

MOCK TEST PAPER – 1

FINAL COURSE: GROUP – I

PAPER – 4 : CORPORATE AND ALLIED LAWS

SUGGESTED ANSWERS/HINTS

1. (a) According to section 322(1) of the Companies Act, 1956, in case of a limited company if the memorandum permits, then such company can make the liability of the directors or any director or manager as unlimited.

Also, as enumerated in section 323(1) of the Companies Act, a limited company may, if so authorized by its articles, by special resolution, alter its memorandum so as to make the liability of its director/s unlimited.

Hence, by amending the Memorandum of Association of the company by way of passing a special resolution in a general meeting, ABC Ltd. can make the liability of directors unlimited.

- (b) Proxies in the case of stock exchange

Section 7A of Securities contracts (Regulation) Act, 1956, permits a recognised stock exchange to make rules or amend any rules made by it to provide for all or any of the matters listed in section 7A (1) including the restriction on the right of a member to appoint another person as his proxy to attend and vote at a meeting of the stock exchange. If the rules of Allora Stock Exchange Ltd permit its members to appoint only another member as his proxy, then members can not appoint non-members as proxies.

If the rules of Allora Stock Exchange Ltd do not have any such provision, then it is possible to amend the rules providing for such restriction. But the rules can be amended only with approval of Central Government. These should be published in the Official Gazette. Such rules will be valid notwithstanding anything to the contrary contained on the Companies Act, 1956 [Section 7A(2)].

According to section 176(1) of the Companies Act, 1956, a member can appoint another person (whether a member or not) in a company as his proxy. Though Allora Stock Exchange Ltd. is a company; it is possible to provide for restriction relating to appointment of proxies taking advantage of Section 7A of SCRA, 1956.

- (c) IOBL Ltd. can demerge its food processing business with an associate company, BPD Ltd. by obtaining the approval of Court as provided in section 394 of the Companies Act, 1956. For this purpose, IOBL Ltd. is required to take the following steps:
- (1) IOBL Ltd., known as "Transferor Company" for this purpose, has to prepare a scheme under which its properties and liabilities in respect of food processing

business will be transferred to BPD Ltd., known as "Transferee Company" for this purpose. Such scheme must contain the consideration for transfer, known as "Exchange Ratio".

- (2) An application under Section 391(1) of the said Act must be made to Court for an order convening meetings of creditors and/or members.
 - (3) Notice(s) of the meeting(s) must be sent to members/creditors as per the direction of Court. Such notice must be accompanied by a statement under Section 393(1) of the said Act setting forth the terms of the compromise or arrangement and explaining its effect in general and in particular, the effect on the interests of Managerial Personnel.
 - (4) To hold the said meetings and pass necessary resolution approving the scheme subject to the confirmation of Court. It may be noted that the resolution must be passed by a majority in number representing $\frac{3}{4}$ in value of the members/creditors as required under Section 391(2) of the said Act.
 - (5) Thereafter, IOBL Ltd. is required to move to Court jointly with BPD Ltd. for approval of the scheme disclosing all material facts relating to the Company. [Proviso to section 391(2)]. Court as required under section 394A shall give notice to the Central Government and shall take into consideration any representation received from Central Government before passing any order on the application made to it for approval of the scheme.
 - (6) On receipt of Court's order, IOBL Ltd. is required to file a certified copy of the order with the Registrar of Companies (ROC) for registration within 30 days after making of the order by Court. [(Section 394(3)]. This is very important since the non-filing of the order with ROC would make the approval order ineffective.
 - (7) Lastly, to proceed to give effect to the scheme as approved by Court in the manner as directed by it.
- (d) A Company cannot have lien on shares unless provided in the Articles of Association. Therefore, provision to this effect should be in the articles. As per Regulation 9 of Table A of the Companies Act, 1956 the Company has first and paramount lien on every share (which has not been fully paid up for all monies (whether presently payable or not) called or payable at a fixed time in respect of that share and on all shares which are not fully paid up standing registered in the name of a single person, for all moneys presently payable by him or his estate to the Company.

The Board of Directors may, however, at any time declare any share to be wholly or in part exempt from the said provision. Hence, the decision of the Board of Directors of M/s Karma Ltd to relax the provisions of lien in respect of shares held by Dharma is in order and valid (Vide Regulation 9 of Table A). Further the Company's lien is

extended to all dividends payable on such shares as per regulation 9(2) of table A of the Companies Act, 1956.

2. (a) In accordance with the provisions of Section 274(1)(g) a person shall not be capable of being appointed as director of a company if such person is already a director of a public company, which –has not filed the annual accounts and annual returns for any continuous three financial years commencing on and after the first day of April, 1999;

Provided that such person shall not be eligible to be appointed as a director of any other public company for a period of 5 years from the date on which such public company, in which he is a director failed to file annual accounts and annual returns under this clause.

Applying the above provisions as contained in Section 274(1)(g), answers to the given questions are:

- (i) In the given case, Mr. Busy Bee, the Director of Honey Ltd. is disqualified to be appointed as Director of other public companies for a period of 5 years from the date on which default has been committed.

Mr. Busy Bee does not cease to be a director in Honey Ltd. and Sugar Ltd. immediately because Section 283 which provides for 'vacation of office' has not been amended. He can continue as a director till his term ends. He can be reappointed in the defaulting company Honey Ltd., but not in Sugar Ltd. as the disqualification applies only to 'any other public company'.

- (ii) In the second case, Mr. Busy Bee, as a nominee of the Public Financial Institution, shall not be disqualified to be appointed as Director for the reason that the Public Financial Institutions and are exempted from the provisions of Section 274(1)(g) of the Companies Act, 1956.

- (iii) A director of a private company is not disqualified even if that company is a defaulter in filing return.

- (b) The procedure for passing resolution by circulation as under section 289 of the Companies Act, 1956 is as follows:

- (a) Circulate the draft of the resolution in duplicate with all necessary papers if any, to all the directors then in India not being less in number than the quorum for a board meeting and to all other directors at their usual addresses in India for approval by signing one copy of the resolution and send it back to the company.

- (b) If all are majority of the above directors as are entitled to vote on the resolution approve the resolution, the resolution shall deemed to have been duly passed by the Board.

- (c) Record the resolution having been passed by circulation in the minutes of the

immediate next Board meeting.

- (d) See that the resolution do not pertain to the matters which cannot be passed by the Board by circulation [i.e. Sections 262(1), 292, 297, 299, 307 etc].
- (e) Enclose a copy of the circular resolution to the Agenda of the ensuing immediately next Board meeting.

Thus, by following the up procedure, Saransh Ltd. may pass the resolution by circulation under section 289 of the Companies Act, 1956.

- 3. (a) (i) The first auditor or auditors of a company shall be appointed by the Board of Directors within one month of the date of registration of the company; and the auditor or auditors so appointed shall hold office until the conclusion of the first Annual General Meeting (AGM). However, the company may, at a general meeting, remove any such auditor or all or any of such auditors and appoint in his or their places any other person or persons who have been nominated for appointment by any member of the company and of whose nomination notice has been given to the members of the company not less than 14 days before the date of the meeting and if the Board fails to exercise its powers, the company in general meeting may appoint the first auditor/s.
- (ii) The Board of Directors may fill any casual vacancy in the office of an auditor, but while any such vacancy continues, the remaining auditor or auditors, if any, may act.

Where such vacancy is caused by the resignation of an auditor, the vacancy shall only be filled by the company in general meeting. Any auditor appointed in a casual vacancy shall hold office until the conclusion of the next AGM

- (iii) The ceiling on the number of auditor/s accepting audits is as under:
 - (a) in case of a person or firm holding appointment as auditor of a number of companies each of which has a paid up share capital of less than ₹ 25 lacs, the ceiling is 20 such companies.
 - (b) in any other case, 20 companies out of which not more than 10 shall be companies each of which has a paid up share capital of ₹ 25 lacs or more (Explanation I to sub-section (1B) & (1C) of section 224).

In computing the specified number, as stated above, the number of companies in respect of which or any part of which any person or firm has been appointed as an auditor, whether singly or in combination with any other person or firm, shall be taken into account.

- (b) **Penalty for default in case of stock brokers:** Section 15F of Securities and Exchange Board of India Act, 1992 provides for penalty for default in case of stock brokers. If any person who, is registered, as a stock broker under this Act:

- (a) fails to issue contract notes in the form and in the manner specified by the stock exchange of which such broker is a member, he shall be liable to a penalty not exceeding five times the amount for which the contract note was required to be issued by that broker.
- (b) fails to deliver any security or fails to make payment of the amount due to the investor in the manner or within the period specified in the regulations, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.
- (c) charges an amount of brokerage which is in excess of the brokerage specified in the regulations, he shall be liable to a penalty of one lakh rupees or five times the amount of brokerage charged in excess of the specified brokerage, whichever is higher.

Factors for taking into account while action

While adjudging quantum of penalty under section 15J, the adjudicating officer shall have due regard to the following factors:

- (a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the defaults.
- (b) the amount of loss to an investor or group of investors as a result of the default.
- (c) the repetitive nature of the default.

Taking into consideration the above factors, the adjudicating officer may levy a maximum penalty as prescribed in section 15F for default by the concerned stock broker in making the payment to the investor.

4. (a) A company's power of lending money to its directors is strictly regulated by the Companies Act, 1956. The Act prohibits the company not only from directly lending money to its directors but also from giving any guarantee for a loan taken by a director from any other person, and providing any security for such loan. Section 295 deals with loans to Directors.
 - (i) This transaction does not *per se* amount to a loan so as to violate section 295 of the Companies Act, 1956. The burden of proving otherwise lies with the prosecution. Thus, in the absence of any evidence that there has been circumvention of the section by disguising the loan to the wife of the director, who is an employee, as salary advance, the court refused to accept the case for prosecution. *M.R.Electronic Components Ltd. vs. Assistant Registrar of Companies (1987) 6 Comp. Case 8 (Mad)*.
 - (ii) Through the loan given by the company to the firm may not be direct loan to the directors of the company, yet the provisions of section 295 of the Companies Act, 1956 prohibit any loan to a firm in which one or more of the

company's directors are partners. Since one of the directors of the company is a partner of this firm, a loan to this firm is in contravention of the provisions of section 295.

- (iii) In a petition, *Dr. Freddie Ardeshir Mehta V. Union of India* the Bombay High Court came to the conclusion that a company selling one of its flats to one of its directors on receiving more than half the price in cash and agreeing to accept the balance in installments does not amount to giving a loan to the directors. It is a credit sale. It cannot even be described as indirect loan.
- (b) **Oppression & Mismanagement:** Under sections 397 and 398 of the Companies Act, 1956, members may apply to the Company Law Board (CLB) in cases of oppression and mismanagement. However, bona fide decisions consistent with the company's memorandum and articles are not to be equated with mismanagement even if they turn out to be wrong in the circumstances or these cause temporary losses. The Court will not permit the machinery created by the sections to be used by the minority for compelling the majority to come to terms, where the company is honestly managed. Directors' bona fide decision not to declare dividend and to accumulate available profits into reserves is not mismanagement. (*Thomas Vettom (V.J.) vs. Kuttanad Rubber Co. Ltd. (1984) 56 Com. Cases 284 (Ker)*).

Thus, in the given case, the group of shareholders/members who complain to CLB against the decision of the Board not to declare any dividend and to accumulate available profits into reserves, would not succeed, as the act of directors does not amount to mismanagement. Furthermore, the shareholders cannot compel the Board to recommend a dividend. The Board's recommendations are placed in the general meeting. The general meeting can reduce the dividend, but cannot even increase the dividend as recommended by the Board. Therefore, the shareholders/members cannot compel the company to declare dividend and cannot charge the directors with oppression or mismanagement.

Applying the above, answers to the question shall be as under:

- (1) The contention of shareholders/members shall not be tenable.
 - (2) The act of the Board of directors who acted bona fide, not to recommend any dividend shall not amount to oppression or mismanagement.
5. (a) (1) As per section 292A of Companies Act, 1956, every public company having paid up capital of ₹ 5 cores or more must constitute a committee of Board as 'Audit Committee'.
- (2) The audit committee shall consist of minimum 3 directors. Out of the total members of committee, at least two-third shall be executive directors, that is those who are not managing or whole time directors. The committee shall elect its own Chairman. Terms of reference will be specified in writing by the Board (Section 292A(2)).

(3) Draft Board resolution.

“Resolved that, pursuant to section 292A of the Companies Act, 1956 an Audit committee consisting of the following directors be and is hereby constituted

1. Shri_____, Nominee of IFCI
2. Shri_____, Nominee of IDBI
3. Shri_____,
4. Shri_____,
5. Shri_____, Managing Director

Further resolved that the Chairman of the Audit Committee shall be elected by its members from amongst themselves. Further resolved that the Audit Committee shall have the authority to investigate into any matter what may be prescribed under the said section 292 A and the following matters

1. _____
2. _____
3. _____
4. _____”

- (b) **Nomination by Life Insurance Policy Holder:** As per section 39 of the Insurance Act, 1938, the holder of a policy of life insurance on his own life may nominate a person or persons to whom the money secured by the life insurance policy shall be paid in the event of his death. Such nomination can be made either at the time of taking the policy or at any time before the maturity of the policy. Such nomination is either incorporated in the text of the policy or is stated as an endorsement on the policy document. The nomination can be cancelled or altered by the policyholder at any time before the maturity of the policy. The insurer is required to communicate to the policyholder that it has recorded the nomination, its cancellation or alteration as the case may be. In case the policyholder survives the full term of policy, the insurer shall pay the maturity amount to him only and the nomination becomes redundant. In a case where the nominee dies before the maturity of the policy and if no new nomination is made, the maturity proceeds of the policy shall be paid to the policy holder and if dies before the maturity, to the legal heirs of the policy holders.

Minor as a nominee: A minor can be nominated as a nominee in life insurance policy by its holder. The only other requirement as per Proviso to section 39(1) of the said Act is that the policyholder is to appoint, in the prescribed manner, an adult person to receive the money secured by the policy on behalf of the minor in the event of death of the policyholder during the minority of the nominee.

In the light of provisions of section 39 and 39(1) of the Insurance Act, 1938, Mr. Ramesh can appoint his minor son, Master Suresh as a nominee in his life insurance policy, subject to the provisions of section 39(1).

6. (a) (i) As per provisions of section 581ZH of the Companies Act, 1956, a Producer Company may, by special resolution, make donation or subscription to any institution or individual for the following purposes:-

(a) For promoting the social and economic welfare of Producer Members or Producers or general public; or

(b) For promoting the mutual assistance principles.

Thus, as per the above stated provisions of the Companies Act, 1956, a Producer Company may make a donation by passing a special resolution and for the above mentioned purposes.

The 1st Proviso to the said section 581ZH lays down the monetary limit for making the donation by a Producer Company. According to the said proviso the aggregate amount of all such donation and subscription in any financial year shall not exceed three per cent of the net profit of the Producer Company in the financial year immediately preceding the financial year in which the donation or subscription was made.

Since the net profit of the Producer Company as per its last profit & loss account was ₹ 20.00 lacs, it can make a total donation of ₹ 60,000/- in this year being three percent thereof.

- (ii) Under section 581X of the Companies Act, 1956 every Producer Company having an average turnover exceeding ₹ 5 crores in each of three consecutive financial years shall have a whole time secretary who is a member of Institute of Company Secretaries of India (ICSI).

- (b) According to section 591(1) companies falling under the following two classes shall be known as foreign companies namely:

(i) companies incorporated outside India which, after the commencement of this act, establish a place of business within India, and

(ii) companies incorporated outside India which have, before the commencement of this act, established a place of business within India and continue to have an established place of business within India at the commencement of this act.

According to section 591(2) Notwithstanding anything contained in sub-section (1), where not less than fifty percent of the paid up share capital (whether equity or preference or partly equity and partly preference) of a company incorporated outside India and having an established place of business in India, is held by one or more citizens of India or by one or more bodies corporate incorporated in India, or

by one or more citizens of Indian and one or more bodies corporate incorporated in India, whether singly or in the aggregate, such company shall comply with such of the provisions of this act as may be prescribed with regard to the business carried on by it in India, as if it were a company incorporated in India.

Here as more than 50% of the paid-up capital of M/s Water Ltd., is held by Indian citizen (Mr. Yashmit) and Indian company (M/s Jal Ltd.), M/s Water Ltd. shall be treated as Indian company. It shall have to comply with such provision of the act as may be prescribed as if it were a company incorporated in India.

M/s Water Ltd. has to submit the following document with the registrar of companies with 30 days of establishment of business in India.

- (a) a certified copy of the charter, statutes, or memorandum and articles, of the company or other instrument constituting or defining the constitution of the company; and, if the instrument is not in the English language, a certified translation thereof.
 - (b) the full address of the registered or principal office of the company;
 - (c) a list of the directors and secretary of the company, containing the particulars mentioned in sub-section (2).
 - (d) the name and address or the names and addresses of the some 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; and
 - (e) the full address of the office of the company in India which is to be deemed its principal place of business in India.
7. (a) **Abuse of Dominant position:** The Competition commission while inquiring whether the XYZ Ltd. enjoys a dominant position or not under Section 4 of the Competition Act, 2002 will take the following factors into account:
- (i) Market-share of the enterprise
 - (ii) size and resources of the enterprise
 - (iii) size and importance of the competitors.
 - (iv) economic power of the enterprise including commercial advantages over competitors.
 - (v) vertical integration of the enterprises or sale or service net work of such enterprises.
 - (vi) dependence of consumers on the enterprise.
 - (vii) monopoly or dominant position whether acquired as result of any statute or by

virtue of being a Government company or a public sector undertaking or otherwise.

- (viii) entry barriers including barriers such as regulatory barriers, financial risk, high capital cost of entry, marketing entry barriers, technical entry barriers, economies of scale, high cost of substitutable goods or services for consumers.
 - (ix) countervailing buying power.
 - (x) market structure and size of market.
 - (xi) social obligations and size of market.
 - (xii) relative advantage, by way of contribution to the economic development, by the enterprise enjoying a dominant position having or likely to have an appreciable adverse effect on competition.
 - (xiii) any other factor which the commission may consider relevant for the inquiry.
- (b) The distinction between a provision which is mandatory and one which is 'directory' is that when it 'mandatory', it must be strictly complied with, when it is 'directory', it would be sufficient that it is substantially complied with. Non-observance of mandatory provisions involves the consequences invalidating. But non-observance of directory provision does not entail the consequence of invalidating, whatever other consequences may occur.

No general rule can be laid down for deciding whether any particular provision on a statute is mandatory or directory. In each case the court has to consider not only the actual word used, but has to decide the legislatures intent. For ascertaining the real intention of the legislature, the court may consider, amongst other things, the following

1. The nature and design of the statute.
2. The consequence, which would flow from construing one-way or the other.
3. The impact of other provisions by resorting to which the necessity of complying with the provision in question can be avoided.
4. Whether or not the statute provides any penalty if the provision in question is not complied with
5. If the provision in question is not complied with, whether the consequences would be trivial or serious.
6. Most important of all, whether the object of the legislation will be defeated or furthered.

Where a specific penalty is provided in a statute itself for non-compliance with the particular provision of the Act no discretion is left to the court to determine whether such provision is directory or mandatory - it has to be taken as mandatory.

- (c) **Furnishing of Information:-** Every exporter of goods is required to furnish to RBI or other prescribed authority a declaration containing true and correct material particulars, including the amount representing full export value. If full exportable value is not ascertainable at the time of export due to prevailing market conditions, the exporter shall indicate the amount he expects to receive on sale of goods in a market outside India. The exporter of goods shall also furnish to RBI such other information as may be required by RBI for the purpose of ensuring realization of export proceeds by such exporter [section 7(i)].

RBI can direct any exporter to comply with prescribed requirements to ensure that full export value of the goods or such reduced value of the goods as RBI determines, is received without delay [section 7(2)]. Every exporter of services shall furnish to RBI or other prescribed authority a declaration containing true and correct material particulars in relation to payment of such services [section 7(3)].

- (d) **Punishment for offences under the Prevention of Money Laundering Act, 2002:**

Section 4 of the Act provides for the punishment for Money Laundering. Whoever commits the offence of money laundering shall be punishable with rigorous imprisonment for a term which shall not be less than 3 years but which may extend to 7 years and shall also be liable to fine which may extend to ₹ 5 lacs. But where the proceeds of crime involved in money laundering relates to any offence specified under paragraph 2 of Part A of Schedule, the maximum punishment may extend to 10 years instead of 7 years.

Applying the above to the given cases the answers to the problems are as under:

1. In the first case the offence falls within the jurisdiction of Section 7 of the Offences under the Prevention of Corruption Act, 1988 and accordingly punishable as stated above.
 2. Similarly in the second case the offence falls within the jurisdiction of Section 9 of the Act, and therefore, punishable as stated above.
- (e) **Power of RBI to remove director:** Under section 36AA of the Banking Regulation Act, 1949, RBI can terminate any Chairman, Director, Chief Executive, other officials or any employee of the bank where it considers desirable to do so particularly when RBI is of the opinion that conduct of such persons is detrimental to the interest of the depositors or for securing proper management of the banking company. Before such termination concerned person should be given opportunity to be heard of. Such terminated officials can make appeal to the Central Govt. within 30 days from the date of communication of such termination order. The decision of the Central Government cannot be called into question. In case an order is issued

pursuant to this section the concerned person shall cease to hold his office for a period of not exceeding 5 years as may be specified in the order. Contravention of the above provision shall be punishable with a fine, which may extend to ₹ 250 per day.

Any such order shall be valid for a period not exceeding three years or such further periods of not exceeding three years at a time as RBI may specify. Under section 36AB: RBI is empowered to appoint additional Directors for the banking company with effect from the date to be specified in the order, in the interest of the bank or that of depositors. Such additional directors shall hold office for a period not exceeding three years or such further periods not exceeding three years at a time.