secretary in whole-time practice as defined in Section 2(2) of the Company Secretaries Act, 1980 and hence am I qualified to undertake Secretarial Audit of your company.

I do further declare that I do not suffer from any of the disqualifications set out in the Guidance Note issued by the Institute of Company Secretaries of India.

Signature

Name

Address

Certificate of

Practice No.

Membership No.

Place :

Date :

Question 6

- (a) *Bharat Foods Ltd., has decided to invite the public to subscribe its equity capital. List out the services which a Practising Company Secretary can render in respect of the initial public offering (IPO).* (6 marks)
- (b) *Tej Speed Ltd., an unlisted public company, has issued bonus shares in the ratio 2:1. You are required to prepare a check-list to confirm that every requirement has been fulfilled. Further, if the company is a listed company, what are the additional requirements which are required to be met ?* (6 marks)
- (c) *Mention the provisions regarding obtaining of compliance certificate by a company from a Secretary in Whole-time Practice. Also, state the action to be taken on such certificate by the company.* (4 marks)

Answer 6(a)

The plethora of services, which a Practising Company Secretary can render in IPOs include the following:

1. Planning Stage
 - (a) Deciding the time line
 - (b) Compliance related issues
 - (c) Importance of Corporate Governance
 - (d) Structure of Board
 - (e) Promoters consent
 - (f) Method of issuance of shares (Demat/Physical/Both) - Compliance
2. Due diligence
 - (a) Company Contract and Leases
 - (b) Legal and Tax Issues
 - (c) Corporate issues
 - (d) Financial Assets
 - (e) Financial Statement
 - (f) Creditors & Debtors
 - (g) Legal Cases against the company
3. Appointing Advisors and other intermediaries such as:
 - (a) Investment Bankers
 - (b) Book Running Lead Managers
 - (c) Issues with Depository

- (d) Legal Advisor
- (e) Bankers
- 4. Offer Document
 - (a) Drafting the offer document
 - (b) Filing with SEBI
 - (c) In-principle approval of Stock Exchange
 - (d) Filing with Designated Stock Exchanges
 - (e) Complying with Comments received from SEBI
 - (f) Filing with ROC
- 5. Issue Period
 - (a) Adhering to Issue Opening/Closing Date
 - (b) Compiling Field Reports on subscription status
 - (c) Coordinating with Registrar/Bankers to the issue
- 6. Allotment of shares
 - (a) Basis of allotment
 - (b) Board meeting for allotment
 - (c) Crediting shares in beneficiary account/dispatch of share certificates
 - (d) Despatch of refund orders
 - (e) Payment of stamp duty
- 7. Listing
 - (a) Filing for Listing with Designated Stock Exchange
 - (b) Finalisation of Listing Process
- 8. Post issue compliances
 - (a) To ensure proper compliance with Listing Agreement
 - (b) Redressal of shareholder complaints
 - (c) Timely filing of required reports with ROC/SEBI/Stock Exchange

As can be seen from the above, a Company Secretary is a key member in an IPO team. Apart from checking the applicability and eligibility norms or exemption from eligibility norms and the pre-listing requirements of Stock Exchange, he is responsible for ensuring that the company has complied with the pre-issue, issue and post-issue obligations of the company and corporate governance requirements including disclosures with respect to, inter alia, material contracts, statutory approvals, subsidiaries and promoter holding and litigations.

Compliance of SEBI (ICDR) Regulations 2009 and other applicable Acts and guidelines is a primary responsibility of the Company Secretary in case the company proposes to list its securities abroad, he is also required to comply with conditions for listing abroad.

Answer 6(b)

Checklist for issue of Bonus shares

Checklist for unlisted company

Check whether:

- (i) Articles of Association of the company provide for capitalisation of profits;
- (ii) Requisite resolution was passed by the Board and shareholders in their meeting for capitalization of profits and issuing bonus shares;
- (iii) Return of allotment in e-Form No. 2 was filed within 30 days of passing resolution.

Checklist for listed company

With respect to listed companies, SEBI (ICDR) Regulations additionally prescribes the following criteria for issue of bonus shares.

- Ensure that issuer has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;
- Ensure that the issuer has sufficient reason to believe that it has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity and bonus;
- Ensure that the partly paid shares, if any outstanding on the date of allotment, are made fully paid up
- It may be noted that no issuer shall make a bonus issue of equity shares if it has outstanding fully or partly convertible debt instruments at the time of making the bonus 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 partly convertible debt instruments shall be issued at the time of conversion of such convertible debt instruments on the same terms or same proportion on which the bonus shares were issued.
- The Bonus issue shall be made out of free reserves and not out of revaluation reserves.
- The bonus share shall not be issued in lieu of dividend.
- An issuer, announcing a bonus issue after the approval of its board of directors and not requiring shareholders' approval for capitalisation of profits or reserves

for making the bonus issue, shall implement the bonus issue within fifteen days from the date of approval of the issue by its board of directors: However, where the issuer is required to seek shareholders' approval for capitalisation of profits or reserves for making the bonus issue, the bonus issue shall be implemented within two months from the date of the meeting of its board of directors wherein the decision to announce the bonus issue was taken subject to shareholders' approval.

- Once the decision to make a bonus issue is announced, the issue can not be withdrawn.

Answer 6(c)

Under Section 383 A(1) of the Companies Act, 1956, every Company having a paid-up share capital of not less than five crore rupees shall have a whole-time Company Secretary. Every Company not required to employ a whole-time secretary under Section 383 A(1) of the Companies Act, 1956 and having a paid up capital of ten lakhs rupees or more shall obtain a certificate from a secretary in whole-time practice. . It is necessary for the company to attach a copy of the Compliance Certificate with the Board's report while forwarding the same to members and others. The Compliance Certificate is required to be laid by the company in its annual general meeting. The compliance certificate is also required to be filed with the ROC the Compliance Certificate within thirty days from the date on which its annual general meeting is held.

Question 7

(a) Distinguish between any two of the following :

- (i) 'Initial public offering' and 'further public offering'.
- (ii) 'Physical data room' and 'virtual data room'.
- (iii) 'Joint venture' and 'wholly owned subsidiary'. (4 marks each)

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

- (i) Transfer of unpaid amount to the Investor Education and Protection Fund
- (ii) Whistle blower policy
- (iii) Depository participants. (4 marks each)

Answer 7(a)(i)

Initial Public Offering (IPO) is when an unlisted company makes either a fresh issue of securities or an offer for sale of its existing securities or both for the first time to the public. This paves way for listing and trading of the issuer's securities.

A further public offering (FPO) is when an already listed company makes either a fresh issue of securities to the public or an offer for sale to the public, through an offer document. An offer for sale in such scenario is allowed only if it is made to satisfy listing or continuous listing obligations.

Answer 7(a)(ii)**Virtual and Physical Data Room – A comparison**

Some of the major points of distinction between the two include the following:

<i>Sl. No.</i>	<i>Particulars</i>	<i>Physical Data Room</i>	<i>Virtual Data Room</i>
1	Form of documents	Papers, files, boxes or any tangible thing	Electronic / Digital/soft copies of documents including video/audio documents
2	Security of documents	Lies with the integrity of person who is in charge of the data room	More secured through specific log-in id and pass word. In addition facilities like internet fire walls are there.
3	Time required for creation of data room	Longer time required.	Can be created within 48 hours also once demands of prospective bidders are identified.
4	Cost	High because of reasons like— Requirement of one person to take care of data room. Requires bidders to travel from their place to the place of location of data room etc	Low as the documents can be viewed from any location with internet security.
5	Convenience	Low Level because of reasons like— Only one prospective bidder can review the documents at a time Difficult to search the documents that is required	More convenient as it enables multiple bidders to review documents with search facility also.
6	Accessibility to data room	Restricted time	Any time.
7	Facility to restrict access of document access	Not there	Access can be restricted.
8	Facility to check who has reviewed what documents and how many times	Not available	Available
9	Facility to highlight new information	To be conveyed manually to all bidders	A highlight can be made in the site created as data room
10	Ability to copy documents	Possible	Not possible always
11	One to one communication in person with the seller or his representatives	Available	Not available

Answer 7(a)(iii)

Joint Ventures and Foreign Collaborations are important business models which become more popular with the opening up of the economies in the context of liberalization, competition and globalization.

A joint venture is a partnership through which two or more firms create a separate entity to carry out a particular economic activity in which each partner takes an active role in decision making. The essential features of joint ventures may be classified as:

- (a) an agreement between the parties on common long term objectives such as production, sales, financing etc.
- (b) pooling of assets, IPRs and other facilities for achievement of agreed objectives
- (c) sharing of profits.

Joint ventures are considered appropriate when complementary needs exist between companies and there is compatibility with the strategies.

Wholly owned subsidiary with respect to Indian holding company means a foreign entity formed, registered or incorporated in accordance with the laws and regulation of the host country whose entire capital is held by Indian party. Similarly foreign entities may incorporate wholly owned subsidiaries in India subject to conditions and approvals as prescribed.

Answer 7(b)(i)**Transfer of unpaid amount to the Investor Education and Protection Fund**

As per Section 205C of the Companies Act, 1956, the Central Government shall establish a fund to be called the Investor Education and Protection Fund which shall be credited with the following amounts, namely:

- (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.

It may be noted that no such amounts referred to in clauses (a) to (d) above shall form part of the fund unless such amounts have remained unclaimed and unpaid for a period of seven years from the date they became due for payment.

The Fund shall be utilised for promotion of investor awareness and protection of the interests of investors in accordance with such rules as may be prescribed.

Answer 7(b)(ii)

Whistle Blower Policy

The company may establish a mechanism for employees to report to the management concerns about unethical behaviour actual or suspected fraud or violation of the company's code of conduct or ethics policy. This mechanism could also provide for adequate safeguards against victimization of employees who avail of the mechanism and also provide for direct access to the Chairman of the Audit Committee in exceptional cases. Once established, the existence of the mechanism may be appropriately communicated within the organization.

Answer 7(b)(iii)

Depository Participants

Just as a broker 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 balance and intimate the status of holding to the account holder from time to time. According to SEBI guidelines, financial institutions like banks, custodians, stock brokers 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.

Question 8

Critically examine and comment on any four of the following :

- (i) The objective of due diligence is to allow the investigator to consider the various options, considering the facts found in the course of due diligence.*
 - (ii) Whenever a corporate action is announced, the issuer or its Registrar and Transfer Agent (RTA) should inform its depository just after the day of communication of the same to the relevant stock exchange(s).*
 - (iii) A limited two-way fungibility scheme has been put in place by the Government of India for ADRs/GDRs.*
 - (iv) Overseas investments by established proprietorship or unregistered partnership exporter firms will be subject to certain conditions.*
 - (v) Corporate laws are core competence areas of a Company Secretary and corporate compliance management broadly requires complete compliance of these laws.*
- (4 marks each)*

Answer 8(i)

The goal of due diligence is to provide the party proposing the transaction with sufficient information to make a reasoned decision as to whether or not to complete the transaction as proposed. It should provide a basis for determining or validating the

appropriate terms and price for the transaction incorporating consideration of the risks inherent in the proposed transaction.

Withdrawal of deal - if the due diligence uncovers information that disclosed the investments, loan or participation, a risky or undesirable one and which cannot be adequately resolve then the investigator may withdrawal from the deal.

Adjusting the valuation of the investment – the investigator may revise his valuation of the company or reassess the price at which it will provide services. More often, the information will be adverse and therefore the valuation will go down or the price will go up.

Solving of problems uncovered - it may be possible for a problem uncovered by the due diligence to be solved before the deal goes ahead. For example, unpaid stamp duty could be paid, company filing could be put in order or, if negative information is uncovered on a principal of the target company, the investor may put pressure on the target is put into a state that the investigator is happier with before it deals with it.

Answer 8(ii)

Whenever a corporate action is announced, the issuer or its register and transfer agent, should inform its depository just after the day of communication of the same to the relevant stock exchange(s). The depository should then inform the participants through a circular about the relevant action, the no-delivery period, the cut-off date and the procedure to be followed by the participants.

On the basis of the particulars of the holding a beneficial owners received from the depository as of the cut-off date, the issuer or its register and transfer agent would distribute dividend, interest and other monetary benefits directly to the beneficial owners.

Answer 8(iii)

A limited two-way fungibility scheme has been put in place by the Government of India for ADRs/GDRs. 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 in 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.

Answer 8(iv)

Overseas investments by established proprietorship or unregistered partnership exporter firms will be subject to the following conditions:

- (i) The Partnership/Proprietorship firm is a (Director General of Foreign Trade) DGFT recognized Star Export House.
- (ii) The Authorised Dealer category-I bank is satisfied that the exporter is KYC (know your customer) compliant-B engaged in the proposed business and meets the requirement.
- (iii) Exporter has proven track record i.e. export outstanding does not exceed 10 per cent of the average export realization of preceding three financial years.

- (iv) The exporter has not come under adverse notice of any government agency like Enforcement Directorate, CBI and does not appear in the exporters' caution list of the Reserve Bank or in the list of defaulters to the banking system in India.
- (v) The amount of investment outside India does not exceed 10 per cent of the average of three financial years export realization or 200 per cent of the net owned funds of the firm, whichever is lower.

Answer 8(v)

Corporate Compliance Management can add substantial business value only if compliance is done with due diligence. A Company Secretary is the 'Compliance Manager' of the company. It is he who ensures that the company is in total compliance with all regulatory provisions. Corporate disclosures, which play a vital role in enhancing corporate valuation, is the forte of a Company Secretary.

Corporate laws are core competence areas of a company secretary and corporate compliance management broadly requires compliance of laws by corporates which includes:

- (i) Companies Act, 1956 and the various Rules and Regulations framed there under, MCA-21 requirements and procedures.
 - (ii) Secretarial standards/Accounting Standards/Cost Accounting Standards issued by ICSI/ICAI/ICWAI respectively.
 - (iii) Foreign Contribution Regulation Act, 1976.
 - (iv) Competition Act, 2002.
 - (v) Foreign Exchange Management Act, 1999.
 - (vi) Prevention of Money Laundering Act, 2007.
 - (vii) Micro Small and Medium Enterprises Development Act, 2006.
 - (viii) Essential Commodities Act, 1955.
 - (ix) Intellectual Property Laws, etc.
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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 where as 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.

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	<u>4,840</u>
25% of Paid-up Capital & Free Reserves	<u>1,210</u>
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		<u>540</u>
		<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>	<u>1,510</u>
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.
-