

ACCOUNTS AND AUDIT

Question 1

A Government company holds 49% of the subscribed share capital in Smart & Co. Ltd. Mr. R has been appointed as the auditor at the Annual General Meeting of Smart & Co. Ltd through an ordinary resolution. Certain members of the company object to this appointment on the ground that the appointment of auditors is violative of the provisions of the Companies Act, 1956. Examine the legal position with reference to the relevant provisions of the Companies Act, 1956.

(5 Marks) (Nov 2008)

Answer

Appointment of Auditors: According to Section 224A (1) of the Companies Act, 1956, the appointment or reappointment at each Annual General Meeting of an auditor or auditors shall be made by a special resolution in case of a Company in which not less than 25% of the subscribed share capital is held, whether singly or in any combination, by-

- (a) a public financial institution or a Government Company of Central Government or any State Government, or
- (b) any financial or other institution established by any Provincial or State Act in which a State Government holds not less than fifty one percent of the subscribed share capital, or
- (c) a nationalized bank or an insurance company carrying on general insurance business.

CONSEQUENCES:

If any company fails to pass at its Annual General Meeting any special resolution for appointment of an auditor or auditors, it shall be deemed that no auditor or auditors had been appointed by the company at the Annual General Meeting and thereupon the provisions of sub-section (3) of Section 224 of the said Act shall become applicable in relation to such company, i.e. the Central Government is to be informed and it will exercise its power of appointing the auditors/s.

Hence in the given problem, it shall be deemed that Mr. R had not been appointed as Auditor of Smart & Co. Ltd. because the company had not passed special resolution in the Annual General Meeting for appointment of Mr. R as auditor of the company.

Question 2

Audited Accounts of a public company are not available. Examine the possibility of filing unaudited accounts with the Registrar of companies with reference to the relevant provisions of the Companies Act, 1956. (5 Marks) (Nov 2008)

Answer

Filing of unaudited accounts with Registrar Of Companies: Section 220(1) of the Companies Act, 1956 requires that the Balance Sheet and Profit and Loss Account shall be filed with Registrar Of Companies together with all documents which are required by the Companies Act to be attached/annexed thereto. Section 216 stipulates that the Auditor's Report (including the auditor's separate or supplementary report, if any) shall be attached to the Balance Sheet. According to Section 218, if any copy of Balance Sheet is issued, circulated or published without there being annexed or attached thereto as the case may be a copy each of (i) the Profit and Loss Account, (ii) any accounts, reports, or statements which, by virtue of Section 212, are required to be attached to the Balance Sheet (iii) the Auditor's report and (iv) the Board's report. The company and every officer of the company, who is in default, shall be punishable with fine which may extend to ` 5000. In view of the requirements of Section 216, 218 and 220, unaudited Balance Sheet and Profit and Loss Account cannot be filed with Registrar Of Companies.

Question 3

Examine the validity of the following with reference to the provisions of the Companies Act, 1956:

- (i) *The Balance Sheet and Profit and Loss Account of TXN Ltd. for the year ended 31st March, 2009 was signed by one of its Directors and the Secretary.*
- (ii) *Mr. Prakash, a Chartered Accountant in full time practice was appointed as the auditor of ABC Ltd., a company which is a subsidiary of DGH Ltd. and DGH Ltd. has another subsidiary called PKM Ltd. Mr. Prakash had taken a loan of ` 25,000 from PKM Ltd. and the loan is outstanding as on the date of his appointment as auditor of ABC Ltd.*

(5 Marks) (June 2009)

Answer

- (i) Applicable provisions of section 215 of the Companies Act, 1956 provides that every Balance Sheet and every Profit & Loss account of a company (other than a banking company) shall be signed by its manager or secretary, if any, and by not less than two Directors of the Company one of whom shall be the Managing Director where there is a Managing Director in the Company.

In view of the above provisions of the Companies Act, 1956, the signing of the Balance Sheet and Profit & Loss Account by only a Director and Secretary does not fulfill the requirements of the law.

In the given case, if the company has a managing director, then the managing director and at least one other director together with the secretary of the company shall sign the Balance Sheet and Profit & Loss A/c. If there is no managing director then two directors authorized by the Board and the Secretary shall sign the same.

- (ii) Section 226(3) of the Companies Act, 1956 provides for the disqualifications of an auditor. Clause (d) of the said Section states that if a person is indebted to a company for a sum exceeding ₹1,000/- then such person is not qualified for being appointed as the auditor of that company. Section 226(4) of the said Act states that a person shall also not be qualified for appointment as auditor of a company if he is, by virtue of said Section, disqualified for appointment as auditor of any other body corporate which is that company's subsidiary or holding company or a subsidiary of that company's holding company.

In view of the above provisions of law, since ABC Ltd is a subsidiary of DGH Ltd; which is the holding company of PKM Ltd. to whom Mr. Prakash is indebted for a sum exceeding ₹ 1,000/- his appointment as the auditor of ABC Ltd. is not in order as it is violative of provisions of Section 226(3) read with Section 226(4) of the said Act.

Question 4

A group of share holders has approached you for advice regarding the affairs of LPM Paper Mills Ltd. According to them, the management of the company is not carrying out its functions in accordance with the prudent commercial practice and if the affairs of the company are allowed to run in future in the same manner, the company's solvency would be in danger. They want that a Special Audit under the Companies Act, 1956 be conducted to find out the actual nature of the transactions. You are required to draft an application to be submitted to the appropriate authority in this respect.

(5 Marks) (June 2009)

Answer

Section 233A of Companies Act, 1956 deals with the matter relating to Special Audit. The special audit can be ordered by Central Government under certain circumstances, as enumerated in the said Section.

Draft application to Central Government requesting Special Audit:

Dated _____

To,

The Secretary,

Ministry of Corporate Affairs,

Government of India,

(Address)

New Delhi

Sir,

We, the undersigned, the shareholders of LPM Paper Mills Ltd. would like to bring to your kind notice that for a long time the affairs of the said company are not being managed in accordance with sound business principles and prudent commercial practices.

We are of the view that certain expenditure which are being incurred by the company are not related to the business of the company and the company is not getting any benefit out of such expenses. Moreover, we have the apprehension that there are certain business transactions which are being entered into by the directors with the concerns which are owned by the relatives of the Directors and the prices charged for such transaction are not comparable with the prices charged by other parties for similar transactions.

If such state of affairs is allowed to be carried on for long, the financial position of the company will reach a stage where it will endanger its solvency.

We feel that the modus operandi of the transaction is such that it may be difficult for the regular statutory auditor to detect them in course of normal audit.

It is, therefore prayed that the Central Government be pleased to appoint, pursuant to Section 233A of the Companies Act, 1956, a Special Auditor to properly audit the accounts of the Company and find the real nature of the transactions and determine the losses so far sustained and being sustained by the company on this account.

Yours faithfully

1.

2.

3.

4.

5.....

Shareholders

Question 5

Parkash Carriers Limited appointed Mr. Raman as its auditor in the Annual General Meeting held on 30th September, 2009. Initially, he accepted the appointment. But he resigned from his office on 31st October, 2009 for personal reasons. The Board of Directors seeks your advice for filling up the vacancy by appointment of Mr. Albert as auditor. Advise.

Also suggest the procedure to be adopted in case Mr. Albert is proposed to be removed from his office before the expiry of his term.

(5 Marks) (Nov 2009)

Answer

Under section 224(6) of the Companies Act, 1956, the Board may fill any casual vacancy in the office of an auditor. However, where such vacancy is caused by resignation of an auditor, the vacancy shall be filled by the company in general meeting. Thus, in the present case, the company may convene an Extra Ordinary General Meeting to appoint Mr. Albert as its auditor consequent upon the resignation by Mr. Raman.

In term of section 224(7) of the Act, 1956, Mr. Albert may be removed from office before the expiry of his term only by the Company in General Meeting after obtaining previous approval of the Central Government.

Question 6

Ambitions Engineering Consultants Ltd., whose financial year ends on 31st March, has acquired Struggling Techies Ltd. making it a subsidiary company. The financial year of the subsidiary company ends on 30th June. The management of the holding company wants to change the financial year of the subsidiary company, if possible, so as to coincide with the financial year of the holding company. State the relevant provisions of the Companies Act, 1956 regarding the financial year and the maximum period upto which the accounts can be prepared in a Financial Year and the approvals, if any, required to be taken to accomplish this task.

(5 Marks) (May 2010)

Answer

Financial Year of holding company and subsidiary company: According to Section 210(4) of the Companies Act, 1956, the financial year of a company can be less or more than a calendar year, but it shall not exceed 15 months. However, the financial year can be extended upto 18 months if a special permission is granted by the Registrar of Companies. Further according to Section 213(1) the Central Government has the power to extend the financial year of either the holding company or subsidiary company so that the subsidiary's financial year may be with of the holding company. Thus Ambitious Engineering Consultants Ltd. can make an application to the Central Government or the Registrar of Companies according to the requirement. In case the extension of financial year is beyond 15 months and upto 18 months, the application has to be made to the Registrar of Companies. If the period exceeds 18 months, then application has to be made to the Central Government for approval. The company on its own can extend the financial year upto 15 months without obtaining any approval.

Question 7

A is the Auditor of B and Co. Ltd. Board of Directors decided to remove A on certain grounds. Please indicate what procedure is to be followed to remove A? Advise the Board.

(5 Marks)(Nov 2010)

Answer

Section 225 of the Companies Act, 1956 prescribes certain procedure for removal of auditors. The Board shall be advised as follows:

- (i) Special Notice shall be required for a Resolution at an annual general meeting appointing

as auditor a person other than a retiring auditor or providing expressly that a relating auditor shall not be reappointed.

- (ii) On receipt of notice of such a resolution the company shall forthwith send a copy thereof to the retiring auditor.
- (iii) Where notice is given of such a resolution and the retiring auditor makes with respect thereto representations in writing to the company (not exceeding a reasonable length) and request their notification to members of the company, the company shall, unless the representations are received by it too late for it to do so:
 - (a) in any notice of the resolution given to members of the company, state the fact of the representations having been made; and
 - (b) send a copy of the representations to every member of the company to whom notice of the meeting is sent, whether before or after the receipt of the representations by the company;

If a copy of the representations is not sent as aforesaid because they were received too late or because of the company's default the auditor may (without prejudice to his right to be heard orally) require that the representations shall be read out at the meeting unless Central Government directs otherwise.

However, a resolution for removal of an auditor can be passed in the general meeting only after obtaining the prior approval of the Central Government in this behalf. (Section 224(7)).

Question 8

XYZ Ltd. while preparing the Balance Sheet and Profit and Loss Account for the financial year ended 31st March, 2010 did not comply with the Accounting Standards. State the consequences that follow in case of Non-compliance. (8 Marks)(Nov 2010)

Answer

Where the Profit and Loss Account and the Balance sheet of the company do not comply with the Accounting Standards read with section VI and Section 211 of the Companies Act, 1956, such companies shall disclose in its Profit and Loss account and Balance Sheet, the following:

- (i) the deviation from the accounting standards.
- (ii) the reasons for such deviations; and
- (iii) the financial effect, if any, arising due to such deviation.

If any such person as is referred to in sub-section (6) of Section 209 fails to take all reasonable steps to secure compliance by the company, as respects any accounts laid before the company in general meeting, with the provisions of this section and with the other requirements of this Act as to the matters to be stated in the accounts, he shall, in respect of each offence, be punishable with imprisonment for a term which may extend to 6 months, or with fine which extend to ` 10,000 or with both.

Question 9

As required under the provisions of the Companies Act, 1956, as amended in 2000, a company incorporated under the Act has to include in the Report of Board of Directors a 'Directors Responsibility Statement'. Directors of the company seek your advise about the matters to be included in the statement. Advise. (8 Marks) (Nov 2010)

Answer

Directors' Responsibility Statement: Section 217 of the Companies Act, 1956 deals with the Report of Board of Directors to be placed before the general meeting. A new sub-section (2AA) was added by the Companies (Amendment) Act, 2000 to provide that the Report shall also include a Directors' Responsibility Statement as under:

- (i) that the applicable accounting standards have been followed in preparing the Annual accounts. If there is material departure, explanation for the same should be given.
- (ii) that the directors have selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent So as to give a true and fair view of the state of affairs of the company while Preparing the annual accounts.
- (iii) that the Directors have taken proper and sufficient care:
 - (a) for maintenance of adequate accounting records as required by the Act,
 - (b) for safeguarding the assets of the company, and
 - (c) for preventing and detecting fraud and other irregularities.
- (iv) that the directors have prepared the annual accounts on a going concern basis.

Question 10

Evershine Ltd., whose financial year ended on 31st March, 2010 held its annual general meeting on 30th September, 2010. The meeting transacted all other business except the accounts as they were not ready and adjourned the meeting to 20th December, 2010 for consideration of accounts. The Registrar of Companies issued show cause notice for violation of section 210 of the Companies Act, 1956. Advise. (5 Marks) (May 2011)

Answer

Adjournment of meeting as accounts were not ready: As per Section 166(1) of the Companies Act, 1956 every company must hold its first Annual General Meeting within 18 months of its incorporation and subsequently one in each calendar year. Not more than 15 months shall elapse between the two Annual General Meetings. Powers are vested in the Registrar of Companies to grant extension of time up to 3 months for holding an Annual General Meeting for genuine reasons.

Section 210(3)(b) provides that every company should lay before every subsequent Annual General Meeting its annual accounts within 6 months or the extended period for holding Annual General Meeting, if any, granted by the Registrar of Companies, from the date of closure of the accounts.

Annual General Meeting including any adjournment thereof shall be completed within the statutory period specified under section 166 and 210. Company cannot adjourn the Annual General Meeting beyond the last date on which the Annual General Meeting is required to be held.

In the given case, Evershine Ltd. convened and held the Annual General Meeting within 6 months from the date of closure of the accounts, but failed to lay the accounts within 6 months. Hence, it has violated the provisions of section 210 of the Act and the Registrar of Companies was justified in issuing the show cause notice.

ALTERNATIVE ANSWER:

Question refers to advising the company about the action to be taken by the company with regard to the matter referred to in the question. Since the company has violated the provisions of Section 210 of the Companies Act, 1956, therefore, in view of the decided case (referred to above), the company has to go for only the compounding of offence under Section 621A, since the offence is punishable with imprisonment or fine or with both.

NOTES:

1. Registrar of Companies permission is required only when Annual General Meeting is not at all held. Here Annual General Meeting has been held and adjourned for item relating to laying over of annual accounts.
2. In the given case since the adjourned meeting is the continuation of the Annual General Meeting, therefore, question of seeking extension from the Registrar does not arise.

DIVIDEND

Question 1

Examine the validity of the resolution passed at the Annual General Meeting of a public company for payment of dividend at a rate higher than that recommended by the board of directors. Is it possible for the board of directors of the company to revoke the dividend declared at the Annual General Meeting?
(5 Marks) (Nov 2008)

Answer

Dividend: According to Regulation 85 of Table A of the Companies Act, 1956, a company in general meeting may declare dividends, but no dividend shall exceed the amount recommended by the Board of Directors of the company. The shareholders at an Annual General Meeting may reduce the amount of dividend recommended by the Board of Directors of the company, but they cannot increase it. Hence the resolution passed at the Annual General Meeting for payment of dividend at a rate higher than that recommended by the Board of Directors is not valid.

Revocation of declared dividend: Ordinarily, a dividend once declared at Annual General Meeting, cannot be revoked, except, with the consent of the shareholders, for a declaration of dividend creates a debt to the shareholders in whose favour it is declared.

If a dividend is declared and the amount is paid or credited to the shareholders as dividend, the character of the credit or payment as dividend cannot be altered by a subsequent resolution (*Kishanchand Chellaram VCIT (1962) 32 Company cases 1046,105C (SC)*).

But where a dividend has been illegally declared, or where, due to events intervening — after the declaration, such as fire destroying the company's property, or the out break of a war, or the composition of new heavy tax burden or other causes diminishing the assets of the company makes it advisable to conserve the remaining assets, the Board of Directors will be justified in revoking the declaration of dividend.

Question 2

Board of Directors of M/s. RPP Ltd. in its meeting held on 29th May, 2009 declared an interim dividend payable on paid up Equity Share Capital of the Company. In the Board Meeting scheduled for 10th June, 2009, the Board wants to revoke the said declaration. You are required to state with reference to the provisions of the Companies Act, 1956 whether the Board of Directors can do so.
(5 Marks) (June 2009)

Answer

Prior to the passing of Companies (Amendment) Act, 2000 only Regulation 86 of Table "A" to the Companies Act, 1956 dealt with the question of interim dividend. The said Regulation empowered the directors to declare interim dividend. i.e. dividend in between two annual general meetings. The said amending Act introduced sub-Section 14A in Section 2 of the Companies Act, 1956 whereby interim dividend is now part of dividend. Accordingly, all provisions of the Companies Act, 1956 relating to dividend have become applicable to interim dividend also.

Section 205 of the Companies Act, 1956 has also been amended by the said amending Act to provide as follows:

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

In view of the above legal position, the Board of Directors of RPP Ltd. must have deposited the amount of interim dividend declared on 29th May, 2009 into a separate bank account on or before 3rd June, 2009 i.e. within five days from 29th May, 2009 when the interim dividend was declared. As stated above, the amount once deposited into a separate bank account, can be used only for payment of interim dividend.

As per provisions of the Companies Act, 1956, the Board of RPP Ltd. has no power to revoke the interim dividend declared on 29th May, 2009 and shall not have any power to use the interim dividend amount transferred to a separate bank account for any other purpose.

In case the amount of interim dividend has not been transferred to a separate bank account and is not paid within the time, the company and its directors have exposed themselves to the applicable penal provisions of the said Act.

Question 3

A Public Company has been declaring dividend at the rate of 20% on equity shares during the last 5 years. The Company has not made adequate profits during the year ended 31st March, 2009, but it has got adequate reserves which can be utilized for maintaining the rate of dividend at 20%. Advise the Company as to how it should go about if it wants to declare dividend at the rate of 20% for the year 2008-2009. Would your answer be different if the company utilized only the profits made in the previous years and retained in the profit and loss account for the purpose of payment of dividend at the rate of 20% for the year 2008-2009?

(5 Marks)(Nov 2009)

Answer

As per Rule 2 of the Companies (Declaration of Dividend out of Reserves) Rules, 1975 dividend may be declared by a company for any year out of the accumulated profits earned by it during previous years and transferred by it to the reserves subject to certain conditions. One of the conditions is that the rate of dividend declared shall not exceed the average of the rates at which dividend was declared by it in the 5 years immediately preceding that year or 10% of its paid-up capital whichever is less. As the proposed dividend exceeds 10%, it is necessary to seek the approval of the Central Government as required under section 205A(3) and only after obtaining the approval of the Central Government, the company may declare dividend at rate of 20% for year 2008-09, even if the other conditions relating to the amount that can be drawn from the reserves and minimum balance in the reserve are fulfilled. However, the credit balance, if any, carried in the profit and loss account will be available for declaration of dividend without any restriction. Hence in such a case dividend may be declared at the rate of 20% for 2008-09, without approval of the Central Government.

Question 4

X & Co. Ltd. made a loss of ₹20 lakhs after providing for depreciation for the year ended 31st March, 2009 and as a result the company was not in a position to declare any dividend for the said year out of profits. However, the Board of Directors of the company announced the declaration of dividend of 15% on the equity shares payable out of free reserves. The paid up share capital of the company and its free reserves as on 31st March, 2009 are ₹ Two crores and Ten crores respectively. The average dividend declared by the Company in the last five years is 25%. Examine the validity of declaration of dividend. (5 Marks) (May 2010)

Answer

Powers relating to Declaration of Dividend: In accordance with the provisions of the Companies Act, 1956 as contained in section 205(1), dividends may be declared by a company out of the current year profits arrived at after providing for depreciation or out of previous years profits after providing for depreciation or out of moneys provided by the Government. Further a company must transfer a prescribed percentage of its profits (not exceeding 10%) to its reserves before declaring dividends. It must be noted that the power to declare dividend vests with the Board of Directors. When dividends are declared out of free reserves, the company has to comply with the following conditions as prescribed in the Companies (Declaration of Dividend out of Reserves) Rules, 1975 framed by the Central Government:

- (a) The rate of dividend declared does not exceed the average of the rates at which dividend was declared by it in the 5 years immediately proceeding that year or 10% of the capital whichever is less.
- (b) The total amount to be drawn from the accumulated profits earned in previous years and transferred to the reserves does not exceed an amount equal to 1/10th of the sum of its paid up capital and free reserves and the amount to be drawn must first be utilized to set off the losses incurred in the financial year before any dividend in respect of equity shares is declared.

(c) The balance of such reserves after drawl does not fall below 15% of its paid up share capital.

In view of the above, X & Co. Ltd. cannot declare 15% of dividend as proposed. However, it can declare 10% dividend provided the conditions stated in (b) & (c) above are fulfilled.

Question 5

The agenda for the meeting of the Board of Directors of M/s Brilliant Enterprises Ltd. held on 20-3-2011 for adopting the annual accounts for the year ended 31-12-2010 included an item relating to payment of dividend. At the meeting it became apparent that the profits made during the year ended 31-12-2010 were inadequate to declare dividend. The Board was keen to maintain the rate of 20% dividend on the equity shares as declared in the previous years so as to maintain the image of the company. The company has some accumulated profits earned in previous years, which were transferred to reserves. Advise the company as to how it should go about to achieve the objective to pay dividend at the rate of 20% on the equity shares.

(5 Marks) (May 2011)

Answer

Payment of Dividend out of the accumulated profits: According to Section 205A (3) of the Companies Act, 1956, where, owing to inadequacy or absence of profits in any year, any company proposes to declare dividend out of the accumulated profits earned by the company in previous years and transferred by it to the reserves, such declaration of dividend shall not be made except in accordance with Companies (Declaration of Dividend out of Reserves) Rules, 1975, as may be made by the Central Government in this behalf and where any such declaration is not in accordance with such rules, such declaration shall not be made except with the previous approval of the Central Government.

According to the rules, dividend can be declared by the company out of accumulated profits subject to the following conditions;

1. The rate of the dividend declared does not exceed the average of the rates at which dividend was declared by it in the 5 years immediately preceding that year or 10 per cent of its paid up capital, whichever is less.
2. The total amount to be drawn from the accumulated profits earned in previous years and transferred to the reserves does not exceed an amount equal to 1/10th of the sum of its paid up capital and free reserves and the amount to drawn must first be utilized to set off the losses incurred in the financial year before any dividend in respect of preference or equity shares is declared.
3. The balance of reserves after such drawl does not fall below 15 per cent of its paid up share capital.

Thus, in the present case, if M/s. Brilliant Enterprises Ltd. is not complying with the conditions mentioned in the Companies (Declaration of Dividend out of Reserves) Rules, 1975 then it is required to take previous approval of the Central Government for declaring dividend at the rate of 20% on the equity shares.

DIRECTORS, POWERS, MANAGERIAL REMUNERATION

Question 1

The board of directors of XYZ Limited having paid-up share capital of ₹ 6 crores and free reserves of ₹ 3 crores proposes to increase the sitting fee which is at present ₹ 5,000. They seek your advice about the maximum amount upto which the sitting fee may be increased without seeking the approval of the Central Government. Advise explaining the relevant provisions of the Companies Act, 1956.

(5 Marks) (Nov 2008)

Answer

Sitting fees: The company proposes to increase the Sitting fees payable to directors for attending Board meetings without seeking the approval of the Central Government for such increase. According to the first provision to Section 310 of the Companies Act, 1956, any increase in sitting fees up to prescribed limit will not require approval of the Central Government. As per rule 10b of Companies (Central Governments) General Rules & Forms, 1956 maximum sitting fees payable per meeting of Board of Directors or its committee is as follows-

- a) ₹ 20,000 per meeting if paid up capital plus free reserves are ₹ 10 crore or more or turnover is ₹ 50 crore or more (since word used is "or", it is so sufficient if one of the conditions is satisfied).
- b) ₹ 10,000 per meeting in other cases (i.e. company whose paid up capital plus free reserves is less than ₹ 10 crore and turnover is less than ₹ 50 crore).

The paid up capital plus free reserves of XYZ Ltd is less than ₹ 10 crore and information regarding turnover is not available. If the turnover of the company is also less than ₹ 50 crore, the Sitting fees can be increased only up to ₹ 10,000 per meeting, without seeking approval of the Central Government. If the turnover is ₹ 50 crore or above Sitting fees can be increased up to ₹ 20,000 without approval of the Central Government.

Question 2

Mr. Suresh, an additional director appointed by the board of directors of a public company, is proposed to be appointed as a regular director in the Annual General Meeting. Explain the requirements under the Companies Act, 1956 to give effect to the proposed appointment.

(5 Marks) (Nov 2008)

Answer

When the additional director, Mr. Suresh is to be appointed as a regular director in general meeting a notice in writing of his candidature as director has to be received from him or from any member under Section 257 of the Companies Act, 1956, at least 14 days before the meeting. The candidate or the member proposing a person as director, is also required to pay ₹ 500 as refundable deposit. This is because the additional director who is retiring is not a director retiring by rotation and hence exemption from Section 257 (1) is not available to him.

The members must be duly informed of the candidature (individually) at least 7 days before the meeting or the candidature is duly advertised. Normally the notice is received well in advance and in such a case the contents of the notice are included in notice of the meeting under "special business" with an explanatory statement.

These are the main requirements relating to the proposed appointment of Mr. Suresh as a regular director in the general meeting.

Question 3

The Articles of Association of MKP Limited incorporated with an Authorised Share Capital of ₹ 50 crores divided into 5 crores Equity Shares of ₹ 10 each contained the following clause:

"The qualification of a director shall be the holding of at least 1,000 Equity shares in the Company and such a director if not already so qualified shall have to obtain his qualification within a period of 30 days from the date of his appointment as director."

Examine the validity of the above clause in the light of the provisions of the Companies Act, 1956. (5 Marks) (June 2009)

Answer

The subject matter of the question is covered by the provisions of Section 270 of the Companies Act, 1956. The Companies Act, 1956 does not provide for any qualification for becoming a director of any company. According to the said Section, any person appointed as a director is required to obtain the qualification if it is so provided by the Articles of Association of the Company.

The said Section states that in case the Articles of Association of a company provides for the qualification of a director, then such a director is required to obtain the requisite qualification within a period of two months from the date of his appointment as a director. The Section further states that any clause in the Articles of association requiring the director to obtain the qualification shares within a shorter time than two months shall be void.

The said Section also puts a maximum limit on the qualification that can be prescribed by the Articles of Association. Such maximum limit being shares with nominal value not exceeding ₹ 5,000 or in a case where the nominal value of one share exceeds ₹ 5,000 then the qualification share shall be maximum one share.

Based on the provisions of Section 270 of the Companies Act, 1956 as explained above, the clause in the Articles of Association as given in the question is void since it stipulates the obtaining

of the qualification shares within a period of 30 days which is shorter than two months. Moreover the clause also violates the maximum limit of share qualification by prescribing the same to be 1,000 shares of ₹ 10 each totaling ₹ 10,000 which is more than the limit of ₹ 5,000 as prescribed in the said Section.

It is pertinent to note that as per Section 9 of the Companies Act, 1956, any clause in the Articles of Association of any company which is ultra virus the Act is void.

Question 4

- (i) *Mr. KMP is director of XLS Ltd. He intends to construct a residential building for his own use. The cost of construction is estimated at ₹ 1.50 Crores, which Mr. KMP proposes to finance partly from his own sources to the tune of ₹ 60 lacs and the balance ₹ 90 lacs from housing loan to be obtained from a housing finance company. For the purpose of obtaining the loan, he has approached the housing finance company which has in principle agreed to grant the loan, but has put a condition. The condition put by the housing finance company is that the Company XLS Ltd. of which Mr. KMP is a director should provide the guarantee for repayment of the loan and interest as per the terms of the proposed agreement for granting the loan to Mr. KMP. You are required to advise Mr. KMP on the matter with reference to the provisions of the Companies Act, 1956.*
- (ii) *Draft a Board Resolution of XLS Ltd. For providing guarantee for ₹ 90.00 lacs in respect of a Loan to be obtained by Mr. KMP, a director thereof from a Housing Finance Company for construction of a residential house for his own use. (5 Marks)(June 2009)*

Answer

- (i) According to the provisions of Section 295 of the Companies Act, 1956, no company shall make any loan or give any guarantee or any security in connection with a loan made by any other person to any director of the lending company unless the previous approval of the Central Government is obtained in this respect.

In view of the above provisions of the law, Mr. KMP is required to approach XLS Ltd. intimating the company the full details of the loan transaction and the condition imposed by the housing finance company. The company XLS Ltd. is required to pass a Board Resolution as required by Section 292 of the Companies Act, 1956 and also a special resolution in terms of Section 372A if the facts of the case so require. Thereafter, the company is required to make an application to the Central Government for obtaining the approval under Section 295 of the Companies Act, 1956. On receipt of the approval of the Central Government, XLS Ltd. can provide the guarantee to housing finance company in respect of the loan proposed to be granted to Mr. KMP

- (ii) **RESOLUTION PASSED IN THE MEETING OF THE BOARD OF DIRECTORS OF XLS LTD. HELD ON _____**

“RESOLVED that, subject to the approval of the Central Government, sanction be and is hereby accorded to the proposal of furnishing the guarantee in respect of a loan of

₹ 90.00 lacs to be obtained by Mr. KMP, a director of the Company, from M/s _____, a housing finance company as per terms and conditions contained in the draft loan agreement to be entered into between the said housing finance company and Mr. KMP, a copy of which is placed before this meeting and initialed by the Chairman for the purpose of identification.

RESOLVED FURTHER that Mr. _____, Secretary of the Company by and is hereby authorized to digitally sign the e-form 24AB, submit the application to the Ministry of Corporate Affairs and comply with all other formalities in this regard."

Question 5

Big Ben Ltd., a reputed public company, had advanced certain sum of money to one of its Directors, namely, Mr. Tanmay on certain terms and conditions and fixing the time limit for repayment thereof. Now, Mr. Tanmay has approached the Company with a request to extend the time limit for repayment of balance of loan amounting to ₹ 12.00 lacs by another six months.

You are required to state with reference to the provisions of the Companies Act, 1956, the answer to the following:

- (i) *Who is authorized to grant the extension as requested by Mr. Tanmay?*
- (ii) *Draft an appropriate notice for the meeting where such extension may be granted.*

(5 Marks) (June 2009)

Answer

- (i) As per provisions of Section 293(1)(b) of the Companies Act, 1956, the Board of Directors of Big Ben Ltd., a public company cannot give time for the repayment of any debt due by Mr. Tanmay, a director of the company except with the consent of the Company by way of an ordinary resolution passed in a General Meeting. In view of this provision of the law, the Company in a General Meeting is authorized to grant the extension as requested by Mr. Tanmay.
- (ii) Notice for calling the General Meeting of the company:

BIG BEN LIMITED

Registered Office: _____

NOTICE FOR EXTRA ORDINARY GENERAL MEETING

NOTICE is hereby given that an Extra Ordinary General Meeting of the members of the company will be held at the Registered office of the Company on _____, the _____ day of _____, 2009 at 11.00 A.M. to transact the following business:

- (1) To Pass, with or without modification, the following resolution as an Ordinary Resolution:

“RESOLVED THAT pursuant to the provision of Section 293(1)(b) of the Companies Act, 1956, consent be and is hereby accorded to the company for extending the time for the repayment of the balance amount of ₹ 12.00 Lacs advanced to Mr. Tanmay, a Director of the company, by a further period of six months ending on _____, 2009.”

FOR & ON BEHALF OF THE BOARD

Dated. _____, 2009

Company Secretary

Notes:

- (1) A member entitled to attend and vote at the Meeting is entitled to appoint a proxy to attend and vote instead of himself and such proxy need not be a member of the Company. Proxies in order to be valid must be deposited at least 48 hours prior to commencement of the Meeting.
- (2) Explanatory Statement pursuant to Section 173(2) of the companies Act, 1956 is annexed hereto.

Question 6

A company wants to include the following clause in its Articles of Association:

“Each director shall be entitled to be paid out of the funds of the company for attending meetings of the Board or a Committee thereof including adjourned meeting such sum as sitting fees as shall be determined from time to time by the Directors but not exceeding a sum of ₹ 30,000 for each such meeting to be attended by the Director.”

You are required to advise the company as to the validity of such a clause and the correct legal position under the provisions of the Companies Act, 1956. (5 Marks) (June 2009)

Answer

The payment of sitting fee to a Director is governed by the provisions of Section 310 of the Companies Act, 1956 read with Rule 10B of the Companies (Central Government's) General Rules and Forms, 1956. According to the said provisions, a Company with a paid up share capital and free reserves of ₹ 10 crores and above or a turnover of ₹ 50 Crores and above can pay to its director by way of sitting fee for each meeting of the board of directors or a committee thereof an amount not exceeding ₹ 20,000/- and in case of other companies, the limit has been set at ₹ 10,000/-.

In view of the above legal provisions, the company cannot have a clause in its Articles of Association which exceeds the limit prescribed by law. The company is advised to check whether the aggregate of its paid up capital and free reserves exceeds ₹ 10 Crore or whether its turnover exceeds ₹ 50 crore and accordingly it can have a clause in its Articles of Association. In case the company keeps the clause as given in the question, it shall be ultra vires the Companies Act, 1956 as Section 9 states that any provision contained in Memorandum of Association, Articles of

Association, Agreements or Resolutions to the extent it is repugnant to the provisions to the provisions of the Companies Act, 1956 shall be void.

Question 7

Amar Textiles Ltd. is a company engaged in manufacture of fabrics. The Company has investments in shares of other bodies corporate including 70% shares in Amar Cotton Co. Ltd. and it has also advanced loans to other bodies corporate. The aggregate of all the investments made and loans granted by Amar Textiles Ltd. exceeds 60% of its paid up share capital and free reserves and also exceeds 100% of its free reserves. In course of its business requirements, Amar Textiles Ltd. has obtained a term loan from Industrial Development Bank of India and the said loan is still subsisting. Now the company to increase its holding from 70% to 80% of the equity share capital in Amar Cotton Co. Ltd. by purchase of additional 10% shares from other existing shareholders.

State the legal requirements to be complied with by Amar Textiles Ltd. under the provisions of the Companies Act, 1956 to give effect to the above proposal. (5 Marks) (June 2009)

Answer

Amar Cotton Co. Ltd is not a wholly – owned subsidiary of Amar Textiles Ltd. and hence investments in such a subsidiary company is not covered by exemption under Section 372(A)(8)(e) of the Companies Act. 1956. As the aggregate of the investments in shares and loans granted to other bodies corporate exceeds 60% of the paid-up share capital and free reserves and also 100% of the free reserves, it is necessary for Amar Textiles Ltd. to pass a special resolution in the General Meeting before increasing its holding from 70% to 80%. [First Proviso to section 372A(1)].

The notice of Special Resolution must indicate clearly the specific limits, the particulars of the body corporate in which the investment is proposed to be made, the purpose of the investment, specific source of funding and such other details. [Third Proviso to Section 372A(1)]

In the present case, Amar Textiles Ltd. obtained a term loan from Industrial Development Bank of India (IDBI) which is a public financial institution within the meaning of Section 4A of the said Act and therefore the provisions of Section 372A(2) are attached as such loan is still subsisting. The company is required to obtain prior approval of IDBI for making any further investment.

As required by provisions of Section 372A(2), the investment proposal must be passed at the Board Meeting by unanimous decision of all the directors present at the meeting.

The company must enter the prescribed particulars of investment in a register of investment within 7 days of making the investment. [Section 372A(5)]

The company must also take into consideration the guidelines, if any prescribed by the Central Government under Section 372A(7) of the said Act.

Question 8

Explain the action that can be taken by the Central Government, when a complaint is received from some shareholders of a Public Company that a person has been appointed as the

Managing Director of the Company without seeking the approval of the Central Government, when such approval is required. Also examine the validity of the acts of the Managing Director, if the complaint is found to be true.
(5 Marks) (Nov 2009)

Answer

Improper appointment of Managing Director: On receipt of the complaint, if the Central Government is prima facie, of the opinion that the Managing Director has been appointed without approval of the Central Government, when in fact such approval was necessary, the Central Government may refer the matter to the Company Law Board (Tribunal) for decision [Section 269(7)]. The Company Law Board will issue show-cause notice to the Company as well as the concerned Managing Director [Section 269(8)]. The Company Law Board will hear the case, and if it comes to a conclusion that the appointment is in contravention of requirements of Schedule XIII, it will make an order to that effect [Section 269(9)]. On such order, the appointment of the concerned Managing Director shall be deemed to have come to an end. The person so appointed shall in addition to being liable to pay a fine of ₹ 1 lakh, refund to the company the entire remuneration received by him between the date of his appointment and the passing of such an order [Section 269(10)]. But all acts done by him prior to the declaration of invalidity will be valid, if they are otherwise valid [Section 269(12)].

Question 9

Mr. Kamlesh, son of Managing Director of a Public Company, is proposed to be appointed as Chief Executive of the Company on a Monthly remuneration of ₹ 75,000. State the provisions of the Companies Act, 1956 which are required to be complied with by the company in this regard?

Will it make any difference if Mr. Kamlesh is appointed as Whole-Time Director on the same remuneration?
(5 Marks) (Nov 2009)

Answer

Under Section 314(1B) of the Companies Act, 1956, in case relative of a Director holds office or place of profit under the Company on a monthly remuneration of ₹ 50,000 or more, the Company is required to obtain prior consent of the company by special resolution and approval of Central Government. In the present case, the Company is accordingly required to pass a special resolution and obtain approval of the Central Government.

In case Mr. Kamlesh is appointed as Whole Time Director in the Company, Section 314 will not be attracted in view of sub-section (3) thereof, as he will be drawing remuneration in his capacity as a Director. He will be governed by the provisions of Section 269 read with Schedule XIII of the Act, according to which approval of Central Government is not required as the proposed remuneration of ₹ 75,000 per month is within the ceiling provide in Part II of Schedule XIII provided the conditions prescribed in Part I of the Schedule have been complied with by the Company and the appointee.

Question 10

The Board of Directors of LM Limited propose to donate ₹ 3,00,000 to a school established exclusively for the benefit of children of employees and also donate ₹ 50,000 to a political party during the Financial year ending 31st March, 2010. The average net profits determined in accordance with the provisions of Sections 349 and 350 of Companies Act, 1956 during the three immediately preceding financial years is ₹ 40,00,000. Examine with reference to the provisions of the Companies Act, 1956 whether the proposed donations are within the power of the Board of Directors of company. (5 Marks) (Nov 2009)

Answer

Donations: As per section 293(1) (e) of the Companies Act, 1956, the Board of Directors of a Company must obtain approval of the shareholder by way of resolution passed in their meeting for contributing in any year, to charitable and other funds not directly relating to the business of the company or the welfare of to employees any amount exceeding ₹ 50,000 or 5% of its average net profits of the last 3 financial years, whichever is higher. In the given case, the school is established exclusively for the benefit of the children of the employees of the company and hence the restriction under section 293 (1) (e) is not applicable and the Board is empowered to make the proposed donation.

Donation to political parties: It is presumed that LM Ltd is not a Government Company. It has been in existence for more than 3 years. The proposed donation to a political party is only ₹ 50,000 which is less than 5% of the average net profit for 3 immediately preceding financial years. Hence the Board of Directors is empowered to make a donation by passing a resolution at a Board meeting. The company is also required to make its proper disclosure in the profit and loss account. (Section 293 A).

Question 11

Mr. Sachin was appointed as an additional Director of Conservative Finance Ltd. w.e.f. 1st October, 2009, in a casual vacancy by way of a circular resolution passed by the Board of Directors. The next annual general meeting of the company was due on 31st March, 2010, but the same was not held due to delay in the finalisation of the accounts. Some of the shareholders of the company have questioned the validity of the appointment of Mr. Sachin and his continuation as additional director beyond 31st March, 2010. Advise the company on the complaints made by the shareholders. (5 Marks) (May 2010)

Answer

Appointment of director in a Casual vacancy: Section 262 of the Companies Act, 1956 which deals with the filling of a casual vacancy provides that a director can be appointed only at a validly convened and constituted Board meeting. Hence the appointment of Mr. Sachin by passing a circular resolution is not valid and the shareholders who made a complaint in this regard are correct. The tenure of a director appointed against a casual vacancy will be upto the date to which the original director in whose place he is appointed would have held office. On the other hand, an additional director appointed by the Board will hold office only upto the date of next annual general

meeting and he cannot continue in office beyond the last date of the annual general meeting i.e. 31st March, 2010 on the ground the annual general meeting could not be held. (*Krishna Prasad Pilani vs. Colaba Land Mills Co AIR, 1960, BOM, 312.*)

Question 12

Mr. Ravindranathan is holding the post of Director in three companies out of which Goodluck Colours Limited is one. For the financial year ended on 31st March, 2009, Goodluck Colours Limited failed to pay interest on loans taken from a financial institution and also failed to repay the matured deposits. On 1st June, 2009 Mr. Ravindranathan accepting the post of Additional Director in Soma Footwear Limited, submitted a declaration that the disqualification specified in Section 274 of the Companies Act, 1956 is not applicable in his case. Decide whether the declaration submitted by Mr. Ravindranathan to Soma Footwear Limited is in order.

(5 Marks) (May 2010)

Answer

Disqualification of Director: In accordance with the provisions of the Companies Act, 1956, as contained in section 274(1)(g) a person who is already a director of a public company becomes disqualified for being appointed as director if the concerned public company has failed to repay its deposits or interest on due date or redeem its debentures on due date or pay dividend and such failure continues for one year or more.

The disqualification specified in Section 274(1) (g) of the Companies Act, 1956 is not applicable in matters of loan from public financial institutions. But Goodluck Colours Limited has failed to repay its deposits on due date and the said failure continues for more than one year, Mr. Ravindranathan is disqualified under the said section of the said Act. The declaration submitted by him is not in order and he is not eligible to the appointment as additional director in Soma Footwear Limited.

Notes:

1. The director who shall be exempted from disqualification under section 274(1)(g) will be nominees of Public Financial Institutions, and not other directors.
2. Further, as per the wordings given in the question, it is not clear as to when was (i.e. on what date) the default in payment of the matured deposits occurred for the first time during the financial year ended 31st March, 2009. If default occurred after 31st May, 2009, one year has not elapsed as on 1.6.2009, i.e. the date of appointment of Mr Sachin as additional director. The disqualification is possible if the deposits were matured during April, 2008 to May, 2008 and were not paid and default continued for more than one year. Assumption in the given case is that the company defaulted the payment and the failure continued for more than one year. If default occurred after 1st June, 2008, there is no disqualification in the given case. Therefore, section 274 (1) (g) is not attracted in this case.

Question 13

The Articles of Association of Rajasthan Toys Private Limited provide that the maximum number of Directors in the company shall be 10. Presently, the company is having 8 Directors.

The Board of Directors of the said company desire to increase the number of Directors to 15. Advise whether under the provisions of the Companies Act, 1956 the Board of Directors can do so.
(5 Marks) (May 2010)

Answer

Increase in the number of directors: In accordance with the provisions of the Companies Act, 1956 as contained in Section 259 in the case of a company incorporated after 21st July, 1951 any increase in the number of its directors beyond the maximum fixed by its Articles of Association as originally adopted and registered and in the case of a company existing prior to that date, any increase in the number of directors shall not have any effect unless approved by the Central Government. However, such approval from the Central Government is not required if the number of Directors is increased to 12 or less than that.

The above mentioned provisions of Section 259 of the Companies Act, 1956 are applicable only to public companies or private companies which are subsidiaries of public companies.

In view of the above, since Rajasthan Toys Private Limited is a private company and it is also not subsidiary of any public company, the provisions of Section 259 of the Companies Act, 1956 are not applicable and the Board of Directors of the said company may increase the number of Directors without seeking approval of the Central Government.

Question 14

Advise the Board of Director of Spectra Papers Ltd. regarding validity and extent of their powers, under the provisions of the Companies Act, 1956 in relation to the following matters:

- (i) *Buy-back of the shares of the Company, for the first time, upto 10% of the paid up equity share capital without passing a special resolution.*
- (ii) *Delegation of Power to the Managing Director of the company to invest surplus funds of the company in the shares of some companies.*
(5 Marks) (May 2010)

Answer

Powers of Board of Directors:

- (i) In accordance with the provisions of the Companies Act, 1956 as contained in section 292 (1) (a), a company can buy-back of its shares up to 10 % of the total paid up equity capital and free reserves. Hence, special resolution in general meeting of the company is not required. The proposed buy-back of shares is in order provided other conditions laid down in Section 77A of the Companies Act, 1956 are fulfilled.
- (ii) Section 292 of the Companies Act, 1956 empowers the Board of Directors to delegate to the Managing Director the power to invest in general terms. But Section 372A (2) of the Act provides that no investment shall be made unless it is sanctioned by a resolution passed at a meeting of the board with the consent of all directors present. Section 372A does not provide for delegation. Hence the proposed delegation of power to the Managing Director to invest is not in order.

Question 15

Non-executive Directors of ABC Limited, who are neither in the whole time employment of the company nor Managing Directors have been given the following remuneration --

- (i) *Guarantee Commission has been paid to them for having guaranteed the term loans obtained from a Financial institution.*
- (ii) *Commission payable to them is calculated on the basis of book-profits arrived at after providing for depreciation as per straight line method.*

Examine the validity of these payments in the light of the provisions of the Companies Act, 1956. (5 Marks) (May 2010)

Answer

Remuneration to Non-Executive Directors:

- (i) **Guarantee Commission:** Section 309(1) of the Companies Act, 1956 provides that the remuneration payable to any director shall be inclusive of the remuneration payable for services rendered by him in any other capacity. The question is whether guarantee commission is remuneration within the meaning of Section 309 of the Act. In the case of *Suessen Textile Bearings Ltd. Vs. Union of India (1984)* it has been decided that the guarantee commission paid to the directors for giving surety against loan taken by the company from financial institutions is not a remuneration for any professional services within the meaning of Section 309 and therefore approval of the Central Government is not required.
- (ii) **Depreciation:** Section 350 of the Companies Act, 1956 specifies the manner of ascertainment of depreciation. The amount of depreciation to be deducted is the amount of depreciation as appearing in the books i.e. as shown in the profit and loss account of the relevant financial year at the rates specified in Schedule XIV of the Companies Act, 1956. Thus, the payment of commission calculated on the basis of book profits arrived at after providing for depreciation as per straight-line method is in order.

Question 16

X, who does not hold any shares in his name is appointed as Director in JAM Company on 1st April, 2010. His wife holds 10,000 Equity Shares in the company in her name singly. Certain members of the company objects to X's appointment on the ground that since he does not hold any shares in his own name, his appointment is violative of the provisions of the Companies' Act, 1956. Articles of the Company are silent on the issue of holding any shares by a Director.

Examine the provisions of the Act and decide

- (i) *Whether contention of the members is tenable?*
- (ii) *Whether X wife's shareholding in the company can be the ground for 'X' continuation as a director in the company?*

- (iii) What would be your answer in case 'X' is one of the subscribers of the Memorandum of Association? (5 Marks)(Nov 2010)

Answer

The Companies Act, 1956 does not impose any share qualification on the directors. Therefore, unless the company's articles contain a provision to that effect, a director need not be a shareholder. However, the articles usually provide for a minimum share qualification. As per Regulation 66 of Table A, a director must hold at least one share in a company. Where a share qualification is fixed by the articles of a public company or a private company which is a subsidiary of a public company, Section 270 provides that:

- (i) each director must take his qualification shares within two months after his appointment;
- (ii) the nominal value of the qualification shares must not exceed ₹ 5,000 after his appointment
- (iii) share warrants will not count for purposes of share qualification.

If a director fails to obtain his qualification shares within two months, he vacates office automatically on the expiry of two months after the date of his appointment. However, the subscribers to the Memorandum, as per provisions of the Act and/or Articles are deemed to be the first directors of the company. They need not hold qualification shares, unless the Articles so require.

Examining the above provisions of the Act, following shall be the answers to the questions asked:

- (i) Contention of members shall not be tenable, for the reasons stated above (i.e. provisions of the Act).
- (ii) His wife's holding of shares shall not be the qualification for the director. If the Articles are silent, the director need not hold any shares. Articles may provide that directors need not hold any qualification shares.
- (iii) If he is one of the subscribers to the memorandum, he need not hold the Qualification shares. However, as a subscriber to a Memorandum he has to take at least a share and that share entitles him to qualify as a director. Therefore, he can continue as a director in the given case.

Question 17

A is the Director of M & Co. Ltd. A has borrowed ₹ 50/- lacs on reasonable terms from X for company's benefit and business. A has no power to borrow. What will be the legal position? Please explain. (5 Marks)(Nov 2010)

Answer

Money has been borrowed and used for the benefit of the company and its legitimate business purposes. Therefore, the company cannot repudiate the liability on the ground that the director 'A' has no power to borrow. (*LTR. Practice (Bombay) vs E.D.SASSR & Co. (1936) 6 Comp Cases 90*).

In light of the above, company itself would be liable to pay. 'A' a director stands in a fiduciary relationship with the company (*City Equitable Insurance Co (1925) Ch 407*).

Question 18

X, a Director of MJV Ltd., was appointed on 1st April, 2009, one of the terms of appointment was that in the absence of adequacy of profits or if the company had no profits in a particular year, he will be paid remuneration in accordance with Schedule XIII. For the financial year ended 31st March, 2010, the company suffered heavy losses. The company was not in a position to pay any remuneration but he was paid ₹ 50 lacs for the year, as paid to other directors. The effective capital of the company is ₹ 150 crores. Referring to the provisions of Companies Act, 1956, as contained in Schedule XIII, examine the validity of the above payment of remuneration to X.
(8 Marks) (Nov 2010)

Answer

Where in any financial year during the currency of tenure of the managerial person, a company has no profits or its profits are inadequate, it may pay remuneration to a managerial person, by way of salary, dearness allowance, perquisites and any other allowance, not exceeding ceiling limit of ₹ 24,00,000 per annum or ₹ 2 lacs per month calculated on the scale as given in Schedule XIII of the Companies Act, 1956.

In the given case, the effective capital of the company is ₹ 150 crores. As per the scale given in the Schedule XIII monthly remuneration payable should not exceed ₹ 2,00,000 (for effective Capital ₹ 100 crores or more). The remuneration given to X is ₹ 50 lacs for the whole Year, which is more than the ceiling. Therefore, payment of ₹ 50 lacs is not in order.

Question 19

Under the provisions of the Companies Act, 1956, examine the validity of the following appointments made by Board of VMR Ltd.

- (i) *ABC Ltd. is a subsidiary company of VMR Ltd. in which Y is a Director. Y has been appointed as Manager - Research & Development in V.M.R. Ltd. on a monthly salary of ₹ 2 lacs per month with effect from 1st April, 2010.*
- (ii) *What would be your answer in case VMR Ltd. is a subsidiary of ABC Ltd?*

(8 Marks) (Nov 2010)

Answer

According to Section 314(1) of the Companies Act, 1956, except with the consent of the company accorded by a special resolution-

- (a) no director of a company shall hold any office or place of profit, and
- (b) no partner or relative of such director, no firm in which such director, or a relative of such director, is a partner, no private company of which such director is a director or member, and no director or manager of such a private company, shall hold any office or place of

profit carrying a total monthly remuneration of such sum as may be prescribed, except that of managing director or manager, banker or trustee for the holders of debentures of the company,-

- (i) under the company; or
- (ii) under any subsidiary of the company unless the remuneration received from such subsidiary in respect of such office or place of profit is paid over to the company or its holding company.

From the wordings of the question it is not very clear whether 'Y' is director in ABC Ltd. or in VMR Ltd. The question can be answered on any of the following two assumptions viz.

- (1) That Y is the director in VMR Ltd.
- (2) Y is the director in ABC Ltd.

If Y is director of VMR Ltd. then answers to both sub questions (i) and (ii) remain the same, as a director of a company is appointed in the same company to the office of profit. Therefore, Section 314(1) is attracted in both the cases, and special resolution is required.

ALTERNATIVE:

Y is a director of ABC Ltd. Since the appointment is made in VMR Ltd. the status of VMR is relevant. In the first part of the question VMR Ltd. is the holding company thus Section 314(1) is applicable only to a director of a holding company being appointed to an office of profit in subsidiary. Here a director of a subsidiary company i.e. ABC Ltd. is appointed to an office of profit in the holding company i.e. VMR Ltd. In such a case Section 314(1) is not attracted.

IIInd Part: Q.3 (b) (ii):

Here VMR Ltd. is the subsidiary. Since the director of a holding company is holding an office of profit in a subsidiary hence, Section 314(1) is attracted unless the entire remuneration received by Y is paid back to either of the company, special resolution is required.

When a director of one company is appointed to an office of profit to another company, the relationship between these two companies becomes relevant. Section 314(1) is attracted only if the director of a holding company is appointed to an office of profit in its subsidiary. If the director of a subsidiary company is appointed to an office of profit in its holding company, Section 314(1) is not applicable. Therefore, when we assume that a director of VMR Ltd. is appointed to an office of profit in VMR Ltd. itself, Section 314(1) is attracted, both in respect of part (i) and (ii) of the question. The answer will be different as explained above only when Y is a director of ABC Ltd.

Question 20

In ABC Ltd. three Directors were to be appointed. The item was included in agenda for the Annual General Meeting scheduled on 30th September, 2010, under the category of 'Ordinary Business'. All the three persons as proposed by the Board of Directors were elected as

Directors of the company by passing a 'single resolution' avoiding the repetition (multiplicity) of resolution. After the three directors joined the Board, certain members objected to their appointment and the resolution. Examine the provisions of Companies' Act, 1956 and decide

- (i) *Whether the contention of the members shall be tenable and whether both the appointment of Directors and the 'single resolution' passed at the Company's Annual General Meeting shall be void.*
- (ii) *What would be your answer in case the company in question is an "Association not for Profit" incorporated under Section 25 of the Companies Act, 1956. (8 Marks) (Nov 2010)*

Answer

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

Answer to Problems:

1. Taking into account the above, the contention of the members shall be tenable. Each director has to be appointed by way of a separate resolution.
2. In the second case since the company is an association not for profit under section 25 of the Companies Act, 1956 the above provisions do not apply. In case of association word limited is also not necessary.

Question 21

The Balance Sheet of International Operators Ltd as at 31-03-2011 disclose the following position

	₹ (in crores)
Share Capital	100
Reserves & Surplus	300
Secured Loans	150
Unsecured Loans	100
Current Liabilities	70

Mr X, the Managing Director of the company approaches the Royal Bank for a secured loan of ₹ 600 crores to finance the new projects to be taken up shortly. The Bank seeks your advise

whether it can grant the loan of ₹ 600 crores on the application of Mr. X. Advise the Royal Bank having regard to the provisions of the Companies Act, 1956. (8 Marks) (May 2011)

Answer

Powers of directors related to borrowing funds by the company: The management of Royal Bank should be aware of the provisions of Sections 292 and 293 of the Companies Act, 1956, which govern the powers of directors in the matter of borrowing funds by the company. According to Section 292, the Board of Directors of International operators Ltd. can exercise the borrowings by passing a resolution at a duly convened meeting of the Board of Directors. However, under Section 293, the Board of Directors of a public company cannot, except with the consent of the members of the company in general meeting borrow moneys, where the moneys to be borrowed together with the moneys already borrowed by the company, exceeds the aggregate of the paid up capital of the company and its free reserves.

In the present case, the proposal of the company to borrow ₹ 600 crores exceed the paid up share capital and free reserves of the company to the tune of ₹ 200 crores (i.e. ₹ 600 crores – ₹ 400 crores = ₹ 200 crores) without taking into account the existing loan. Thus Royal Bank should advise Mr. X, the Managing Director of the company to get the approval of the shareholders of the company as provided in Section 293 before considering the request of the company for a loan of ₹ 600 crores. In case, the loan is secured by mortgaging the assets of the company the bank should also ensure that the particulars of the charge are registered with the Registrar of Companies as provided in Section 125 of the Companies Act, 1956.

Question 22

X Ltd. was registered in the year 2005 under the Companies Act 1956. The management of the company decides to make donation to recognized political party. Advise the management about the restrictions and the extent up to which such donation can be made under the aid Act. Will it make any difference if X Ltd. was registered in the year 2009? (8 Marks) (May 2011)

Answer

Donation to Recognized Political Party: According to Section 293A of the Companies Act, 1956, no Government Company and no other company which has been in existence for less than three financial years shall contribute any amount or amounts directly or indirectly (i) to any political party, or (ii) for any political purpose to any person. Any other company may however, contribute any amount directly or indirectly to any political party or for any political purpose to any person, provided that the aggregate of the amount so contributed by the company in any financial year shall not exceed 5% of the its average net profits determined in accordance with the provisions of Sections 349 and 350 of the Act during the three immediately preceding financial years.

Thus X Ltd., in the present case, can contribute to the recognized political party provided it is not a Government Company within the meaning of Section 617 of the Act and it is in existence for more than three financial years at the time of making the donation. Further political donations can be made by X Ltd. only out of its profits.

Further, the political donation is required to be authorized by a resolution passed at a Board of Directors meeting (Section 293A (2)). In addition, the company is also required to disclose in its Profit & Loss Account particulars of total amount contributed and the name of the political parties to which such amount has been contributed. (Section 293A (4)).

If X Ltd. was registered in the year 2009 it cannot make political donations because the company has not been in existence for three years.

Question 23

Explain when a Public Limited Company is necessarily required to appoint a managing Director under the Companies Act, 1956. Draft a Board resolution for the appointment of Mr. Intelligent as the managing Director of Smart Limited on a salary of ₹ 5 Lakhs per month along with other usual perquisites. (8 Marks) (May 2011)

Answer

Appointment of Managing Director: According to Section 269 of the Companies Act, 1956 every public company or a subsidiary of a public company having a paid up share capital of ₹ 5 crores or more is required to appoint a Managing Director or Whole Time Director or a Manager.

In the given case, the remuneration exceeds ₹ 4 Lakhs, therefore, as per Schedule XIII Part II-C special resolution at a general meeting of the company is also required.

Draft of Board Resolution

Resolved that Mr. Intelligent be and is hereby appointed as Managing Director of the Company subject to the approval of the Central Government for a period of 5 years effective from 1-4-2011 and that he may be paid remuneration as follows:

- (i) Salary: ₹ 5 lakhs per month plus annual increment of ₹ 2.5 lakhs.
- (ii) Commission: 1% of the net profits of the company subject to a maximum of ₹ 10 lakhs.
- (iii) Perquisites: Housing, car, etc. as applicable to the Senior Executive of the company.

Resolved further that the Secretary of the Company be and is hereby authorized to make an application to the Central Government seeking their approval to the above appointment.

Sd/-

For the Board of Directors

Note: It is assumed that the remuneration proposed to be paid to Mr. Intelligent exceeds the limits that down in Schedule XIII to be the Companies Act, 1956, in which case passing of special resolution in general meeting and the approval of the Central Government is required.

Question 24

Annual general meeting of Hero Ltd. has been scheduled in compliance with the requirements of the Companies Act, 1956. In this connection, it has some directors who are rotational and out of which some have been appointed long back, some have been appointed on the same day.

Decide in this connection:

- (i) *Which of the directors shall be retiring by rotation and be eligible for re-election?*
 - (ii) *In case two directors were appointed on the same day, how would you decide their retirement by rotation?*
 - (iii) *In case the meeting could not decide how the vacancies caused by retirement to be dealt with, what shall be consequences ?*
 - (iv) *What will be your answer, assuming that the matter could not be decided even at the adjourned meeting?*
- (8 Marks) (May 2011)*

Answer

Rotational Directors and Retirement:

- (i) According to Section 256 of the Companies Act, 1956, out of the 2/3rds rotational directors only 1/3rds must retire by rotation at one general meeting. If the number is not three or multiple of three, then the number nearest to 1/3 must retire from office. First those directors who are the longest in office must retire.
- (ii) If two directors have been appointed on the same day, their retirement will be determined either mutually or by lot.
- (iii) The vacancies caused by such retirement may be filled in the same annual general meeting by appointing either the retiring directors or some other person. But the meeting may also decide that the vacancies shall not be filled.
- (iv) Where, however, the meeting has not done either of two, then the meeting is deemed to have been adjourned for a week. If at the adjourned meeting held after the said week, fresh appointment is not made and if no resolution against appointment is passed, then the retiring directors shall be deemed to have been appointed except in the following cases:
 - (a) Where at the meeting or at the previous meeting the resolution for the reappointment of a particular director was put to vote but lost;
 - (b) Where the retiring director has expressed his unwillingness to be reappointed by a written notice addressed to the company or its Board of Directors;
 - (c) Where he is unqualified or has been disqualified for appointment; and
 - (d) Where any special or ordinary resolution is required for his appointment or reappointment.

MEETING, POWERS OF THE BOARD AND RELATED PARTY TRANSACTIONS

Question 1

P, son of A, who is the Managing Director of ABC Limited, proposes to give his flat on lease to the company. The paid-up share capital of ABC Limited is ₹ 10 crores. Advise the company explaining the restrictions, if any, under the Companies Act, 1956. (5 Marks) (Nov 2008)

Answer

Lease of flat: Section 297 of the Companies Act, 1956 requires certain contracts on which the directors of a company are interested to be sanctioned by the Board of Directors of the Company and in certain cases (i.e. where the paid up share capital of the company is ₹ 1 crore or more) it is also required to be approved with the previous approval of Central Government. Section 297 applies only to contracts of sale, purchase or supply of goods, materials and services or for underwriting the subscription of any shares in, or debentures of the company. Providing premises on a rental or lease basis by a director or his relative to company is not covered by Section 297. Since this Section does not apply to transactions in immovable properties, hence the proposed lease does not require either board resolution or approval of the Central Government.

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

Question 2

The board meeting of MNO Ltd. was held on 10th May, 2008 at Chennai at 11a.m. At the time of starting the board meeting the number of directors present were 7. The total number of directors were 10. The board transacted ten items in the board meeting. At 12 noon after the completion of four items in the agenda 4 directors left the meeting. Examine the validity of these transactions explaining the relevant provisions of the Companies Act, 1956.

(5 Marks) (Nov 2008)

Answer

Quorum: Section 287 of the Companies Act, 1956 provides for the quorum for meeting. The quorum for a meeting of the Board of Directors of a company shall be one third of its total strength (any fraction contained in the said one third being rounded off as one), or two directors, whichever is higher. Where at any time the number of interested directors exceeds or it's equal to two thirds of the total strength, the number of remaining directors, that is to say, the number of directors who are not interested present at the meeting being not less than two shall be the quorum during such time. In this case, the quorum is 4 (i.e. $1/3^{\text{rd}}$ of 10 = $3\frac{1}{3}$ rounded off as 4). Hence the quorum was present at the time of commencement of meeting.

As a rule, in the case of a meeting of the Board of Directors, the meeting cannot transact any business, unless a quorum is present at the time of transacting the business. It is not enough that a quorum was present at the commencement of the business.

The quorum of the Board is required at every stage of the meeting and unless a quorum is present at every stage, the business transacted is void. (*Balakrishna V. Balu Subudhi AIR 1949 pat 184*).

In the given situation four items were transacted with the quorum and thus they are valid. Six items were transacted after 4 Directors left the meeting resulting in the reduction of quorum as only 3 Directors were present as against the required quorum of 4 Directors. Such six transactions are void

Question 3

Chairman of Board of Directors of ABC Ltd. came across a matter, which required the approval by way of a board resolution. In the prevailing circumstances, it is not possible to convene and hold a Board Meeting. The Chairman approaches you to advise him of the way and the relevant procedure to obtain such approval without holding the Board Meeting. You are required to advise him on the matter as per the provisions of the Companies Act, 1956.

(5 Marks) (June 2009)

Answer

As per the provisions of the Companies Act, 1956 several Board Resolutions are required in course of carrying on the affairs of a limited company. But, it may sometimes so happen that a Board Meeting can not be held. To meet such eventualities, the Companies Act, 1956 contains the solution in Section 289. According to this section, the board resolution can be passed by way of circulation. It may, however, be noted that the matters listed in the provisions of Section 292 requiring passing of resolution at the board meetings only can not be passed by way of circulation.

The chairman of ABC Ltd. is advised that the approval in the form of a Board Resolution may be obtained by way of passing the relevant resolution by circulation if the matter is not covered by Section 292 of the said Act.

Assuming that the present resolution required to be passed is not falling within the items listed in Section 292 of the said Act, the resolution can be passed by circulation.

The procedure to be adopted for the purpose of passing a resolution by circulation is as follows:-

- (i) Send the draft of the resolution in duplicate together with the necessary papers, if any, to all the directors then in India. It is to be ensured that the number of such directors is not less than the directors required to form the quorum for a Board Meeting.
- (ii) Send that draft of the resolution in duplicate together with the necessary papers, if any, to all other directors at their usual address in India.
- (iii) Obtain one copy of the draft resolution duly signed by the directors, whether approving the resolution or disapproving the same. It may be noted that the resolution shall be deemed to be passed by the Board if all the directors then in India or majority of all directors as are entitled to vote on the matter approve the resolution by signing one copy and returning the same to the company.
- (iv) The resolution passed by circulation shall be placed before the next Board Meeting for confirmation.
- (v) The resolution shall be recorded in the minutes of the next Board Meeting.

Question 4

ABC Ltd. has 12 directors on its Board and has the following clause in its Articles of Association:

"The questions arising at any meeting of the Board of Directors or any Committee thereof shall be decided by a majority of votes, except in cases where the Companies Act, 1956 expressly provides otherwise."

In one of the meetings of the Board of Directors of ABC Ltd., 8 directors were present. After completion of discussion on a matter, voting was done. 3 directors voted in favour of the motion, 2 directors voted against the motion while 3 directors abstained from voting.

You are required to state with reference to the provisions of the Companies Act, 1956 whether the motion was carried or not. It is clarified that the motion being voted upon was not concerning a matter which requires consent of all the directors present in the meeting.

(5 Marks) (June 2009)

Answer

Regulation 74(1) of Table A of Schedule 1 to the Companies Act, 1956 provides that save as otherwise expressly provided in the Companies Act, 1956, questions arising at any meeting of the Board shall be decided by a majority of votes.

In the problem given in the question, the similar article exists in the Articles of Association of ABC Ltd. In the given case, only 8 directors out of a total strength of 12 directors are present and out of those 8 directors present only 5 directors have exercised their votes. In such a case, only those directors who are present and vote on a motion are considered for determining whether the motion is carried or not. That means out of the 5 directors who voted on the motion are to be considered.

Accordingly, since number of directors who voted in favour of the motion being 3, is higher than the number of directors who voted against the motion being 2, the motion is carried or is considered to be passed by majority.

Question 5

Examine the validity of the following with reference to the relevant provisions of the Companies Act, 1956 and/or decided case laws:

The Articles of Association of Big Limited provide that a meeting of the Board of Directors of the company shall be held at 11.00 A.M. on the last day of every quarter ending 31st March, 30th June, 30th September and 31st December. Relying on such a clause in the Articles, the company did not send notices to the directors in respect of the board meeting held on 30th September, 2008. Some of the directors have questioned the validity of the board meeting on the ground that individual notices have not been sent to the directors. (5 Marks) (June 2009)

Answer

If the articles of association of Big Limited provides that a meeting of the board of directors shall be held on the last day of each quarter, it is not necessary that separate notices are required to be served on the directors. It was held in the case of *Arunachalam Chettlar vs. Kaleswarar Mills Ltd.* [(1956) 26 COMP. CAS. 431] that where articles of the company provide that there will be a meeting of the board of directors on the first Saturday of every month, there will be no necessity of service of notice to individual director and such clause in the articles of association is sufficient compliance of Section 286(1) of the Companies Act, 1956. In view of the said judgement the clause in the article is sufficient compliance of the requirement of sending the notice for a board meeting and the contention of some of the directors is not legally valid. However, as a good secretarial practice, notice for every board meeting should be sent to all the directors eligible to receive the notice.

Question 6

LMB Ltd., Kolkata is a multiproduct manufacturing company having paid up capital of ₹ 5.00 crores. In order to increase the product portfolio, the said company intends to procure certain machines and equipments worth ₹ 1.00 crore from a partnership firm, namely, M/s. MLPK, in which the son of managing director of LMB Ltd. is a partner. The contract for purchase of said machines and equipments is to be placed the Board of Directors of the company for its consideration.

In view of above facts, you are required to explain briefly the procedure under the provisions of the Companies Act, 1956 to be followed by LMB Ltd. to enter into the said contract.

(5 Marks)(June 2009)

Answer

As per provisions of Section 297 of the Companies Act, 1956, when a company enters into a contract in which some of the directors are interested, then consent of the Board of Directors of the

company is required to be obtained. In the present case since the Managing Director of LMB Ltd is interested in the contract for the purchase of machines and equipments because of his son's partnership in the supplier firm, the same should be approved by the Board of Directors of the company.

Proviso to Section 297(1) of the said Act states that in the case of a company having a paid-up share capital of not less than rupees one crore, no such contract shall be entered into except with the previous approval of the Central Government. Since the paid up capital of LMB Ltd. is ₹ 5.00 Crores the company is required to take prior approval of the Central Government.

For this purpose, following steps are required to be taken:

- (i) Hold a board meeting and place the terms of the contract for consideration. The Managing Director should disclose the nature of his interest as required under section 299 of the Companies Act, 1956.
- (ii) The managing director should not participate in discussion when in the board meeting, the matter in respect of the above mentioned contract is being discussed. He must not also vote on the relevant resolution. Moreover, his presence shall also not be counted for determining the quorum of the board meeting. (Section 300 of the Companies Act, 1956)
- (iii) The consent of the Board of Directors must be accorded by way of resolution and not otherwise.
- (iv) An application to the Central Government (by delegation to Regional Director) should be made in prescribed form (Form No. 24A). Following enclosures should be made with the said form:
 - (a) A certified true copy of the board resolution approving the contract.
 - (b) A copy of the proposed agreement
 - (c) A copy of the Memorandum and Articles of Association of the company.
 - (d) A copy of latest audited annual accounts with directors' and auditors' reports thereon
 - (e) Bank draft or treasury challan evidencing the payment of prescribed fees.
- (v) Necessary entries are to be made in Register of Contracts (Section 301).

On receiving the approval from the Central Government (Regional Director), the company can proceed to enter into the contract for supply of machines and equipments with the firm M/s MLPK in which the son of Managing Director is a partner.

Question 7

Proximo Limited has 9 Directors out of whom 3 Directors have gone abroad. The Chairman had an urgent matter to be approved by the Board of Directors which could not be postponed till the next Board meeting. The Company, therefore, circulated the resolution for approval of the Directors. 4 out of 6 Directors in India approved the resolution. The Company claimed that

the resolution was passed. Examine with reference to the provisions of Section 289 of the Companies Act, 1956 the validity of the resolution. (5 Marks) (Nov 2009)

Answer

Passing of Resolution by Circulation: According to Section 289 of the Companies Act, 1956, a resolution by circulation shall not be deemed to have been passed, unless the resolution has been circulated in a draft, together with the necessary papers, if any to all the directors then in India (not less in number than the quorum fixed for a meeting of the Board) as the case may be, and all other directors at their usual addresses in India, and has been approved by such of the directors as are then in India or by majority of such of them, as are entitled to vote on the resolution. In this case, the resolution has been approved by 4 directors out of 6 in India; the majority of total number of directors who were entitled to vote was 5 as against 4 directors who approved the resolution. Thus both the alternate conditions were not fulfilled. The resolution cannot be deemed to have been passed.

Question 8

Premier Machineries Limited having a paid-up share capital of ₹ 90 lakhs proposes to enter into a contract with the following parties for supply of components with effect from 1st January, 2008 for a period of 3 years:

- (a) *XYZ Metal Forging Private Limited in which Mr. John, a Director of Premier Machineries Limited, is a Director and member.*
- (b) *ABC Casting Limited in which Mr. Philips, a Director of Premier Machineries Limited, holds 30% of the paid-up share capital.*

The capital of Premier Machineries Limited was increased to ₹ 1.50 crores on 1st January, 2009 by issue of further shares.

Briefly discuss the legal requirements to be complied with under the Companies Act, 1956 to give effect to the above proposals taking into account the increase in the paid-up share capital as on 1st January, 2009. (5 Marks) (Nov 2009)

Answer

- (i) Under section 297 of the Companies Act, 1956 as Mr. John, a director of Premier Machineries Ltd. is interested in XYZ metal Forging Private Ltd. as a director and a member of the Company, a resolution in the meeting of the Board of Directors is required to be passed before entering into a contract with XYZ Metal Forging Private Ltd. If due to urgency it is not possible to pass a Board resolution before entering into the contract, the requisite consent of the Board shall be obtained within three months of the date on which the contract was entered into under Section 299, Mr. John must disclose his interest to the Board and not participate in the said meeting/deliberations.

Since the paid up capital of the Company is ₹ 90. lakhs, approval of the Central Government is not necessary. In this case, the paid up capital was increased to ₹ 1.50.

crore subsequent to the date of entering the contract. No approval of the Central Government will be required as on the material date of entering into the contract, the paid up capital was less than ₹ 1 crore.

- (ii) Section 297 does not cover cases of Public Limited Companies, hence aforesaid approvals will not be necessary. In both the cases the interested directors must make disclosure of interest as required under section 299 and also comply with section 300. Entries are also required to be made in the Register of Contract under section 301.

Question 9

A company proposes to appoint a Sole Selling Agent for its products. State the cases in which such appointment requires approval of Central Government. Draft a Board Resolution to appoint a sole selling agent in a case where such appointment does not require approval of Central Government.
(5 Marks)(Nov 2009)

Answer

Appointment of sole selling agents: Under Section 294AA of the companies Act, 1956, in following cases, appointment of sole selling agents will require approval of Central Government:

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

Board Resolution

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

INSPECTION AND INVESTIGATION

Question 1

An inspector was appointed under Section 235 of the Companies Act, 1956 to investigate the affairs of a public company. Mr. WM, the works manager of the company, who is aware of certain misdeeds of the management, desires to know whether he is entitled to any protection against dismissal by the company, if he discloses the misdeeds during the course of examination by the inspector. Advise him explaining the relevant provisions of the Companies Act, 1956.

(5 Marks)(Nov 2008)

Answer

Protection of employees during investigation: Section 635B of the Companies Act, 1956 protects against dismissal, discharge, removal etc. of the employees of the company under investigation who makes disclosure during the course of investigation. The Section provides that if during the course of investigation under Section 235, 237 etc, the Company proposes to discharge any employee from service or punish him by way of dismissal removal or reduction in rank, then the Company must send to Company Law Board/Tribunal a previous intimation in writing of the action proposed to be taken against the employee. If the Company Law Board has any objection to the proposed action, it must send a notice there of to the employer. The Company Law Board is not bound to hear the company or any other person before issuing the notice (*Ashoka Marketing Ltd Vs CLB (1968) 38 Com Cases 5/9 Calcutta*) If the company does not receive any notice of objection from the Company Law Board within 30 days of sending of the intimation when the company may proceed to take the proposed action against the employee.

If the company is dissatisfied with the objection raised by Company Law Board, it may, within 30 days of the receipt of notice of the objections prefer an appeal to the Court/appellate tribunal in the prescribed manner. The decision of the Court on such appeal shall be final and binding on the Company Law Board and on the company. The works manager in this case is entitled to this protection under Section 635 B.

Question 2

The report submitted by the inspector appointed under Section 235/237 of the Companies Act, 1956 to investigate the affairs of a Company revealed that substantial funds of the Company have been misappropriated by the Managing Director of the Company. The Central

Government is of the opinion that effective action may not be taken the company for recovery of the funds misappropriated by the Managing Director. Examine with reference to the provisions of the Companies Act, 1956 the action that can be taken by the Central Government for recovery of damages or funds misappropriated by the Managing Director.

(5 Marks) (June 2009)

Answer

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

Question 3

Mr. Ramesh and his supporters hold more than 50% of the equity share capital of Progressive Realtors Ltd. Dissatisfied with the performance of the company, Mr. Ramesh sends a notice to the Board of Directors about his intention to inspect the account books of the company. Explain the provisions of the Companies Act, 1956 regarding the persons who can inspect the books of account and the right of Mr. Ramesh in this matter.

(5 Marks) (May 2010)

Answer

Inspection of books of account – By Whom? In accordance with the provisions of the Companies Act, 1956, as contained in section 209A, the following persons can inspect the books of account of a company.

- (i) Directors of the company
- (ii) Registrar of Companies
- (iii) Such officer of Government as may be authorized by the Central Government in this behalf.
- (iv) An Officer of Securities Exchange Board of India has also power to carry out in respect of matters covered under section 55A dealing with listed companies.

Mr. Ramesh cannot exercise the power to carry out the inspection even though he and his supporters hold more than 50% of the equity share capital of the company. It is, however, possible

for Mr. Ramesh and his group to come into the management by occupying the posts of directors by virtue of shareholdings and then inspect the books of account of the company.

Question 4

XYZ Ltd. was registered in the year 2005 under Companies Act, 1956. There are allegations that the three directors who manage the affairs of the company are siphoning the funds of the company. The company has not declared any dividends on the ground that company is incurring losses. Mr. A, who controls 51% of the share capital of the company sends a notice to the management that he will inspect the books of account to verify the allegations. Examine the right of Mr. A to carry out the inspection. State the persons who have the right to carry out the inspection under the Companies Act, 1956. (5 Marks) (May 2011)

Answer

Right to carry out the inspection of the books of accounts: Mr. A has no right to carry out an inspection of the books of accounts of the company despite the fact that he holds 51% of the share capital of the company and can be called the 'owner' of the company. According to Sections 209 and 209A of the Companies Act, 1956, the following persons have the right to carry out the inspection of the books of accounts of the company.

- (i) Directors of the Company [Section 209(4)]
- (ii) Registrar of Companies [Section 209A]
- (iii) Such officer of Government as may be authorised by the Central Government in this behalf (Section 209A).
- (iv) Such officers of SEBI as may be authorised by SEBI [Section 209A (1) (iii)] read with Section 55A.

Since Mr. A is not a director, he is not eligible to carry out the inspection.

Note: According to Regulation 95, of Table A, Companies Act, 1956, a member has right to inspect the books of accounts if he is so authorized by a resolution of the Board of Director or a resolution passed by the company in general meeting. According to this, the members have right to inspect the books of account.

COMPROMISE, ARRANGEMENTS AND RECONSTRUCTIONS

Question 1

A scheme of amalgamation was approved by overwhelming majority of members of both the merging companies. The exchange ratio was fixed by a firm of reputed Chartered Accountants. When the scheme of amalgamation was awaiting sanction of the court, a small group of members of one of the merging companies raised objection on the ground that the exchange ratio was unfair. Examine with reference to decided case law whether the objection is likely to be sustained. What would be your answer in case similar objection was raised by the Central Government?
(5 Marks) (Nov 2008)

Answer

Exchange Ratio: Courts leave the aspect of share valuation to expert valuers and shareholders. Unless the person who challenges the valuation satisfies the court that the valuation is grossly unfair, the court will not disturb the scheme (*Piramal Spg Vs Weaving Mills Ltd*). In this case the valuation is confirmed to be fair by eminent firm of auditors and is also confirmed by majority of members. The objection of the some by small group of shareholders cannot be sustained as held in *Hindustan Lever Employees Union Vs Hindustan Lever Ltd*.

Section 394A of the Companies Act, 1956 requires the Court (Tribunal) to give notice of every application made to it under Section 391 or 394 to the Central Government. The Court (tribunal) should take into consideration the representations if any made to it by that Government before passing any order. The role played by the Central Government is that of an impartial observer who acts in public interest and advises the Court (tribunal) whether it is or it is not feasible for the two companies to amalgamate (*Ucal Fuel Systems Ltd Sure*). But the court is not bound to accept the views of the Central Government. Thus objection of the Central Government as regards valuation of shares was rejected by the Court (Tribunal), in the face of views expressed by two independent chartered accountants (*M.G Investments & Industrial Co. Ltd Vs New Shorrock spinning & Mgf Co. Ltd*). Hence even in the case of representation bay Central Government, unless that Government establishes that the exchange ratio was unfair and not in public interest, the court will refuse to interfere.

Question 2

Answer the following explaining the relevant provisions of the Companies Act, 1956:

- (1) *Whether the Companies being amalgamated must be Companies registered under the Companies Act, 1956.*
- (2) *Whether the Companies seeking sanction of the court for a scheme of amalgamation must have specific power to amalgamate in the object clause of their Memorandum of Association.* (5 Marks) (Nov 2009)

Answer

Amalgamation: A scheme of compromise or arrangement may provide for amalgamation of companies under section 394 of the Companies Act, 1956. Section 394(4)(b) defines the 'transferor' and 'transferee' companies. While the 'transferee' company does not include any company other than a company within the meaning of the Companies Act, 1956, the transferor company includes any body corporate, whether a company within the meaning of the Companies Act or not. 'Body Corporate' includes a company incorporated outside India [(section 2(7))]. Hence transferor company may be a company incorporated outside India, but transferee company must be a company incorporated under the Companies Act, 1956.

Usually the Memorandum of Association of a company contains in its object clause the power to amalgamate. But, in a number of cases it has been held that it is not necessary to have in the memorandum of association a specific power to amalgamate with another company. The provisions of Section 391/394 of the Companies Act, 1956 indicate the scope of the statutory power for amalgamating a company with another company despite the absence of any specific enabling provision in their memoranda. (*Aimco Pesticides Ltd, Feedback Reach Consultancy Pvt Ltd., Sir Matturdas Vissaji Foundation in re*). Hence even companies not having specific power to amalgamate in their Memoranda can seek sanction of the Court for a scheme of amalgamation.

Question 3

A scheme of reconstruction of Southern Stone Company Limited was approved by its shareholders and creditors in their meeting and resolutions to that effect were passed. Afterwards a few shareholders and creditors of the company raised objections against the said arrangements of reconstruction. The entire paid up capital of the company was wiped out by the accumulated losses. Advise the Directors of the said company about the steps to be taken, to give effect to the proposed scheme under the Companies Act, 1956. (5 Marks) (May 2010)

Answer

Scheme of Reconstruction: Since the company in question is a sick company and therefore can be considered as a company liable to be wound up within the meaning of Section 390 of the Companies Act, 1956. The proposed scheme involves a compromise or arrangement with members and creditors and attracts Section 391 of the Act. An application to be submitted before

the High Court under Section 391 of the Act. On such application the court may order that a meeting of creditors and/or members be called and held as per the directions of the court.

The company must send notice of meeting to every creditor/member containing a statement setting forth the terms of compromise explaining its effects. At the meetings convened as per directions of the court majority in number representing at least $\frac{3}{4}$ in value of creditors/members present and voting must agree in compromise or arrangements. Thereafter the company must present a petition to the court for confirmation of the compromise or arrangement.

The notice of application made by the company will be served on the Central Government and the court will take into consideration representation, if any, made by the Central Government (Section 394A). The Court will sanction the scheme, if satisfied, after consideration of all relevant matters. Copy of order issued by the court must be filed with the Registrar of Companies and then only the order will come into effect. Copy of the said order must be annexed to Memorandum of Association issued thereafter. The scheme sanctioned by the court shall be binding on all members and creditors even on those who were dissenting.

Notes:

1. The powers under section 391 are still exercised by the High Courts and the National Company Law Tribunal is yet to be constituted.
2. In the given case, it is presumed that the company passed a resolution on its own, not on the directive given by the High Court. The company has to file a petition before the High Court for approval of the scheme and comply with all the conditions as specified in section 391. After approval by the High Court, the scheme shall be binding on the creditors, members and also on the company.

Question 4

The members of both Sugam Synthetix Limited and Gaurav Textiles Limited approved the schemes of amalgamation by overwhelming majority. A reputed firm of Chartered Accountants fixed the exchange ratio. The scheme of amalgamation was submitted, as per procedure, for the sanction of the Court. During pendency of the matter a small group of members of one of the merging companies objected to the amalgamation on the ground that the exchange ratio was unfair.

Decide whether the said objection is likely to be sustained. Would your answer be different if similar objection was raised by the Central Government? (8 Marks) (May 2011)

Answer

Amalgamation – Exchange Ratio: In the matter given in the question, the court leaves the aspect of share valuation to expert valuers and shareholders. Unless the person who challenges the valuation satisfies the court that the valuation is grossly unfair, the court will not disturb the scheme of amalgamation. (*Piramal Spg. Vs. Weaving Mills Ltd.*)

In this case, the valuation is confirmed to be fair by reputed firm of Chartered Accountants and is also confirmed by majority of members. The objection raised by some shareholders of a small group cannot be sustained. (*Hindustan Lever Employees Union Vs. Hindustan Lever Ltd.*)

Section 394A of the Companies Act, 1956 requires the Court (Tribunal) to give notice of every application made to it under Sections 391 or 394 of the said Act, to the Central Government. The Court (Tribunal) should take into consideration the representations, if any, made to it by the government before passing any order. The role played by the Central Government is that of impartial observer who acts in public interest and advises the court (Tribunal) whether it is or it is not feasible for the two companies to amalgamate. Thus, in case of objection by the Central Government, the court will refuse to interfere unless the Government establishes that the exchange ratio was unfair and not in public interest. (*M.G. Investment & Industrial Co. Ltd. Vs. New Shorrock Spinning & Mfg. Coi. Ltd.*)

PREVENTION OF OPPRESSION AND MISMANAGEMENT

Question 1

The issued, subscribed and paid up capital of OPM Limited is ₹ 5 crores consisting of 50,00,000 equity shares of ₹ 10 each. The company has 700 members. A petition was made to the appropriate authority duly signed by 80 members holding 2,50,000 equity shares of the company seeking relief against oppression and mismanagement. Subsequently 20 of them withdrew their consent. Examine with reference to the relevant provisions of the Companies Act, 1956 and decided case law whether the petition is maintainable. (5 Marks) (Nov 2008)

Answer

Members eligible to make petition seeking relief under Section 397 and 398: The requisite number of members who must sign the application under Sections 397 and 398 is given in Section 399 of the Companies Act, 1956. In the case of a company having a share capital, the application must be signed by, (i) atleast 100 members or, (ii) by at least 1/10th of total number of members, whichever is less. In the alternative valid application may be made by any members holding not less than 1/10th of the issued share capital of the company.

In this case the application was made by 80 members and it is more than 1/10th of total number of members. Hence the application is valid at the time of presentation. The number of members required for the purpose of making a petition is 70. Subsequently 20 members withdrew their consent and the number of members continuing to give their consent is reduced to 60.

It was held in *Rajahmundry Electric Supply Corporation Ltd. Vs A. Nageswara Rao* that the validity of a petition must be judged on the facts as they were at the time of its presentation and where a petition was valid when it was presented, it could not cease to be voidable by reason of events subsequent to its presentation. In view of this Supreme Court decision, it can be said that withdrawal of consent by 20 members subsequent to the presentation of application would not affect the validity of the petition.

Question 2

State the conditions which must be satisfied before filing a petition under Section 397 of the Companies Act, 1956 for prevention of oppression. (5 Marks) (June 2009)

Answer

The conditions which are required to be satisfied before filing a petition under Section 397 of the Companies Act, 1956 can be enumerated as follows:

- (i) An application under the said Section 397 can be made only by the members. In the case of a company having share capital minimum one hundred members or one-tenth of total number of member of the company, whichever is less; or a member or members holding not less than 10% of the paid up capital of the company can file such petition. In case of a company not having share capital, minimum one-fifth of the total number of members of the company are required for the purpose. However, Central Government may authorise any lesser number of members to file such petition.
- (ii) It must be established that the affairs of the company are being conducted in a manner (a) oppressive to any member/members of the company or (b) prejudicial to public interest.
- (iii) The oppression complained of must affect a person in his capacity as a member of the company. Rights and interests as a member of a company can only be agitated and not in relation to any commercial relation that a member has with the company as was decided by the Company Law Board in the case of *Anil Gupta vs. Mirai Auto Industores Ltd.* [(2003)113 COMP. CAS.63].
- (iv) The acts complained of must be continuing acts of oppression. The acts constituting oppression must continue till the date of making the application.
- (v) The applicant must make out a prima facie case that the degree of oppression is so severe that there is just and equitable ground for winding up of the company. But at the same time, it must also be established that the winding up of the company would not unfairly prejudice the applicant.
- (vi) It may be noted that ex-pression "issued share capital" in section 399(1) includes both the preference and equity share capital.

Question 3

A group of members of XYZ Limited has filed a petition before the Company Law Board alleging various acts of oppression and mismanagement by the majority shareholders of the Company. The Petitioner group holds 12% of the issued share capital of the Company. During the pendency of the petition, some of the petitioner group holding about 5% of the issued share capital of the Company wish to disassociate themselves from the petition and they along with the other majority shareholders have submitted before the Company Law Board that the petition may be dismissed on the ground of non-maintainability. Examine their contention having regard to the provisions of the Companies Act, 1956. (5 Marks) (Nov 2009)

Answer

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

Question 4

Certain Members of MDV Company Limited having share capital feel that the affairs of the company are being mismanaged by Directors. Members therefore, decide to move the Company Law Board, complaining the mismanagement of company affairs by Directors of the Company. Examine the provisions of the Companies' Act, 1956 and state

- (i) *Whether members are entitled to complain the Company Law Board.*
- (ii) *Whether the following acts of the Board, of Directors amount to mismanagement:*
 - (A) *Continuation of Directors in their office after expiry of their tenure and infighting continues among them.*
 - (B) *Non-declaration of dividend when it does not lead to devaluation of shares.*

(8 Marks) (Nov 2010)

Answer

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

Conditions Precedent:

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

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

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

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

REVIVAL AND REHABILITATION OF SICK INDUSTRIAL COMPANIES

Question 1

What is meant by a "Sick industrial company" under the Companies Act, 1956? Whether the provisions of the Companies Act, 1956 relating to "Sick industrial company" are applicable to Government companies.
(5 Marks) (Nov 2008)

Answer

SICK INDUSTRIAL COMPANY: "Sick Industrial Company means an Industrial Company which has (i) the accumulated losses in any financial year equal to fifty percent or more of its average net worth during four years immediately preceding such financial year or (ii) failed to repay its debts within any three consecutive quarters on demand made in writing for its repayment by a creditor or creditors of such company (Section 2(46AA) of the Companies Act, 1956). The term used is creditor and hence if any creditor (secured or unsecured) is not paid for 9 months despite demand made by him, the company will be a sick industrial company.

Section 424A (1) of the said act which provides for making a reference to Tribunal shall not apply to a Government Company. However a Government Company may, with the prior approval of the Central/State Government, make a reference to Tribunal and thereafter all the provisions of the Act shall apply to such Government Company.

CORPORATE WINDING UP AND DISSOLUTION

Question 1

Under what circumstances shall it be deemed that the substratum of a company has gone? A company has ceased to carry on two of the ten business stated as the main objects of the company. Examine whether the company can be wound up on the ground that substratum of the company is gone.
(5 Marks) (Nov 2008)

Answer

LOSS OF SUBSTRARUM OF A COMPANY AND THE WINDING UP: A company's substratum is the purpose or the main object, for which the company was formed. If the company has abandoned all of its main objects and not merely some of them, or if it cannot achieve any of its main objects, its substratum has gone and will be wound up by the Tribunal.

In *Re German Date Coffee Co.*, Where a company was formed for the purpose of coffee from dates under a patent which was to be granted by the Government of Germany. The German patent was never granted. On a petition of a shareholder it was held that the substratum of the company had failed and it was impossible to carry on the object for which it was formed. Therefore, it was just and equitable that the company be wound up.

In other words the substratum of a company is deemed to have disappeared or gone, if the main objects for which the company was formed has become impracticable, i.e. permanently impracticable. Usual tests for determining whether the substratum of the company has disappeared are whether:

the subject matter of the company is gone, or

the object for which it was formed has substantially failed, or

it is impossible to carry on the business of the company except at a loss, which means there is no reasonable hope that the object of trading at a profit can be attained, or the existing and probable assets are insufficient to meet the existing liabilities. (*In re Kaithal & General Mills Co. Ltd.*, 1951, 31, Comp. Cas. 461.)

Therefore, applying the above to the given situation in the question it can be said that in this case the substratum of the company cannot be said to have gone, since there are other businesses authorized by the Memorandum which can be carried out successfully. A company, therefore,

cannot be wound up on the ground that it has ceased to carry on two of the 10 business authorized by the Memorandum of Association. (*Re Amalgamated Syndicate (1897)*).

Question 2

M/s Raman Ltd. was wound up by the Court. The official liquidator invited claims from its creditors which stood as under:

Income tax dues	₹ 11 lakhs
Sales tax dues	₹ 5 lakhs
Dues of workers	₹ 25 lakhs
Unsecured loans payable to directors	₹ 25 lakhs
Trade creditors who supplied raw material	₹ 15 lakhs
Secured creditor being the bankers of the company	₹ 75 lakhs
	₹ 156 lakhs

Official Liquidator could realize only ₹ 80 lakhs by sale of assets and realizations made from the company's debtors, which is not sufficient to pay to all the creditors. Please decide the order of priority for payment to creditors explaining the relevant provisions of the Companies Act, 1956. (5 Marks) (Nov 2009)

Answer

Under section 529A of the Companies Act, 1956, (i) workmen's dues, and (ii) debts due to secured creditor shall be paid in priority of all debts, and shall be paid in full, unless the assets are insufficient to meet them, in which case they shall abate in equal proportions.

Income tax dues and sales tax dues are preferential creditors under section 530 of the Act, and subject to the provisions of section 529A, the same may be paid in priority to the claims of unsecured creditors.

In the present case, the available funds are only to the extent of ₹ 80 lakhs which will be distributed amongst the secured creditor and workmen in proportion to their dues, as follows:

Workmen

(1/4th of ₹ 80 lakhs) : ₹ 20 lakhs

Secured creditor

(3/4th of ₹ 80 lakhs) : ₹ 60 lakhs

As such, the dues of preferential creditors (namely, Income tax and sales tax dues) and unsecured creditors (unsecured loan and trade debtors) cannot be paid any amount.

Question 3

Ganesh Textiles Private Limited has discontinued its Business since 2006. Negligible assets are available with the company, but also some liabilities. The company has been regular in

filing Annual Returns and Balance Sheets. The Director of the Company propose to apply to the Registrar of Companies for striking the name of the company on the ground that it is a defunct company.

Advise, as to what steps can be taken to get the name of the company struck off under the provisions of the Companies Act, 1956. (5 Marks) (May 2010)

Answer

Striking off defunct company: In the given case Ganesh Textiles Private Ltd. is required to follow the established procedure to enable the Registrar to remove the name of the company under Section 560 of the Companies Act, 1956. For this purpose, an application accompanied with the following documents be submitted to the Registrar of Companies:

1. An affidavit of at least two directors including that of the Managing Director or Whole Time Director to the effect that the company has no assets or liabilities as on date and the company has not been carrying on any business during the last one year or more.
2. Latest audited balance sheet and profit and loss account of the company.
3. An indemnity bond from the aforesaid directors to the effect that the liabilities of the company if any will be met by them even after the name of the company is struck off.

In view of the above, Ganesh Textiles Private Limited must first take steps to realize all the assets and pay all the liabilities and make it nil. Thereafter the company may apply to the Registrar of Companies alongwith "nil" balance sheet, affidavit and indemnity bond. After making necessary inquiry, the Registrar will publish notice in the Official Gazette that the name of the company has been struck off. Under Section 560(5) of the said Act, the company shall stand dissolved from the date of publication of notice in the Official Gazette.

Question 4

Mr. X is an unsecured creditor and has to recover a sum of ₹ 7 lakhs from Global Footwear Company Limited. The said company has become financially insolvent and hence unable to pay its debts. With the object of recovery of the said amount Mr. X is willing to proceed for compulsory winding up of the company. Advise the steps and procedure in this relation under the provisions of the Companies Act, 1956. (5 Marks) (May 2010)

Answer

Procedure in case of Compulsory Winding-Up: Mr. X has to take the following steps to put the company into compulsory winding up:

1. A petition for winding up of the company is to be filed in the High Court, where the registered office of the company is located under section 439(l)(b) read with section 433(e) and (f) of the Companies Act, 1956. A copy of the petition should be served on the company.
2. The petition should be filled along with an affidavit showing sufficient ground for the

appointment of a provisional liquidator till an order is passed by the High Court appointing an official liquidator (Rule 106 of the Companies (Court) Rules 1959).

3. After obtaining the winding up order from the high court the same should be advertised within 14 days in a newspaper in English language and in the regional language of the state where the company is registered (Rule 113 of the Companies (Court) Rules, 1959).
4. A certified copy of the winding up order passed by the court should be filed with the concerned Registrar of Companies along with the prescribed fees within 30 days from the date of the winding upto order (Section 445(i)).
5. If the shares of the company are listed in a stock exchange, copy of the petition along with the order may be filed with the stock exchange.
6. The winding up proceedings will be carried out by the official liquidator till dissolution of the company.

Question 5

In relation to winding up of a company incorporated under the Companies' Act 1956; explain clearly the meaning of the term 'overriding preferential payments'. Examine the provisions of the Companies Act and decide whether the following debts of a company under the winding up shall be 'Preferential payments' and shall be paid in priority to the claim of unsecured creditors:

- (a) Wages amounting to ₹ 30,000/- (Rupees Thirty thousand) only of an employee for services rendered for a period of 8 months within the preceding 12 months next before the relevant date.
- (b) ₹ 1 lac due to an employee from Provident Fund and ₹ 50,000/- towards gratuity.
- (c) ₹ 20,000/- payable by the company on account of expenses incurred in respect of investigation held under Section 235 of the Companies' Act, 1956. (8 Marks) (Nov 2010)

Answer

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

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

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

of it shall be the preferential payment.

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

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

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

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

Question 6

Define "contributory" in a winding up. Explain the liabilities of contributories as present and past member. (8 Marks) (May 2011)

Answer

Contributory: According to Section 428 of the Companies Act, 1956 in a winding up, the term "contributory" means a past or present member liable to contribute to the assets of the company in the event of its being wound up and includes holders of shares which are fully paid up. If a member is once placed in the list of contributories, he is liable to the extent of original shares that remain unpaid, unless he proves that he should not have been placed in the list.

When a company goes into liquidation, every member, whether past or present, has to contribute to the assets of the company. However, a past member will not be required to contribute in the following circumstances:

- (a) if he had ceased to be a member for a period of one year or upwards before the commencement of winding up.
- (b) if the debt or liability of the company was contracted or incurred after he ceased to be a member.
- (c) if the present members are able to satisfy the contributions required to be made by them under the Act.

Question 7

The Registrar of Companies, Mumbai filed a petition in the Bombay High Court for compulsory winding up of 'Constant Overtrading Ltd' on the ground that a perusal of the Balance Sheet of the company as at 31-03-2009 revealed that its liabilities far exceeded the assets and consequently the company is unable to pay its debts. Examine with reference to the provisions of the Company Act, 1956, the various factors the High Court will take into account before the

company is ordered to be wound up compulsorily and whether there is any justification in the present case for the Court to order winding up of the company. (8 Marks) (May 2011)

Answer

Compulsory Winding Up: In the case law *Registrar of Companies Punjab vs. Ajanta Lucky Scheme and Investment Co. Private Ltd.*, the Registrar of Companies filed a petition for the winding up of the respondent company under Section 433 (e) read with Section 439(5) of the Companies Act, 1956 on the ground that the Company was unable to pay its debts and that its liabilities exceeded its assets. In the said case it was held by the Court that for determining the Company's ability or otherwise to pay its debts, it was to be considered whether the company was able to meet its liability as and when they accrued due. Section 434 of the Act, prescribes the circumstances in which a company was to be treated as unable to pay its debts. Admittedly none of these circumstances was present in the said case and no complaint had even been received by the company from its creditors as regards non-fulfilments of any of their claims against the company. In a case where no debt had been due, a demand, therefore, could not be made. The mere fact that certain liabilities might accrue due in further, which could exceed the existing assets of the company, would not necessarily lead to the conclusion that the company would be unable to meet its liabilities when they accrued due. The mere fact that the Company's liabilities being in excess of its assets could not *ipso facto* be a ground for putting the company into liquidation. The test would be that the company should be commercially solvent i.e., the company ought to be in a position to meet its liabilities as and when they arose.

Thus in the present case, the Bombay High Court may not order the winding up of the Company viz. Constant Overtrading Ltd. Merely because its liabilities far exceeded the assets of the Company. The Court will take into account whether the company has failed to meet any of the demands made by the creditors etc.

PRODUCER COMPANIES

Question 1

A producer company wants to amend its Memorandum and Articles of Association. The director of the company approaches you for advice in this regard. Advise the director about the procedure to be followed for amending the Memorandum and Articles of Association of the company.
(5 Marks) (Nov 2008)

Answer

Amendment of Memorandum of a producer company (Section 581H): A producer company shall not alter the conditions contained in its memorandum except in the cases by the mode and to the extent for which express provision is made in the Act. However, a producer company, may, by special resolution, not inconsistent with Section 581B alter its objects specified in its memorandum. A copy of the amended memorandum, together with a copy of the special resolution duly certified by two directors shall be filed with the Registrar within thirty days from the date of adoption of resolution. Where as in case of transfer of the registered office of a producer company from the jurisdiction of one Registrar to another, certified copies of the special resolution certified by two directors shall be filed with both the Registrars within thirty days, and each Registrar shall record the same, and thereupon the Registrar from whose jurisdiction the office is transferred, shall forthwith forward to the other Registrar from whose jurisdiction the office is transferred, shall forthwith forward to the other Registrar all documents relating to the producer company. The alteration of the provisions of memorandum relating to the change of the place of the registered office from one state to another shall not take effect unless it is confirmed by the Company Law Board on petition.

Amendment of Articles (Section 581-I): Any amendment to the articles should be proposed by not less than two third of the elected directors or by not less than one third of the members of the producer company and adopted by the members by a special resolution.

A copy of the amended articles together with the copy of the special resolution, both duly certified by two directors, should be filed with the Registrar within thirty days from the date of adoption.

Question 2

A Producer Company wants to issue bonus shares. You are required to state the relevant provisions of the Companies Act, 1956 in this regard.
(5 Marks) (June 2009)

Answer

As per provisions of Section 581ZJ of the Companies Act, 1956, any Producer Company may, upon recommendation of the Board and passing of resolution in the general meeting, issue bonus shares by capitalization of amounts from general reserves referred to in Section 581ZI in proportion to the shares held by the Members on the date of the issue of such shares.

Question 3

A Producer Company has received applications from Mr. Ramanathan, a Director of the Company, and Mr. Prem, a member of the Company, for grant of loan of ₹ 2,00,000 and ₹ 25,000 respectively. Discuss the relevant provision of the Companies Act, 1956 as to how the applications for grant of loan will be disposed of by the Company. (5 Marks) (Nov 2009)

Answer

Under Section 581ZK of the Companies Act, 1956, the Board of the Producer Company may, subject to the provision in the Articles of Association, provide financial assistance by way of loan and advances against such security as may be specified in its Articles of Association to any member repayable within a period exceeding three months but not exceeding seven years from the date of disbursement of such loan or advances. In the instant case, member has applied for loan of ₹ 25,000. The period is not specified in the question. The Company may grant the member a loan of ₹ 25,000 against such security and at such rate of interest as may be specified in the Articles. However, in the case of a director, loan of ₹ 2 lakh can be granted only after its approval by the members in general meeting.

Question 4

Under provisions of Companies' Act, 1956, relating to producer company, examine whether the office of director of such company shall fall vacant in the following circumstances:

- (i) *X a Director of ABC Ltd., a producer company has made a default in payment of loan taken from a company and default continues for 60 days.*
- (ii) *Z a Director of the above company could not call the Annual General Meeting for the company due to some natural calamity occurred three days before the Schedule date.*

(4 Marks) (Nov 2010)

Answer

Producer Company - Vacation of Office of a Director:

1. According to provisions of Companies Act, 1956, as contained in Section 581Q, if the producer company in which a director has made a default in repayment of any advances or loans taken from any company or institution or any other person and such default continues for 90 days, the office of such director shall become vacant. In the given case the default on the part of X, the director continues for less than 90 (i.e. only 60 days) days, the office of director shall not fall vacant.

2. The office of director of a producer company shall become Vacant if the Annual General Meeting or extraordinary general meeting of the producer company, in which he is a director, is not called in accordance with the provisions of this Act except due to natural calamity or such other reason. In the given case since the Annual General Meeting could not be held due to some natural calamity, the office of Z, the director shall not fall vacant. This is an exception.

COMPANIES INCORPORATE OUTSIDE INDIA

Question 1

Indian citizens incorporated a company in U.K. for the purpose of carrying on business there. Examine with reference to the relevant provisions of the Companies Act, 1956 whether it is a "Foreign Company". What would be your answer in case the U.K. company was incorporated by a company registered in India?
(5 Marks) (Nov 2008)

Answer

Foreign Company: Foreign company as per Section 591 of the Companies Act, 1956 means a Company incorporated outside India but having a place of business in India. Accordingly, to qualify as foreign company a company must have both the following features:

it should be a company incorporated outside India

it should have a place of business in India

In view of the provisions of Section 591 explained above, the company incorporated in U.K. for the purpose of carrying on business in U.K. is not a foreign company. Its incorporation by Indian citizens is immaterial. In order to be a "Foreign Company" the U.K. company must have a place of business in India.

The answer would be the same, even if the U.K. company was incorporated by a company registered in India.

Question 2

A company incorporated in Singapore has established its place of business at Chennai. State the documents which are required to be furnished on such establishment of business in India under the Companies Act, 1956 and the authorities to whom such documents are to be furnished.
(5 Marks) (June 2009)

Answer

Foreign Company: A foreign company has to furnish to the Registrar of Companies the following documents within 30 days of the establishment of the place of business in India (Section 592 of the Companies Act, 1956).

(i) Certified copy of charter, statute or memorandum and articles of the company or other

instruments deferring the constitution of the company. If it is not in English Language its certified translation should be submitted.

- (ii) Full address of the registered or principal office of the company.
- (iii) List of directors and Secretary giving details like present and former name and surname, his usual residential address, nationality, business occupation etc.
- (iv) The names and address of one or more persons resident in India authorized to accept on behalf of the company, service of process and any notices or other documents required to be served on the company.
- (v) The full address of the office of the company in India which is deemed to be its principal place of business in India.

The aforesaid documents shall be required to be filed at two places first with the Registrar of the state where principal place of business (Chennai) is situated i.e. Registrar of Tamil Nadu in this case and second with the Registrar of New Delhi (Section 597).

Question 3

Examine whether the following Companies can be considered as 'Foreign Companies' under the Companies Act, 1956:

- (i) *A company which is incorporated outside India employs agents in India but has no place of Business in India.*
- (ii) *A company incorporated outside India having shareholders who are all Indian citizens.*
- (iii) *A company incorporated in India but all the shares are held by foreigners.*

(5 Marks)(Nov 2009)

Answer

- (i) As definition given Section 591(1) of the Companies Act, 1956 a Company incorporated outside India and having not established a place of business in India, is not deemed to be a Foreign Company. Thus establishing a place of business is an essential ingredient in the definition. In the given case, the company has not established a place of business in India. It will not be deemed to be a foreign company.
- (ii) A company incorporated outside India, unless it has a place of business in India will not be deemed to be a Foreign Company even though all the shareholders are Indian citizens.
- (iii) A company incorporated in India but having all foreign shareholders will be deemed to be an India Company as it is not incorporated outside India though it has a place of business in India.

OFFENCES AND PENALTIES

Question 1

Mr. X a Director of XYZ Limited received a show-cause notice from the Registrar of Companies for an offence under Section 297 (1) of the Companies Act, 1956 in respect of certain contracts entered into with the company without the approval of the Central Government. The offence is punishable with fine only under Section 629A of the Act. He seeks your advice whether he can take steps for getting the offence compounded either before or after the prosecution is launched. Advise him explaining the effect of compounding of offence either before or after institution of prosecution. (5 Marks) (Nov 2008)

Answer

Compounding of offence: The offence under Section 297(1) of the Companies Act, 1956 is punishable with fine only and as such it is compoundable under Section 621A of the said act.

An offence may be compounded either before or after the institution of prosecution in the court. The compounding of offence will act as a bar to the prosecution where the compounding was done before the institution of the prosecution. However, if an offence is compounded after the institution of any prosecution in respect of that offence, the Registrar of companies must give intimation thereof in writing to the court in which the prosecution has been instituted and upon such intimation being given the company or the officer against whom the prosecution has been launched and which offence has been compounded shall be discharged on the prosecution and the prosecution dropped. The court has no power to refuse to grant the discharge.

The effect of the compounding of an offence is thus condonation from prosecution for an offence.

Hence, Mr. X in this case can take steps for getting the offence compounded either before or after the prosecution is launched, provided a similar offence was not compounded earlier within a period of 3 years.

Question 2

Explain what is meant by (i) Compoundable Offences and (ii) Non-Compoundable Offences. State the authorities who can compound the said offences. Indicate whether the following offences are compoundable or non-compoundable:

(i) Failure to hold the annual general meeting of the company.

- (ii) *Failure to file copies of annual accounts with the Registrar of Companies.*
- (iii) *Acceptance of deposits in excess of the prescribed limits and*
- (iv) *Non-distribution of dividend to the members within the prescribed time.*

(8 Marks) (May 2011)

Answer

Compoundable and Non Compoundable Offences: Compoundable offences are those offences under the Companies Act, 1956 which can be compounded by the Regional Director if the maximum amount of fine is upto ₹ 50,000 and by the Company Law Board if the maximum amount of fine exceeds ₹ 50,000. There are certain offences punishable with imprisonment or with fine or both, which can be compounded with the permission of the Court under Section 621A (6) (a) of the Companies Act, 1956. Non-compoundable offences are those punishable with imprisonment and fine under Section 621 A (7) (b) of the Act.

- (i) Failure to hold the annual general meeting of the company is compoundable u/s 168 of the Act because there is only a monetary penalty.
- (ii) Failure to file copies of annual accounts with the Registrar of Companies is also compoundable under Section 220 (3) because there is monetary penalty only.
- (iii) Acceptance of deposits in excess of the prescribed limits is a non-compoundable offence under Section 58A (6) (a)(i) because it is punishable with imprisonment and fine.
- (iv) Non distribution of dividend to the members within the prescribed time limit of 30 days under Section 207 is also non-compoundable because it is punishable with imprisonment and also fine.

E-GOVERNANCE

Question 1

Mr. X applied to the Central Government for allotment of Director Identification Number. What are the obligations of Mr. X and the companies in which he is appointed as a director, after "DIN" is allotted to him, under the Companies Act, 1956 and the rules made thereunder?

(5 Marks) (Nov 2008)

Answer

Director Identification Number: The obligations of the person who has been allotted DIN and the company provided in Section 266D, 266E and 266F of the Companies Act, 1956 is explained below:

Every existing director shall within one month of the receipt of DIN from the Central Government intimate his DIN to the company or all companies wherein he is a director Intimation to companies from Director shall be in Form DIN-2 [Section 266D read with the Companies (Director Identification) Rules] Intimation to companies by directors in form DIN-2 may be given in physical /paper form.

Companies, in turn are required to file Form DIN-3 for sending intimation of DIN to the Registrar of Companies (online through MCA 21 portal) within one week of receipt of intimation from directors. Form No. DIN-3 is required to be verified by Managing Director or Director or Manager of the company and certified by the company secretary in full time employment of the company or company secretary in whole time practice [Section 266 E read with companies (Director Identification) Rules].

It is obligatory on the part of the company to quote DIN in any return or information furnished under the Act, if such return contains any information relating to a director (Section 266F).

Changes in the personal particulars of a director must be intimated by the concerned director to the Central Government within 30 days of the change in Form DIN-4.

Question 2

What do you understand by the term "Director Identification Number" (DIN)? Describe the procedure to obtain the same as enumerated under the Companies Act, 1956 read with the relevant Rules.

(5 Marks) (June 2009)

Answer

Director Identification Number (DIN) is a unique identification Number given by the Ministry of Corporate Affairs. It is required to be obtained by every person who is or intends to become a director of any company. DIN is a pre-requisite for filling various forms with the Registrar of Companies. The electronic system of the Ministry of Corporate affairs will not allow to file/submit the forms if DIN of the signatory director is not mentioned in the form being filed/submitted.

In order to obtain DIN from the Ministry of Corporate Affairs, following procedure is to be adopted.

- (i) To check whether the computer system through which the DIN Application is being made has the requisite hardware and the software as well as the Internet facility.
- (ii) Using the internet facility, DIN Application Form has to be downloaded from the website of Ministry of Corporate Affairs.
- (iii) The DIN application Form is to be filled up and submitted electronically.
- (iv) On electronic submission of the DIN application Form, a provisional DIN will be generated and displayed on the said Application Form.
- (v) Thereafter, the form is to be printed, signed and submitted to the Ministry of Corporate Affairs – DIN Cell along with following papers/documents:
 - (a) Passport size photograph of the Applicant duly attested by a Magistrate or a Notary Public or a practising Chartered accountant or a practising Company Secretary or a practising Cost Accountant or a Gazetted Officer.
 - (b) Attested copy of any one of the following as a proof of identity:
 - a. Passport
 - b. Election/Voter Identity Card
 - c. Driving Licence
 - d. Income Tax Pan Card
 - e. Any other document which will prove the identity of the Applicant
 - (c) Attested copy of any one of the following as a proof of residence:
 - a. Passport
 - b. Election / Voter Identity Card
 - c. Ration card
 - d. Driving Licence
 - e. Electricity Bill
 - f. Telephone Bill
 - g. Bank account Statement

- h. Any other document which will prove the residential address of the Applicant

On Submission of the above, the DIN Cell of the Ministry of Corporate Affairs shall allot final DIN and send an intimation letter to the Applicant. The intimation is also sent via e-mail.

The status of DIN application can also be checked online.

Question 3

The Board of Directors of DJA Ltd. seek your advice about the procedure to be followed for 'Electronic filing and Authentication of Documents' with the Registrar of Companies, Mumbai. Advise the Board about the procedure to be followed in this regard and explain the manner in which the 'E' filing is regulated by the Central Govt. (8 Marks) (Nov 2010)

Answer

Procedure:

1. When the business or the registered users access the My MCA portal, they enter their username and authentication details – Password/ Digital Certificate.
2. The user will be shown a list of eForms category-wise under **eForms** tab.
3. At any time, the users can read the related instruction kit, available under **Help** menu, to authorized themselves with the procedures.
4. The users can then fill the appropriate eForm for the service required. There is an option of pre-fill facility in the eForms, where the static details such as name and address of the company will be pre-filled by the system automatically on entering the Corporate Identity Number (CIN).
5. The users attach the necessary documents to the eForm.
6. The users may avail the pre-scrutiny service of the eForm. The documents will be verified (pre-scrutinised) by the system. In case of any inadequacies, for example, if a mandatory column in the eForm is not filled in, the user will be asked to rectify before the document is ready for execution (signature).
7. The applicant or a representative of the applicant will then submit the duly signed documents electronically through Digital Signatures.
8. The system will calculate the fee, including late payment fees, if applicable.
9. Payments will have to be made through appropriate mechanisms – electronic (credit card, Internet banking) or traditional means (at the bank counter).
 - (a) Electronic payments can be made at the Virtual Front Office (VFO).
 - (b) If the user selects the traditional payment option, the system will generate a pre-filled challan in the prescribed format. Traditional payments through cash, cheques can be done at the designated network of banks using the system generated

challan. There will be five banks with estimated 200 branches authorized for accepting challan payments.

10. The payment will be exclusively confirmed for all online (Internet) payment transactions using payment gateways.
11. Acceptance or rejection of any transaction will be explicitly communicated to the applicant (including facility to print a receipt for successful transactions).
12. MCA 21 will provide a unique transaction number, which can be used by the applicant for enquiring status pertaining to that transaction.
13. Filing will be complete only when the necessary payments are made.
14. In case of a rejection, helpful remedial tips will be provided to the applicant.
15. The applicants will be provided an acknowledgement through e-mail or alternatively they can check the MCA portal.

OTHER RELEVANT MISCELLANEOUS PROVISIONS OF THE COMPANIES ACT, 1956

Question 1

Explain, how the provisions of the Companies Act, 1956 relating to Audit Committee will help in achieving some of the objectives of Corporate Governance. (5 Marks) (June 2009)

Answer

AUDIT COMMITTEE:

For better corporate governance the concept of Audit committee for companies was introduced by section 292A of the Companies Act, 1956. Every public company having paid up capital of not less than ₹ 5.00 Crores must have an Audit Committee.

The auditors, the internal auditor, if any and the Director-In-Charge of finance shall attend and participate at meetings of the Audit Committee [Section 292A(5)]

As per Section 292A (6) of the said Act, the functions of the Audit Committee includes the following:

- (a) The Audit Committee should discuss with the auditors periodically about internal control systems, the scope of audit including the observations of the auditors.
- (b) The Audit Committee should review half yearly and annual financial statements before submission to the Board.
- (c) The Audit Committee should ensure compliance of internal control systems.

The Audit committee shall have authority to investigate into any matter in relation to the items specified in this Section or referred to it by the Board and for this purpose, shall have full access to information contained in the records of the company and external professional advice, if necessary. [Section 292A (7)].

The recommendations of the Audit Committee on any matter relating to financial management including the audit report shall be binding on the Board and if the Board does not accept the recommendations of the Audit Committee, it shall record the reasons therefore and communicate such reasons to the shareholders. (Section 292A(8) & (9)).

The above provisions of law relating to powers and functions of the Audit committee relating to financial statements will help in achieving one of the objective of corporate governance i.e. accountability and avoidance of poor financial reporting.

Question 2

Mewar Instrumentations Limited is a subsidiary of a Government Company. The Comptroller and Auditor General of India appointed Sobman & Company to conduct a supplementary audit of Mewar Instrumentations Limited. Discuss, under the provisions of the Companies Act, 1956 whether the Comptroller and Auditor General's power to authorise such audit for the said subsidiary company is in order?
(5 Marks) (May 2010)

Answer

Audit of Subsidiary Company: In accordance with the provisions of the Companies Act, 1956, as contained in section 617, the term 'Government Company' includes a company which is a subsidiary of a Government Company. In view of the above provision, Mewar Instrumentations Limited comes within the purview of Government Company because it is a subsidiary of a Government Company.

Therefore, the power of the Comptroller and Auditor General of India to authorise Sobman & Company to conduct supplementary audit of Mewar Instrumentations Limited is perfectly within the provisions as contained in section 619 (3) (b) of the Companies Act, 1956.

Question 3

ABC Limited, over years, enjoys high reputation and its General Reserve is many times more than the paid up capital of the company. There is apprehension of cornering the shares of the company by some persons likely to result in change in the Board of Directors which may be prejudicial to the Public interest.

Advise, as to how can ABC Limited block the transfer of shares of the company under the provisions of the Companies Act, 1956.
(5 Marks) (May 2010)

Answer

Restrictions and Prohibition of transfer of shares or debentures: In accordance with provisions of the Companies Act, 1956, as contained in section 250 (4), where the Company Law Tribunal (Company Law Board till the Company Law Tribunal becomes operational, referred to as CLB hereinafter) has reasonable grounds to believe that a transfer of shares in a company is likely to take place whereby a change in the composition of the Board of Directors of a company is likely to take place and the CLB is of the opinion that any such change would be prejudicial to the public interest, the CLB may, by an order, direct that any transfer of shares in the concerned company during such period not exceeding three years, as may be specified in the order, shall be void.

Further, in accordance with the provisions of the Act, as contained in section 250 (1) & (2), if the CLB is of the view that there are good reasons to find out the relevant facts about any shares and the CLB is of the opinion that such facts cannot be found out unless the restrictions are imposed,

as an interim measure, it may, by an order, direct that transfer of any such shares shall be void and no voting rights shall be exercised in respect of such shares. However, the CLB is empowered to vary or rescind its order at any time.

The facts given in the question squarely fall within the provisions of section 250 of the Companies Act, 1956. The management of ABC Ltd. may make a complaint to the CLB and convince it that the transfer of shares in favour of the group of unscrupulous persons would change the composition of the Board of Directors of the company which shall be prejudicial to the public interest and if the CLB is convinced with the plea of the company, it may pass an order as stated above which would block the transfer of shares as stated in the question.

CORPORATE SECRETARIAL PRACTICE- DRAFTING OF RESOLUTION, MINUTES, NOTICES AND REPORTS

Question 1

Shri J is already the managing director of two companies viz., M/s ABC Ltd. and M/s CBA Ltd. M/s DEF Ltd. wants to appoint shri J as the managing director of their company for a period of five years from 1.12.2008. You are required to prepare a draft board resolution for the appointment of Shri J as managing director of M/s DEF Ltd., taking into consideration the requirements under the Companies Act, 1956. (5 Marks) (Nov 2008)

Answer

Resolution for appointment of Managing Director who is already Managing Director in another two companies:

Resolution- Board Resolution

“RESOLVED that subject to the approval of the Central Government under sub Section (4) of Section 316, Mr. J, who is already the Managing Director of two companies, namely M/s ABC Ltd, and M/s CBA Limited, be and is hereby appointed as Managing Director of the company for a period of five years commencing from 1st December, 2008, with the consent of all the Directors present at the meeting of which meeting and the resolution to be moved there at specific notice was given to all the Directors then in India, on the terms and conditions in the draft agreement tabled before the meeting and initialed by the Chairman for purposes of identification and that Shri MG, the Secretary of the Company be and is hereby authorized to apply to the Central Government for seeking approval.

RESOLVED FURTHER that Smt. VR, Director and Shri MG the Secretary of the company be and are hereby authorized to execute the said agreement subject to such modifications/ alternations made by the Central Government while giving their approval and to affix the common seal of the company therein”.

Note :- In the above question, Mr. J cannot be appointed as Managing Director of M/s DEF Ltd. because he is already holding the position of Managing Director in two public companies. The

appointment can be made only when the Central Government may, by order, permit any person to be appointed as a managing director of more than two companies if the Central Government is satisfied that it is necessary that the companies should, for their proper working, function as a single unit and have a common managing director.

But in the question it is not mentioned that all the companies are working as a single unit. If we take the assumption that these are working as a single unit then the appointment can be made.

So, candidates who wrote that appointment cannot be made shall also be given due credit of marks as it is also correct according to the provisions of the Companies Act, 1956.

Question 2

Draft a board resolution for appointment of Mr. Paul as the Managing Director for 5 years with effect from 1st July, 2009 of DBM Limited passed in the board meeting of the said company held on 6th June, 2009.
(5 Marks) (June 2009)

Answer

Resolution passed at the meeting of Board of Directors of DBM Limited held at its registered office at on 6th June, 2009 at A.M.

“RESOLVED that subject to the approval by the shareholders in a general meeting and pursuant to provisions of Sections 198, 309, 310, schedule XIII and other applicable provisions of the Companies Act, 1956, Mr. Paul be and is hereby appointed as the Managing Director of the Company with effect from 1st July, 2009 for a period of five years on a remuneration approved by the Remuneration committee as enumerated below:

1. Salary: ₹_____per month.
2. Perquisites, Benefits & Facilities:

RESOLVED FURTHER that Mr. Paul, so long as he functions as the Managing Director of the Company, shall not be entitled to any sitting free for attending any meeting of the Board of Directors or any Committee thereof and that he shall not be liable to retire by rotation.

RESOLVED FURTHER that Mr. Paul, till he holds the office of Managing Director of the Company, shall not become interested or concerned in any selling agency directly or through his wife or minor children in future without prior approval of the Central Government.

RESOLVED FURTHER that Mr. Paul, the Chairman, as well as the company shall have right to terminate the appointment by giving 3 (three) months' notice in writing.

RESOLVED FURTHER that the Secretary of the company be and is hereby directed and authorized to electronically file necessary returns with the Registrar of Companies by putting his digital signature and to do all other necessary things required under the provisions of the Companies Act, 1956.”

Question 3

Mr. Mutthu Swami is working as Chief Accountant in Eastern Pharmaceuticals Ltd. The Board of Directors of the said company propose to charge him with the duty of ensuring compliance with the provisions of the Companies Act, 1956 so that accounts and Balance Sheet and Profit and Loss account can be maintained and prepared in accordance with the provisions of law for the time being in force. Draft a "Board Resolution" for the said purpose. Also point out the consequences in case of default, when such resolution is passed. (5 Marks) (May 2010)

Answer**Maintenance of accounts of the Company - Board's resolution:**

"Resolved that pursuant to Section 209(7) and 211(8) of the Companies Act, 1956. Mr. Muthu Swami, Chief Accountant of the company be and is hereby charged with the duty of seeing/ensuring that the requirements of Sections 209 and 211 of the Companies Act, 1956 are duly and fully complied with".

Resolved further that the said Mr. Muthu Swami is hereby entrusted with the authority to do such Acts, things and deeds as may be necessary or expedient for the purpose of compliance with the requirements of Section 209 and 211 of the said Act."

Consequences:

According to Section 209(6) of the Companies Act, 1956 the following persons are responsible

- (a) The Managing Director or Manager of the company of
- (b) All officers and other employees of the company or
- (c) If the company has no Managing Director, every Director of the Company.

Penalty for default is imprisonment upto the six months or fine upto ₹ 10,000/- or both if the persons mentioned above fail to take all reasonable steps to ensure that the provisions of Section 209 are duly complied with by the company or default has been committed by their own willful Act.