SUGGESTED ANSWERS

EXECUTIVE PROGRAMME

COMPANY LAW
(EP-CL/2013)

THE INSTITUTE OF
Company Secretaries of India
IN PURSUIT OF PROFESSIONAL EXCELLENCE
Statutory body under an Act of Parliament
ICSI House, 22, Institutional Area, Lodi Road, New Delhi 110 003
Phones : 41504444, 45341000; *Fax* : 011-24626727
E-mail : info@icsi.edu; *Website* : www.icsi.edu

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TEST PAPER 1/2013

Time allowed : 3 hours *Maximum Marks : 100*

NOTE *: Answer ALL Questions*

Question No. 1

(a) Fill in the blanks with suitable answers:

(i) The issue of ESOPs or ESOS shall be subject to approval of shareholders through a _____ resolution.

(ii) Registration and index of debenture holders should be preserved for _____ after the redemption of the debentures.

(iii) The register and index of debenture holders of a company should be preserved for _____ till after the redemption of the debentures.

(iv) Without the consent of the general meeting, the Board of directors can borrow money subject to a maximum of _____.

(v) A director can be the member of _____ Committees. (1 mark each)

(b) Comment on the following:

(i) A person can be a director in more than 20 companies.

(ii) Misstatement in prospectus is a civil offence.

(iii) Where the corporate veil has been used for commission of fraud or improper conduct, Courts have lifted the veil and looked at the realities of the situation.

(iv) Interim dividend once declared becomes a debt. (5 marks each)

Answer to Question No. 1(a)

(i) The issue of ESOPs or ESOS shall be subject to approval of shareholders through a **special** resolution.

(ii) Registration and index of debenture holders should be preserved for **15 years** after the redemption of the debentures.

(iii) The register and index of debenture holders of a company should be preserved for **15 years** till after the redemption of the debentures.

(iv) Without the consent of the general meeting, the Board of directors can borrow money subject to a maximum of **aggregate of paid-up capital and free reserves**.

(v) A director can be the member of **15** Committees.

Answer to Question No. 1(b)(i)

Section 275 of the Companies Act, 1956 prohibits the appointment of a person holding office of a director at the same time in more than fifteen companies.

Section 277 of the Act lays down that when a person holding office of a director in fifteen companies is appointed as a director of any other company, the appointment shall not take effect unless such person has, within fifteen days thereof, effectively vacated his office as director in any of the companies in which he was already a director and the new appointment shall become void immediately on the expiry of the fifteen days if he has not before such expiry, effectively vacated his office as director in any of the other companies.

Section 278 of the Act lays down that directorship in the following companies shall be excluded for the purpose of calculation of the permissible maximum number of directorships for the purposes of Sections 275, 276 and 277:

(a) a private company which is neither a subsidiary nor a holding company of a public company;

(b) an unlimited company;

(c) an association not carrying on business for profit or which prohibits the payment of dividend; and

(d) a company in which such person is only an alternate director.

In view of the above provisions, a person can be a director in 20 companies at the same time but subject to a condition that out of such 20 companies, the number of public companies shall not be more than 15. In other words, he can be a director in 15 public companies and can also be at the same time a director in any number of private companies or unlimited companies or association not carrying on business for profit or which prohibit the payment of dividend or an alternate director.

Answer to Question No. 1(b)(ii)

Where an untrue statement occurs in a prospectus, there may arise (i) civil liability (ii) criminal liability. Every person who is a director of the company at the time of the issue of the prospectus, every promoter of the company and every person, including an expert, who has authorised the issue of a prospectus, shall be liable.

The first remedy against the company is to rescind the contract. A person who takes shares on the faith of a prospectus containing false statements, may apply to the Court for the contract to be set aside, and his name to be struck off from the register of members. He may also claim his money back. But the allottee must act within a reasonable time, before any proceedings to wind up the company have been commenced, and before he does anything after notice of misrepresentation which is inconsistent with the right to rescind. He will lose his right to rescind if he attempts to sell the shares or attends a general meeting of the company, or receives dividends.

The second remedy against the company is to sue for damages for deceit. This suit is founded on the tort of deceit, and is not a case of fraud on the part of directors or promoters. The allottee may recover damages from the company for any loss he may have suffered if the invitation to take shares is emanating from the company and the persons making it on behalf of the company have fraudulently mis-represented material facts. The allottee cannot both retain the shares and get damages against the company.

In actual practice, however, suits for damages against the company are rarely filed. Damages are generally claimed from the directors, promoters and other persons who authorised the issue of the prospectus.

Answer to Question No. 1(b)(iii)

Ever since the decision in the *Salomon* v. *Salomon & Co. Ltd.*, *(1897) A.C. 22* normally Courts are reluctant or at least very cautious to lift the veil of corporate personality to see the real persons behind it.

Nevertheless, Courts have found it necessary to disregard the separate personality of a company where the corporate veil has been used for commission of fraud or improper conduct. In such a situation, Courts have lifted the veil and looked at the realities of the situation [*Jones* v. *Lipman*, *(1962) I. W.L.R. 832].*

As separate personality of the company is a statutory privilege, it must be used for legitimate business purposes only. Where a fraudulent and dishonest use is made of the legal entity, the individuals concerned will not be allowed to take shelter behind the corporate personality. The Court will breakthrough the corporate shell and apply the principle of what is known as “lifting of or piercing through the corporate veil”.

Answer to Question No. 1(b)(iv)

Interim dividend once declared becomes debt and payable within 30 days of declaration. Section 2(14A) defines ‘Dividend’ to include interim dividend. Both interim and final dividend when declared become debt.

Prior to the coming into force of the Companies (Amendment) Act, 2000, the Act did not contain specific provisions for payment of interim dividend. However, if the articles of association of company authorised payment of interim dividend as per regulation 86 of the Table A of Schedule I, then the Board of directors of such company could declare an interim dividend where its profits warranted such payment. A mere resolution for declaration of an interim dividend did not create any liability and could be rescinded at any time before actual payment. This was so even if the cash to cover the proposed dividend had been placed into a separate account. The distinction between interim and final dividend was that, unlike interim dividend, a final dividend once declared by the company in general meeting was a debt and created an enforceable obligation. [*Punjab National Bank* v. *Union of India* (1986) 59 Com Cases 35 (Del.)]

With the enactment of the Companies (Amendment) Act, 2000, this position has changed. Interim dividend stands on the same footing as that of the final dividend. Both interim and final dividend when declared become debt and are payable within 30 days of declaration.

Question No. 2

Examine the following statement under the provisions of the Companies Act, 1956:

(a) A single member does not constitute quorum for a meeting.

(b) Minutes of the proceedings can be maintained in the loose leaf form.

(c) Books of account shall be kept at any office of the company.

(d) Variation of member's rights. *(5 marks each)*

Answer to Question No. 2(a)

Normally, a single member cannot constitute quorum for a meeting. The Department of company affairs (now the Ministry of Corporate Affairs) has also clarified that a single person cannot by himself constitute a quorum. However, exceptions to this rule do exist as under:-

(i) In *East* v. *Bennet Bros. Ltd.* (1911) Ch. 163, where all the preference shares in the company were held by one shareholder only it was held that a meeting of preference shareholders (class meeting) attended by only him was valid;

(ii) When the Company Law Board/Tribunal calls or directs the calling of a meeting under Section 167 of the Act;

(iii) If there is only one creditor or debenture holder, he constitute quorum for the creditors/debenture holders meeting;

(iv) One member of the company present in proxy or by person, shall be deemed to constitute a meeting where the Company Law Board/Tribunal orders a meeting of the company to be held under section 186 of the Act.

Answer to Question No. 2(b)

Section 193 provides that every company must keep minutes containing a fair and correct summary of all proceedings of:-

(a) every general meetings;

(b) every meetings of Board of directors; and

(c) every committee of the Board.

For this purpose every company is allowed to make entries of the proceedings of the meetings in books kept for that purpose within 30 days of the conclusion of the meeting. In no case the attaching or pasting of papers of proceedings of meeting is allowed in the minute books.

A loose-leaf ledger or loose leaves fastened together between two covers is not a book as required by section 193.

However, the Ministry of Corporate Affairs (previously the department of company affairs) has allowed minutes to be kept in loose leaf binder provided the following safeguards are taken :-

(a) The pages of minutes books must be consecutively numbered;

(b) Each page of every such book has been signed and the last page has been dated and signed by the chairman

(c) The loose leaves can be got bound at reasonable interval say, six months.

Further, the Company Law Board*, however, may not object if the minutes are maintained in the loose leaf form provided all other procedural requirements are complied with and all possible safeguards against manipulation or interpolation of the minutes are ensured.

Answer to Question No. 2(c)

Section 209 of the Companies Act, 1956 requires every company to keep the books of account at its registered office. However, all or any of the books of account may be kept at such other place in India as the Board of Directors may decide. When the Board so decides, the company is required within seven days of such decision to file with the Registrar a notice in writing giving full address of that other place in e-Form No. 23AA alongwith requisite filing fee.

Answer to Question No. 2(d)

Member's rights are determined by the Companies Act, Memorandum of Association, Articles of Association of the company and the terms of issue of shares. Rights attached to a class of shares are known as "class rights".

Member's rights relate to dividend, voting at members' meetings and return of capital. Preference shareholders may have rights to a fixed amount or a fixed rate of dividend or to cumulative dividend. Where the ordinary shareholders are conferred the right to participate in the surplus assets on winding up of a company, it is not deemed to be a class right as it is implied even in the absence of any express provision in the articles.

Section 106 of the Companies Act, 1956 lays down that the rights attached to the shares of any class can be varied with the consent in writing of the holders of not less than three-fourths of the issued shares of that class or with the sanction of a special resolution passed at a separate meeting of the holders of the issued shares of the class. Further, the variation of rights of shareholders can be effected only:

(i) if provision with respect to such variation is contained in the Memorandum or Articles of Association of the company; or

(ii) in the absence of any such provision in a Memorandum or Articles of Association of the company, if such a variation is not prohibited by the terms of issue of the shares of that class.

Question No. 3

(i) Ajeet subscribed shares issued by Flordia Ltd. The prospectus of Flordia Ltd. included a statement which was misleading in the forms and contents. On the faith of the prospectus believing it to be a true, Ajeet subscribed for shares and sustained loss. Can Ajeet sue for compensation of loss? If so, who will be sued for such loss?

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* To be replaced by the Tribunal under the Companies Act, 2013.

(ii) *A meeting of the Board of directors of Sreeram Ltd. was convened on 30th September, 2012, but the meeting did not take place for want of quorum. As a* result, the company did not hold any Board meeting for the quarter ended 30th September, 2012 and there is a complaint that the company has violated the provisions of the Companies Act, 1956 in this regard.

(iii) *The articles of association of Nakarash Ltd. provide that dividend can be declared at an extra-ordinary general meeting. Explain the validity of such a provision in the articles.*

(iv) *Rakesh the Managing Director of Rustam Ltd. wants to get sitting fees for attending the Board meetings over and above his salary. Is this legally permissible? Advice, suppose you are the company secretary of Rustam Ltd.*

(5 marks each)

Answer to Question No. 3(i)

Yes, Ajeet can sue for compensation of loss.

According to section 62 of the Companies Act, 1956, the following persons are liable to pay compensation to an allottee for loss or damage sustained by reason of untrue statement included in a prospectus:-

(a) Every person who is the director of the company at the time of issue of prospectus

(b) Every person who has authorized himself to be named in the prospectus either as a director, or has having agreed to become a director, either immediately or after an interval of time

(c) Every person who is the promoter of the company

(d) Every person who has authorized the issue of prospectus

Ajeet having sustained loss because of having believed the fact given in the prospectus issued by Flordia Ltd. to be true, can sue the four categories of persons indicated above for compensation of his loss. Apart from the above, he may sue the company for damages for deceipt.

Answer to Question No. 3(ii)

As per section 285, in case of every company, a meeting of its Board of Directors shall be held at least once in every 3 months and at least 4 such meetings shall be held in every year.

According to section 288(2), the provisions of section 285 shall not be deemed to have been contravened merely by reason of the fact that a meeting of the Board which had been called in compliance with the terms of that section could not be held for want of a quorum.

Thus, the allegation that the company has contravened the provisions of section 285 in the matter of holding the Board meeting is not correct.

Answer to Question No. 3(iii)

In terms of section 9 of the Companies Act, 1956, if there is a conflict between the Act and the company's Memorandum or Articles of Association, the provisions of the

Act will prevail and that any provision which is repugnant to the provisions of the Act shall be void.

A provision in the Articles of Association of a public company that dividend can also be declared at an extra-ordinary general meeting is void because such a provision in the Articles would run against section 173 of the Act which stipulates that declaration of dividend is an ordinary business at an annual general meeting. It was also held in *Raghu Nandan Neotia* v. *Swadeshi Cloth Dealers Ltd. (1964) 34 Com Cases 570 (Cal.)* that dividend can be declared only at an annual general meeting.

Answer to Question No. 3(iv)

Sitting fees are payable to a director as a compensation for the time spent at the meeting of the Board. A Managing Director is expected to devote his whole time to the affairs of the company. Attending Board meeting is a part of his duties and responsibilities. As such the question of payment of sitting fees to a Managing Director would not arise. But if a company chooses to pay sitting fees to its Managing Director in addition to his remuneration, it can do so provided the remuneration and the sitting fees together do not exceed 5% of net profits.

Question No. 4

(a) Briefly state the 'rule of majority' and its exception.

(b) Examine the position of directors of a company as its trustee, agent and employee. According to you, what is the true relationship between the company and its directors?

(c) State the consequences of false and misleading statements in a prospectus.

(d) Explain the provisions relating to appointment of chairman of a general meeting.

(5 marks each)

Answer to Question No. 4(a)

The management of companies is based on majority rule. Board of Directors exercise their powers vested on them by the Articles of Association of the company, Companies Act and powers given to them by the shareholders in general meetings and passed by a simple majority or by a Special Resolution, and therefore majority rule prevails.

Company law provides for adequate protection for the minority shareholders when their rights are oppressed/abused by the majority. However, the Court will not usually intervene at the instance of shareholders. The basic principle of non-interference with the internal management of company by the court is laid down in *Foss* v. *Harbottle (1843) 67 E.R. 189* ; that no action can be brought by a member against the directors in respect of a wrong alleged to be committed to a company. The company itself is the proper party of such an action. The rule really preserves the right of the majority to decide how the company's affairs shall be conducted. The supremacy of the majority, does not prevail in all situations, as over a period of time, certain exceptions have developed. For instance –

Under common law the exceptions are as under:

— *ultra vires* acts.

— fraud on minority.

— wrongdoers in control.

— breach of duties etc.

— resolution requiring special majority passed with simple majority.

— Individual membership rights invaded by the majority of shareholders.

— Prevention of oppression and management

The Companies Act, 1956 extends protection to minority by granting various rights to them as under:

— Prevention of oppression and management

— The variation of class rights

— Schemes of reconstruction and amalgamation

Answer to Question No. 4(b)

Position of director : - It is very difficult to define the exact position of directors. They are sometimes described as agents, sometimes as trustees and sometimes as managing partners, but each of these expressions do not exhaust their powers or responsibilities.

(i) *Directors as agents* :- A company as an artificial person, acts through directors who are elected representatives of the shareholders. Directors are, in the eyes of law, agents of the company for which they act. The general principle of the law of agency applies to the company and its directors. This position was established long back in *Ferguson* v. *Wilson (1866) L.R. 2 Ch. App 77*.

(ii) *Directors as employees* :- In addition to his directorship, he may hold a salaried employment in the company and in such a condition he will enjoy all the rights available to an employee or servant of the company.

(iii) *Directors as trustees* :- As a trustee of the company' s money and property, directors are accountable for their proper use and are required to refund or restore the same if improperly used. Apart from the money and property of the company, the trusteeship of directors also extends to trade secrets and other items of intellectual property, the existence or particulars of which may be within the personal knowledge of the directors [*Baket* v. *Citibbons*, *(1972) WCR 693*].

Answer to Question No. 4(c)

(A) Civil Liability for mis-statement in prospectus

A person who has subscribed for shares on the faith of misleading statement in prospectus has remedies against the company, directors, promoters & experts.

Remedies against the company

(i) *Rescission of the contract* : The right entitles the allotee to repudiate the contract

to take shares, seek immediate removal of his name from the register of members and claim his money back with interest.

(ii) *Damages for deceit* : Any person induced by a fraudulent statement in a prospectus to take shares is entitled to sue the company for damages.

Remedies against the promoters, directors and expert

A person who subscribed for shares on the faith of a false prospectus may claim from directors or promoters:

(i) damages for fraudulent misrepresentation,

(ii) Compensation under Section 62 of the Act,

(iii) Damages for non-compliance with the requirements of Section 56 of the Act.

(B) Criminal Liability for mis-statement in prospectus

According to Section 63 of the Companies Act, 1956, where a prospectus includes any untrue statement, every person who has authorised the issue of the prospectus shall be punishable with imprisonment for a term which may extend to 2 years; or fine which may extend to ₹ 50,000; or both.

However, where a person who has authorised the issue of prospectus proves, either that the statement was immaterial or that he had reasonable ground to believe, and did up to the time of issue of prospectus believe, that the statement was true, may be relieved from the criminal liability.

Answer to Question No. 4(d)

For conducting a meeting, a head called Chairman is essential. Generally, articles of a company provides for appointment of Chairman of general meeting.

Section 175(1) states that unless the articles otherwise provide, the members present in person at a meeting shall elect on a show of hands one of their members to be the chairman. In this context, regulation 50, 52 of Table A are relevant. Regulation 50 of Table A provides that Chairman, if any, of the Board shall preside as Chairman at every general meeting of the company.

If there is no Chairman or he is not present within fifteen minutes after the appointed time of the meeting or is unwilling to act as Chairman of the meeting, the directors present shall elect one among themselves to be Chairman of the meeting (Regulation 51).

If, at any meeting, no director is willing to act as Chairman or if no director is present within fifteen minutes after the appointed time of the meeting, the members present should choose one among themselves to be the chairman of the meeting (Regulation 52).

If after the election of a Chairman on a show of hands, poll is demanded, it must be taken forthwith and the Chairman elected by show of hands will exercise the powers of chairman till the poll is taken. If a different person is elected as chairman on a poll, then he will be the chairman for the rest of the meeting. If the articles are silent, the members

can elect one among themselves as chairman of the meeting through a show of hands, unless a poll is demanded.

Question No. 5

Write short notes on

(a) Statutory books and statistical books

(b) Transfer of shares and transmission of shares

(c) Irregular allotment

(d) Designated partners

(e) Demerger. *(3 marks each)*

Answer to Question No. 5(a)

In addition to the books of account, the Companies Act, 1956, specifically requires certain other books to be kept by a company for maintaining a record of its different activities in order to safeguard the interests of the shareholders and creditors. These books are known as Statutory Books. Some of such books are laid down as below:

1. Register of investments in securities made by the company but not held by it in its own name
2. Register of fixed deposits
3. Register of Securities bought back
4. Register of charges
5. Register and index of Members

A company usually maintains a number of statistical books in order to keep complete records of the numerous details connected with the business operations. The following is the list of some of such important statistical books:

1. Share Application and Allotment Book
2. Share Call Book
3. Share Certificate Book
4. Share Transfer Book
5. Debenture Interest Book

Answer to Question No. 5(b)

Transfer of shares – As per Section 108(1) of the Companies Act, 1956, a company, whether public or private, shall not register a transfer of shares unless a proper instrument of transfer duly stamped and executed by or on behalf of the transferor and by or on behalf of the transferee has been delivered to the company along with the certificate relating to the shares or debentures, or if no such certificate is in existence, then along with the related letter of allotment.

Transmission of shares – When a person dies, all his property vests at the moment of death in his legal representative. This is known as transmission or transfer by operation of law or involuntary assignment. Thus, transmission of shares takes place when the registered shareholder dies and shares in his name are transferred to his legal heir by operation of law.

The distinction between transfer and transmission is as under:

1. Transfer takes place by a voluntary act of the transferor while transmission is the result of the operation of law.
2. An instrument of transfer is required in case of transfer but no instrument of transfer is required in case of transmission.
3. Transfer is a normal course of transferring property whereas transmission takes place on death or insolvency of a shareholder.

Answer to Question No. 5(c)

Irregular Allotment

An allotment is irregular if it is made without complying with the conditions precedent to a regular allotment, viz, the provisions of Section 69 and 70 of the Act. Consequences of irregular allotment depend upon the nature of irregularity involved. These may be noted as follows:

1. *Failure to deliver a copy of the prospectus to the Registrar before its issue* — In case an allotment has been made without delivering to the Registrar of Companies, a copy of the prospectus along with other specified documents either before or on the date of its issue, the company and every person who is knowingly a party to the issue of the prospectus shall be punishable with fine which may extend to ₹ 50,000 [Section 60(5)]. The allotment, however, shall remain valid.

2. *Non-compliance with provisions of Section 69 and Section 70* — In the event of non-compliance with the provisions of Section 69 and Section 70 (viz allotment without raising minimum subscription or without either collecting application money or collecting less than 5% as application money or failure to deliver a copy of statement in lieu of prospectus at least 3 days before allotment), the following consequences shall follow:

   (a) The allotment is rendered voidable at the option of the applicant. The option must however be exercised —

      (i) within 2 months after the holding of the statutory meeting of the company and not later; or

      (ii) where the company is not required to hold a statutory meeting, or where the allotment is made after the holding of the statutory meeting, within 2 months after the date of allotment and not later.

      The irregular allotment is voidable even if the company is in the course of being wound up.

   (b) Any director who has knowledge of the fact of the irregular allotment of

shares shall be liable to compensate the company and the allottee respectively for any loss, damages or costs which they may have sustained.

Answer to Question No. 5(d)

Section 7 of the Limited Liability Partnership Act, 2008 provides that every limited liability partnership shall have at least two designated partners who are individuals and at least one of them shall be a resident in India. In case of a limited liability partnership in which all the partners are body corporates, at least two partners shall nominate their respective individuals who are to act as "designated partners" and one of the nominees shall be a resident of India.

Every designated partner of a limited liability partnership shall obtain a Designated Partner Identification Number (DPIN) from the Central Government and the provisions of Sections 266A to 266G (both inclusive) of the Companies Act, 1956 shall apply *mutatis mutandis* for the said purpose. The Central Government, vide Notification No. GSR 506(E) dated 5th July, 2011, notified Limited Liability Partnership (amendment) Rules, 2011 whereby it has integrated the Director's Identification Number (DIN) issued under Companies Act, 1956 with Designated Partnership Identification Number (DPIN) issued under Limited Liability Partnership (LLP) Act, 2008 with effect from 9.7.2011.

As per the LLP Act, the designated partner would be liable to all penalties imposed on the LLP for the contravention of the provisions of the Act and as such the designated partner would be required to pay all the monetary fines imposed on the LLP.

Answer to Question No. 5(e)

The expression "demerger" is not expressly defined in the Companies Act, 1956. However, it is covered under the expression 'arrangement' as defined in clause (b) of Section 390 of the Companies Act, 1956. According to this definition, 'arrangement' includes a re-organisation of the share capital of the company by the consolidation of shares of different classes, or by the division of shares into shares of different classes or, by both these methods. Such divisions may take place for various reasons internal or external. Internal factors are generally split in family rather than lack of competence on the part of management.

The Companies Act does not contain the concept of 'demerger' as such, but indirectly, it does recognize it in the following sections–

(a) Section 391/394 – as a scheme of compromise, arrangement or reconstruction; and

(b) Section 293(1)(a) – sale, lease or otherwise dispose of –

— the whole of the undertaking of the company; or

— substantially the whole of the undertaking of the company; or

— if the company owns more than one undertaking, of the whole, or substantially the whole, of any such undertaking.

TEST PAPER 2/2013

Time allowed : 3 hours *Maximum Marks : 100*

NOTE *: Answer ALL Questions.*

Question No.1.

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

(i) What is XBRL?

(a) Xtended Business Reporting Language

(b) Xtensible Bureau Reporting Language

(c) Xtensible Business Reporting Language

(d) Xtended Bureaucratic Reporting Language

(ii) Revised Schedule VI to Companies Act, 1956 provides-

(a) Format of cash flow statement

(b) Format of Balance Sheet

(c) Format of Statement of Profit and Loss

(d) Both 'b' & 'c' above.

(iii) A public company can borrow money--

(a) Before incorporation

(b) Soon after incorporation

(c) After one year of incorporation

(d) After obtaining Certificate to commence business.

(iv) The particulars of investment, loan, guarantee or security referred to above shall be entered chronologically in the register of loans made, guarantees given, securities provided and investment made within

(a) five days

(b) seven days

(c) fifteen days

(d) thirty days. *(1 mark each)*

(b) Re-write the following sentences after filling in the blanks spaces with appropriate word(s)/ figures(s):

(i) Sweat equity shares issued to employees or directors shall be locked in for a period of _____ from the date of allotment.

(ii) The name which is struck off by the ROC can be revive within _____years.

(iii) A company can keep its books of accounts at a place other than the registered office of the company by giving a notice in writing to the ROC within ____ days of the decision.

(iv) A notice of change of registered office is required to be given to the Registrar in e-form _____.

(v) Secretarial Standard-4 issued by ICSI deals with _____.

(vi) Preliminary contracts are contracts executed before the_____ of companies (1 mark each)

(c) State with reason in brief, whether the following statements are true or false.

(i) The change of name of a company may affect the rights and obligations of the company.

(ii) A company can ratify a pre-incorporation contract.

(iii) A charge created always requires registration under the Transfer of property Act, 1882.

(iv) Every company in India shall have at least three directors on its Board of directors.

(v) All listed companies have to file documents as required under section 220 using Extensible Business Reporting Language. (2 marks each)

Answer to Question No. 1(a)(i)

(c) Xtensible Business Reporting Language

Answer to Question No. 1(a)(ii)

(d) Both 'b' & 'c' above.

Answer to Question No. 1(a)(iii)

(d) After obtaining Certificate to commence business.

Answer to Question No. 1(a)(iv)

(b) seven days

Answer to Question No. 1(b)

(i) Sweat equity shares issued to employees or directors shall be locked in for a period of **3 years** from the date of allotment.

(ii) The name which is struck off by the ROC can be revived within **20** years.

(iii) A company can keep its books of accounts at a place other than the registered office of the company by giving a notice in writing to the ROC within **seven** days of the decision.

(iv) A notice of change of registered office is required to be given to the Registrar in **e-form 18**.

(v) Secretarial Standard-4 issued by ICSI deals with **Registers and Records**.

(vi) Preliminary contracts are contracts executed before the **incorporation** of companies.

Answer to Question No. 1(c)(i)

False

The change of name of a company will not affect any rights and obligations of the company, or legal proceedings commenced under the old name.

Answer to Question No. 1(c)(ii)

False

A company cannot ratify a pre-incorporation contract. However, it is open for the company to enter into a new contract after its incorporation to give effect to a contract made before its formation.

Answer to Question No. 1(c)(iii)

False

A charge created by operation of law does not require registration under the Transfer of Property Act 1882. However, a charge created by act of parties requires registration.

Answer to Question No. 1(c)(iv)

False

As per Section 252 of the Companies Act, 1956, every public company shall have at least three directors whereas every other company shall have at least two directors.

Answer to Question No. 1(c)(v)

True

As per Companies (Filing of documents and forms in Extensible Business Reporting Language) Rules, 2011, all Companies listed with any Stock Exchange in India and their Indian subsidiaries will have to file their Balance Sheet, Profit and Loss Account and other documents as required under section 220 of the Companies Act, 1956 with the Registrar using the Extensible Business Reporting Language (XBRL) with e-Form no. 23AC-XBRL and 23ACA-XBRL.

Question No. 2

Comment on the following :

(a) Examine the position of directors of a public company as its trustee, agent and employee. What is the true relationship between company and its directors? Give some case laws.

(b) Whether GDR holders are members of the Company? If no, state the condition in which they can be the members.

(c) Advise the management on the following matters stating the legal provisions and procedure therefore for political contributions by a company. (5 marks each)

Answer to Question No. 2(a)

Position of director : It is very difficult to define the exact position of directors. They are sometimes described as agents, sometimes as trustees and sometimes as managing partners, but each of these expressions do not exhaust their powers or responsibilities.

(i) *Directors as agents* :- A company as an artificial person, acts through directors who are elected representatives of the shareholders. Directors are, in the eyes of law, agents of the company for which they act. The general principle of the law of agency applies to the company and its directors. This position was established long back in *Ferguson* v. *Wilson (1866) L.R. 2 Ch. App 77*.

(ii) *Directors as employees* :- In addition to his directorship, he may hold a salaried employment in the company and in such a condition he will enjoy all the rights available to an employee or servant of the company.

(iii) *Directors as trustees* :- As a trustee of the company' s money and property, directors are accountable for their proper use and are required to refund or restore the same if improperly used. Apart from the money and property of the company, the trusteeship of directors also extends to trade secrets and other items of intellectual property, the existence or particulars of which may be within the personal knowledge of the directors [*Baket* v. *Citibbons, (1972) WCR 693*].

Answer to Question No. 2(b)

The Ministry of Corporate Affairs, vide its Circular No.1/2009 No.17/67/2009 CL-V dated 16/6/2009 has clarified that :

(a) As per section 41(1) and (2) of the Companies Act, a person is a member of the company, (i) who is a subscriber to the Memorandum or (ii) whose name has been entered in the register of members. Since, holder of Global Depository Receipts is neither the subscriber to the Memorandum nor a holder of the shares, his name cannot be entered in the Register of Members. Therefore, a holder of Global Depository Receipts cannot be called a member of the company.

(b) As per Section 41(3) of the Companies Act, 1956, a person holding a share capital of the company and whose name is entered as beneficial owner in the records of the depository, is deemed to be a member of the company. Since the Overseas Depository Bank as referred in the 'Scheme' is neither the Depository as defined in the Companies Act, 1956 and the Depositories Act, 1996 nor holding the share capital, therefore, it cannot be deemed to be a member of the company.

(c) A holder of Global Depository Receipts may become a member of the company only on transfer/redemption of the GDR into underlying equity shares after following the procedure provided in the "Scheme"/provisions of the Companies Act, 1956.

(d) Since the underlying shares are allotted in the name of Overseas Depository Bank, the name of such Overseas Depository Bank is to be entered in the Register of Members of the issuing company. However, until transfer/redemption

of such GDR's into underlying shares, Overseas Depository Bank cannot be considered a nominee of the holder of GDR for the purpose of Section 42 read with Section 41 of the Companies Act, 1956.

Answer to Question No. 2(c)

Government Companies and Companies which have been in existence for less than three financial years cannot make any contribution to political party or for any political purpose to any person.

Section 293A(2) permits Non-Government Companies which are in existence for not less than three financial years, to make contributions, directly or indirectly, in any financial year, to any political party or for any political purpose to any person, amounts not exceeding 5% of their average net profits determined in accordance with provisions of Sections 349 and 350 during the three immediately preceding financial years.

It is further provided that no such contribution shall be made by a company unless a resolution authorising the making of such contribution is passed at a meeting of the Board of directors and such resolution shall, subject to other provisions of this section, be deemed to be justification in law for the making and the acceptance of the contribution authorised by it.

Such contributions are required to be disclosed by every company in its profit and loss account, giving particulars of the total amount contributed and the name of the party or the person to which or to whom such amount has been contributed [Section 293A (4)].

Question No. 3

Differentiate:

(a) ESOP and ESPS

(b) Limited Liability Partnership (LLP) and Partnership

(c) Nominee and Legal heirs

(d) Red herring prospectus and information memorandum (5 marks each)

Answer to Question No. 3(a)

ESOP or Employee Stock Option Scheme means a scheme under which options given to the whole-time directors, officers or employees of a company to purchase or subscribe at a future date, the securities offered by the company at a pre-determined price.

No ESOP can be offered to the employees of the company unless the shareholders of the company approve ESOP by passing special resolution in the general meeting. The company shall have freedom to specify the lock-in-period for the shares issued on exercise of option.

ESPS or Employee Stock Purchase Scheme means a scheme under which the company offers shares to employees as part of a public issue or otherwise. An employee who is a promoter or belongs to a group of promoters shall not be eligible to participate in ESPS.

Issue of ESPS requires approval of the shareholders of the company by passing special resolution in the general body meeting of the shareholders.

ESPS will have lock-in period of minimum one year.

Answer to Question No. 3(b)

The principle points of difference between a LLP and partnership are as follows:

1. LLP is a separate legal entity and therefore, can be sued or it can sue others without involving the partners. A partnership firm is not distinct from the several persons who compose it.
2. The partners of a LLP would have limited liability i.e. they would not be liable beyond the money contributed by them. Whereas, partners of a firm would have unlimited liability.
3. The retirement or death of a partner would not dissolve the LLP. On the other hand, the death or retirement of a partner would dissolve the partnership firm.
4. In a partnership, the property of the firm is the property of the individuals comprising it. In a LLP, it belongs to the LLP and not to the individuals comprising it.
5. Whereas a partnership can be formed either orally or by a deed of agreement whether registered or not, LLP is formed by an incorporation document and an LLP agreement, thus, giving it a legality.
6. Whereas a registered or unregistered partnership cannot have more than 20 partners, LLP can have more than that number since no upper limit has been laid down by the Act.
7. A LLP has perpetual succession, i.e. the death or insolvency of a shareholder or all of them does not affect the life of the LLP, whereas the death or insolvency of a partner dissolves the firm, unless otherwise provided.

Answer to Question No. 3(c)

A nominee is someone who has been nominated for something. In legal parlance, nominee is 'a person to receive the benefits under nomination and distribute the same to the legal heirs/beneficiaries under law'. On the other hand, a person legally entitled to inherit the property of someone who dies *intestate* is called a legal heir. Legal heir is an individual who receives an interest in, or ownership of, land, tenements, or hereditaments from an ancestor who has died *intestate*, through the laws of Descent & Distribution.

The legal position of a nominee has always been accepted to be that of an 'agent' or 'trustee' and nomination is not considered to be a kind of testamentary succession. Nomination did not operate as a third kind of succession which could be styled as a statutory testament. A nominee could not be treated as being equivalent to an heir or *legatee*. The Bombay High Court in *Harsha Nitin Kokate* v. *The Saraswat Co-op. Bank Ltd. [2010] 159 Com Cases 221 (Bom)* while interpreting Section 109A of the Companies Act, 1956 ruled that *"on the death of the share holder, the nominee would become entitled to all rights in the shares to the exclusion of all other persons"*.

Section 109A of the Companies Act provides that upon the death of a shareholder, the shares would "vest" in the nominee. The provision adds that the nominee shall become entitled to all the rights attached to the shares to the exclusion of all others regardless of anything stated in any other disposition, testamentary or otherwise. Therefore, regardless of what is stated in privately executed wills, a company would have to only deal with the nominee as a person now exercising the rights of the deceased shareholder.

Where a nomination has been made by a shareholder/debentureholder of his shares/ debentures in a company, the nominee will be entitled to all the rights in respect of shares in the event of death of the shareholder as against the legal representative/legal heirs of the deceased member.

Answer to Question No. 3(d)

A public company making an issue of securities may circulate information memorandum to the public prior to filing of Prospectus. A company inviting subscription by an information memorandum shall be bound to file a prospectus prior to the opening of the subscription lists and the offer as a red-herring prospectus, at least three days before the opening of the offer. [Section 60B]

On the other hand, explanation to sub-section (4) of section 60B provides that "Red-herring prospectus" means a prospectus which does not have complete particulars on the price of the securities offered and the quantum of securities offered. It is issued during book building process. Red herring prospectus contains either the floor price of securities offered or a price band along with the range within which the Bids can move. The information memorandum and red herring prospectus carry same obligations as are applicable in the case of prospectus. Every variation between the information memorandum and the red-herring prospectus shall be highlighted by the issuer company and shall be individually intimated to the persons invited to subscribe to the securities.

Question No. 4

Write short notes on the following:

(i) Compounding of offences

(ii) Investor Education and Protection Fund

(iii) Companies Bill 2012

(iv) Secretarial Standards

(v) Director's Responsibility Statement. *(3 marks each)*

Answer to Question No. 4(i)

Provisions and procedure for Compounding of offences, which are punishable under Companies Act, 1956 are stipulated under section 621A of the Act. To 'compound' means to settle by mutual agreement or to condone a liability or offence in exchange for money; to forbear from prosecuting; to forbear prosecution of offence for a consideration.

Only those offences which are punishable with either penalty or penalty or imprisonment i.e. where it is at discretion of the court to impose penalty or imprisonment,

are compoundable under section 621A. In other words, offence which is specifically punishable with imprisonment only or imprisonment plus fine is non-compoundable.

Similarly, offence must not be a subsequent offence committed within a period of 3 years from compounding of an offence of similar nature. It means if an offence is compounded in favour of a person and if that person commits that offence once again within a span of three years from the previous compounding then the subsequent offence shall not be eligible for compounding. However if the period of 3 years has lapsed from previous compounding then the subsequent offence shall be considered as fresh offence and shall be eligible for compounding.

The power of compounding of offence is conferred upon the Company Law Board* and Regional Director. Once the offence is compounded, no further prosecution shall be initiated either by the Registrar or shareholder or any other person in respect of that offence.

Answer to Question No. 4(ii)

Investor Education and Protection Fund

As per Section 205C of the Companies Act, 1956, the Central Government shall establish a fund to be called the Investor Education and Protection Fund (hereafter referred to as the "Fund"). There shall be credited to the Fund the following amounts, namely:

(a) amounts in the unpaid dividend accounts of companies;

(b) the application moneys received by companies for allotment of any securities and due for refund;

(c) matured deposits with companies;

(d) matured debentures with companies;

(e) the interest accrued on the amounts referred to in (a) to (d) above;

(f) grants and donations given to the Fund by the Central Government, State Government, companies or any other institutions for the purposes of the Fund; and

(g) the interest or other income received out of the investments made from the Fund.

However, no such amounts as mentioned in (a) to (d) above shall form part of the Fund unless such amounts have remained unclaimed and unpaid for a period of seven years from the date they became due for payment.

Answer to Question No. 4(iii)

The Companies Bill, 2012 is the result of detailed consultative process adopted by the Central Government. The Bill was passed by the Lok Sabha on 18th December, 2012 and finally by the Rajya Sabha on 8th August, 2013.

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* To be replaced by the Tribunal under the Companies Act, 2013.

The Bill has 470 clauses and 7 Schedules as against 658 Sections and 15 Schedules in the existing Companies Act, 1956. The entire Bill has been divided into 29 chapters.

Following new aspects have been introduced, viz.

- Registered Valuers
- Class action suits
- Descriptive Annual Return
- Contribution to CSR by certain companies
- National Company Law Tribunal & Appellate Tribunal
- Special Courts
- Serious Fraud Investigation Office (SFIO) etc.

The Bill empowers Central Government to make rules, etc. through delegated legislation after having detailed consultative process.

The Bill provides for self-regulatory process and stringent compliance regime.

The Bill was assented by the Hon'ble President of India on 29th August, 2013 and notified in the Gazette of India on 30th August, 2013 and finally became the Companies Act, 2013.

Answer to Question No. 4(iv)

Companies follow diverse secretarial practices and therefore, there is a need to harmonise and standardize such practices so as to promote uniformity and consistency.

The objective of introducing Secretarial Standards is to integrate, harmonise and standardize the diverse secretarial practices for good corporate governance.

The Institute of Company Secretaries of India (ICSI) has constituted a Board called Secretarial Standards Board (SSB) for formulating Secretarial Standards. This is a unique and pioneering step towards standardisation of diverse secretarial practices prevalent in the corporate sector. The ultimate goal of Secretarial Standards Board constituted by the ICSI is to promote good corporate practice leading to better corporate governance.

The adoption of the Secretarial Standards by the corporate sector will have a substantial impact on the quality of secretarial practices being followed by companies, making them comparable with the best practices in the world.

Answer to Question No. 4(v)

The Board's report shall include a Directors' Responsibility Statement as required under Section 217(2AA) indicating therein:-

(i) that in the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures;

(ii) that the directors had selected such accounting policies and applied them

consistently and made judgements and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit or loss of the company for that period;

(iii) that the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;

(iv) that the directors had prepared the annual accounts on a going concern basis.

Director's Responsibility Statement is aimed at highlighting the accountability of the directors with a view to ensuring good corporate governance. It will make the directors accountable to safeguard the assets of the company and to take positive steps in this regard.

Question No. 5

(a) Explain the procedure for incorporation of section 25 company.

(b) Is it compulsory to maintain a Debenture Redemption Reserve ? If yes, how ?

(5 marks each)

Answer to Question No. 5(a)

The powers vested in the Regional Director for issue of license under Section 25 of the Companies Act, 1956 have been transferred to the Registrar of Companies vide MCA Notification No. G.S.R. 222(E) dated 17th March, 2011. Accordingly, application has to be submitted to the Registrar having jurisdiction over the company, based on the location of its registered office in the following manner:

I. File e- Form 1A for Name availability application to ROC with following information's/attachment

– Proposed names of the company

– Main object of the proposed company

– Trademark or authorisation to use trade mark, if the name of the company is based on trade mark or application for deed of assignment.

II. File e-form 24A (Application for seeking issue of licence) with followings Attachments

– Memorandum of Association (MoA) & Articles of Association (AoA)

– Declaration as per annexure V of Companies Regulations, 1956

– Future annual income and expenditure estimates

– Assets and liabilities statement with their estimated value as on seven days before making the application

– Declaration by advocate of Supreme Court or High Court, attorney or pleader entitled to appear before a High Court, or a CS or CA in whole time practice

- Details of the promoters and of the proposed directors of the company
- A list of the names, addresses, descriptions and occupations of its directors and of its managers or secretary, if any
- If association is already in existence, then last 2 years' accounts, balance sheet and report on working of the association as submitted to the members of the association
- Statement of brief description of the work, if already done by the association and the work proposed to be done
- Statement of the grounds on which application is made.
- Last 2 years' accounts, balance sheet and report on working of the association as submitted to members of association in case of a company already registered.

After obtaining the License from the Registrar, file E-Forms 1, 18, and 32 for incorporation of the company.

Answer to Question No. 5(b)

Section 117C of the Act requires every company to create a Debenture Redemption Reserve (DRR) to which adequate amount shall be credited out of its profits every year until such debentures are redeemed and shall utilize the same exclusively for redemption of a particular set or series of debentures only. There is no obligation on the part of the company to create DRR if there is no profit for that particular year.

Vide Circular No. 11/02/2012-CL-V(A) dated 11.02.2013, the Ministry of Corporate Affairs has clarified as under:

(i) No DRR is required for debentures issued by All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and banking companies for both public as well as privately placed debentures. For other Financial Institutions (FIs) within the meaning of Section 4A of the Companies Act, 1956, DRR will be as applicable to NBFCs registered with RBI.

(ii) For NBFCs registered with the RBI under Section 45-IA of the RBI (Amendment Act), 1997, the adequacy of DRR will be 25% per cent of the value of debentures issued through public issue as per present SEBI (Issue and Listing of Debt Securities) Regulations, 2008 and no DRR is required in the case of privately placed debentures.

(iii) For other companies including manufacturing and infrastructure companies, the adequacy of DRR will be 25 per cent of the value of debentures issued through public issue as per present SEBI(Issue and Listing of Debt Securities) Regulations, 2008 and also 25% DRR is required in the case of privately placed debentures by listed companies. For unlisted companies issuing debentures on private placement basis, the DRR will be 25 per cent of the value of debentures.

(iv) Every company required to create/maintain DRR shall before the 30th day of April of each year, deposit or invest, as the case may be, a sum which shall not be less than fifteen percent of the amount of its debentures maturing during the year ending on the 31st day of March next following.

Question No. 6

(i) *Alveera Ltd. is a public limited company, incorporated under the Companies Act, 1956. It had failed to register a charge which requires registration under section 125. What will be the consequences of such non-registration? Advice the company.*

(ii) *Asswin Ltd. is a public limited company, incorporated under the Companies Act, 1956. The Board of directors of the said company has recently decided to insert an article in its articles of association relating to expulsion of a member by the Board of directors of the company where the directors were of the view that the activities or conduct of such a member was detrimental to the interests of the company. Is the Board's decision valid in the eye of law?*

(iii) *ABC Ltd. is a listed company having a paid-up share capital of ₹ 36 crore and general reserves of ₹ 24 crore. It desires to make a loan of ₹ 10 crore to XYZ Ltd. ABC Ltd. holds 60% of the equity shares in XYZ Ltd. ABC Ltd. has already made investment in and given loans to other companies aggregating to ₹ 30 crore. ABC Ltd. has not committed any default in respect of institutional loans or in repayment of fixed deposits. State whether the company is eligible to give loan of ₹10 crore to XYZ Ltd. Would your answer be different if XYZ Ltd. is ABC Ltd.'s wholly-owned subsidiary ?*

(iv) *Pawan Ltd. committed default by failing to file Balance Sheet and Profit and Loss Account. Proceedings have been initiated against a non-executive director. However, he contended that he has resigned before the date of default. Whether the contention of the ex-director be taken into account ? (5 marks each)*

Answer to Question No. 6(i)

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

(a) The charge will be void (i) against the liquidator (if the company goes into liquidation) and (ii) against creditors [Section 125(1)]. It shall not be void against a purchaser of the properties charged [*State Bank of India* v. *Vishwanirayat (P) Ltd. (1987) 3 Comp. L. J. 171.*]

(b) The debt in respect of which the charge was given shall remain valid, i.e., it can always be recovered as a unsecured debt [Section 125 (2)]

(c) The charge is good against the company The money secured by the charge becomes payable immediately. [Section 125 (3)]

(d) During liquidation the charge-holder (creditor) assumes the status of an unsecured creditor, as the charge is void against liquidator and creditors.

(e) The holder of an equitable charge whose charge is void on the ground of non-registration, has no lien on the title deeds or documents deposited with him as the deposit is only ancillary to the void charge.

(f) The company and every officer of the company or other person who is in default shall be punishable with fine which may extend to five thousand rupees for every day during which the default continues. [Section 142 (1)].

Answer to Question No. 6 (ii)

The Ministry of Corporate Affairs while clarifying as to whether a public limited company had powers to insert an article in its Articles of Association relating to expulsion of a member by the Board of Directors of the company had stated that an article for expulsion of a member is opposed to the fundamental principles of the Company Jurisprudence and is *ultra vires* the company. Such a provision is against the provisions of the Companies Act relating to the rights of a member in a company, the powers of the Central Government as an appellate authority under Section 111 of the Act and the powers of the Court under Sections 107, 395 and 397 of the Companies Act.

According to Section 9 of the Companies Act, the Act overrides the Memorandum and Articles of Association and any provision contained in these documents repugnant to the provisions of the Companies Act, is void.

The Ministry of Corporate Affairs has, therefore, clarified that any assumption of the powers by the Board of Directors to expel a member by alteration of Articles of Association shall be illegal and void.

Considering the above-mentioned clarification, the Board's decision of Asswin Ltd. is invalid in the eyes of law.

Answer to Question No. 6(iii)

As per section 372A of the Companies Act, 1956, a company can give loan etc. to companies to the extent of 60% of its paid up capital and free reserves or 100% of free reserves, whichever is higher, with the prior approval of the Board. Any investment, or loan or, guarantee beyond this limit can be made with the previous approval of the members in general meeting by way of special resolution.

In case of ABC Ltd., the limit upto which the company can give loans/guarantee is as follows:

	Amount in ₹
Paid up Capital	36 crores
General Reserves	24 crores
Total	60 crores
60% of 60 crores	36 crores
100% of 24 crores	24 crores

As 60% of paid up capital and free reserves is more than 100% of free reserves, the overall limit for release of loan is ₹ 36 crores.

The company can give loan upto ₹ 36 crores without obtaining the approval of members.

	Amount in ₹
Existing loans and investments	30 crores
Proposed loans	10 crores
Total loans and investments	40 crores

It can be seen that the total loans and investments exceeds the limit upto which the company can give loans i.e. ₹ 36 crores in the present case. Thus, a loan of ₹ 10 crore can be given to XYZ Ltd. with the previous approval of the members by passing a special resolution in a general meeting.

Further, if XYZ Ltd. is ABC Ltd.'s wholly owned subsidiary, then ABC Ltd. can give loan exceeding the limit as specified above without passing a special resolution as per the exemption provided under section 372A(8).

Answer to Question No. 6 (iv)

In the case of *Jayesh R More* v. *State of Gujarat*, *(2000) CLC 200 (Guj)*, where the director in question had resigned before the default occurred, it was held that he ceased to be a director and had no relationship with the company on the date of the alleged commission of the offence. He did not fall in the definition of an officer in default. The complaint against him was liable to be quashed.

Therefore, in view of the above, contention of the ex-director that he had resigned before the date of default can be taken into account.

TEST PAPER 3/2013

Time allowed : 3 hours *Maximum Marks : 100*

NOTE *: Answer ALL Questions.*

Question No.1.

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

(i) The Registrar of Companies can extend the time for holding an Annual General Meeting by not more than _____

(a) one month

(b) three months

(c) six months

(d) None of the above

(ii) The additional fee levied by MCA for delay in filing forms can be extended to

(a) Two times

(b) Four times

(c) Six Times

(d) Nine Times

(iii) Memorandum of Association and Articles of Association are filed with ROC at the time of

(a) Registration of the Company

(b) Appointment of Director

(c) Removal of Auditor

(d) None of the above.

(iv) Sweat equity shares issued to employees or directors of a company shall be locked-in for a period of –

(a) Three years from the date of allotment

(b) Two years from the date of allotment

(c) Five years from the date of allotment

(d) Twelve Months from the date of allotment

(v) Under MCA e-governance system a company can be incorporated earliest by

(a) 7 days

(b) 30 days

(c) 24 hours

(d) 5 days (1 mark each)

(b) Re-write the following sentences after filling in the blanks spaces with appropriate word(s)/ figures(s):

(i) Every Limited Liability Partnership shall have at least _____ designated partner.

(ii) _____ is the charter of the company.

(iii) The payment of the value of ₹_____ for MCA21 services can be made only in electronic mode.

(iv) Section 75 of the Companies Act, 1956 provides that a _____ in the prescribed e-form 2 must be filed with the Registrar of Companies within 30 days of the allotment of shares.

(v) A company being a legal entity must have a _____ of its own to execute contracts and establish its separate identity. (1 mark each)

(c) State with reason in brief, whether the following statements are true or false.

(i) Foreign Companies having a place of business in India are also governed by the Companies Act, 1956.

(ii) Winding up is same as dissolution of the company.

(iii) The provisions of the Companies Act relating to prospectus shall apply to the advertisement inviting public deposits also.

(iv) A person can be the Managing Director of two public companies.

(v) The winding up of a company by the Court is deemed to commence at the time of the presentation of the petition for winding up. (2 marks each)

Answer to Question No. 1(a)(i)

(b) three months

Answer to Question No. 1(a)(ii)

(d) Nine Times

Answer to Question No. 1(a)(iii)

(i) Registration of the Company

Answer to Question No. 1(a)(iv)

(a) Three years from the date of allotment

Answer to Question No. 1(a)(v)

(c) 24 hours

Answer to Question No. 1(b)

(i) Every Limited Liability Partnership shall have at least **two** designated partners.

(ii) **Memorandum of Association** is the charter of the company.

(iii) The payment of the value of ₹ **50,000** for MCA21 services can be made only in electronic mode.

(iv) Section 75 of the Companies Act, 1956 provides that a **return of allotment** in the prescribed e-form 2 must be filed with the Registrar of Companies within 30 days of the allotment of shares.

(v) A company being a legal entity must have a **name** of its own to execute contracts and establish its separate identity.

Answer to Question No. 1(c)(i)

True

Sections 591 to 602 of the Companies Act, 1956 apply to foreign companies i.e. companies which are incorporated in a country outside India and have a place of business in India.

Answer to Question No. 1(c)(ii)

False

Winding up is the process for the dissolution of a company. Winding up in all cases does not culminate in dissolution.

Answer to Question No. 1(c)(iii)

True

According to section 58B of the Companies Act, 1956, an advertisement inviting deposits is a prospectus and consequently all the provisions of the Companies Act, 1956, applicable to the prospectus, are applicable to the advertisement inviting deposits.

Answer to Question No. 1(c)(iv)

True

As per section 316 of the Companies Act, 1956, a public company may appoint or employ a person as its managing director, if he is the managing director of one and of not more than one other company including a private company which is not a subsidiary of a public company.

Answer to Question No. 1(c)(v)

False

Where, before the presentation of the petition a resolution has been passed by the company, for voluntary winding up, the winding up shall be deemed to have commenced at the time of the passing of the resolution. In all other cases, the winding up of a company must be deemed to commence at the time of the presentation of the petition for the winding up.

Question No. 2

(i) Define an unregistered company and point out how and when such a company can be wound up ?

(ii) Discuss the provisions of the Companies Act, 1956, relating to remuneration of Managerial Personnel.

(iii) State the areas of practice specified for a company secretary in practice under Section 2(2) of the Company Secretaries Act, 1980. (5 marks each)

Answer to Question No. 2(i)

Section 582 of the Companies Act, 1956 defines "unregistered companies". By virtue of that section, an "unregistered company" does not include the following:

(a) a railway company incorporated by any Act of Parliament or other Indian Law or any Act of Parliament of the United Kingdom;

(b) a company registered under the Companies Act, 1956; or

(c) a company registered under any previous companies law and not being a company the registered office whereof was in Burma, Aden or Pakistan immediately before the separation of that country from India.

Except as aforesaid, any partnership, association or company consisting of more than seven members at the time when the petition for winding up the partnership, association or company, as the case may be, is presented before the Court, will be deemed to be an unregistered company.

Section 583 provides for winding up of unregistered companies. All the provisions of Companies Act with respect to winding up shall apply to an unregistered company in addition to the provisions provided under section 583.

No unregistered company shall be wound up voluntarily by the Court.

The circumstances in which an unregistered company may be wound up are-

— if the company is dissolved or has ceased to carry on business or is carrying on business only for the purpose of winding up its affairs

— if the company is unable to pay its debts

— if the court is of the opinion that it is just and equitable that the company should be wound up.

Answer to Question No. 2(ii)

Section 309 contains provisions regarding remuneration of directors including any managing or whole-time directors. Section 198(1) lays down 11% of the net profits as the overall ceiling on total managerial remuneration payable by a public company or a private company, which is a subsidiary of a public company, to its directors (which mean all directors including managing and whole-time directors) and manager. Section 309(1) provides that remuneration payable to the directors of a company, including any managing or whole-time director shall be determined in accordance with and subject to the provisions of Section 198 and this section either by the articles of the company or by a resolution or, if the articles so require by special resolution passed in general meeting and remuneration so determined shall be inclusive of remuneration payable to such director for services rendered by him in any other capacity.

Section 309(3) provides that a managing director or a whole-time director may be paid remuneration either by way of monthly payment or at a specified percentage of net profits of company or partly by one way and partly by the other. Except with the approval of Central Government such remuneration should not exceed 5 % of net profits for one such director and if there is more than one such director, not more than 10 % for all of them together. Net profits shall be calculated as per Section 198.

Schedule XIII provides guidelines for remuneration of managerial personnel. These guidelines constitute statutory guidelines to the appointment of a person as managing director without the approval of the Central Government.

Section 310 provides that a provision relating to remuneration of any director including a managing or whole-time director, or any amendment thereof, which purports to increase whether directly or indirectly, the amount thereof, whether the provision be contained in memorandum or articles, or in an agreement, or in any resolution passed by the company in general meeting or by its Board of directors, shall not have any effect:

(i) in case where Schedule XIII is applicable, unless such increase is in accordance with the conditions specified in that Schedule, and

(ii) in any other case, unless approved by the Central Government, on an application submitted by the company in revised form, e-Form No. 25A.

and that amendment shall be void, if and in so far as it is disapproved by that Government.

Answer to Question No. 2(iii)

The Company Secretaries Act, 1980 recognises that a member individually or in partnership with other members, can engage in practice of the profession of company secretaries and has specified the areas of practice.

Section 2(2) of the Company Secretaries Act, 1980 has prescribed the following areas of practice for a company secretary in practice:

(a) to engage himself in the practice of the profession of company secretaries to, orin relation to, any company; or

(b) to offer to perform or perform services in relation to the promotion, formation, incorporation, amalgamation, reconstruction, reorganisation or winding-up of companies; or

(c) to offer to perform or perform such services as may be performed by:

  (i) an authorised representative of a company with respect to filing, registering, presenting, attesting or verifying any documents (including forms, applications, and returns) by or on behalf of the company;

  (ii) a share transfer agent;

  (iii) an issue house;

  (iv) a share and stock broker;

  (v) a secretarial auditor or consultant;

(vi) an adviser to a company on management, including any legal or procedural matter falling under the Capital Issues (Control) Act, 1947*, the Industries (Development and Regulation) Act, 1951; the Companies Act, 1956; the Securities Contracts (Regulation) Act, 1956; any of the rules or bye-laws made by a recognised stock exchange, the Monopolies and Restrictive Trade Practices Act, 1969**; the Foreign Exchange Regulation Act, 1973***; or under any other law for the time being in force.

(vii) to issue certificates on behalf of, or for the purposes of a company; or

(d) to hold himself out to the public as a company secretary in practice; or

(e) to render professional services or assistance with respect to matters of principle or detail relating to the practice of the profession of company secretaries; or

(f) to render such other services as, in the opinion of the Council are or may be rendered by a Company Secretary in practice;

Under Section 2(2)(f) of the Company Secretaries Act, 1980, the Council of the Institute has specified certain categories of Management, Advisory and Other Services, which may be rendered by a Company Secretary in Practice.

Question No. 3

Differentiate

(a) Statutory audit and special audit

(b) Subsidiary company and holding company

(c) Private company and LLP. *(5 marks each)*

Answer to Question No. 3(a)

Statutory Audit

By the meaning of word the statutory audit is the audit which is prescribed by a statute. In India, statutory audit means audit under the Companies Act, 1956 in which the auditor reports to the members of the company i.e. shareholders. It is conducted by statutory auditor. It is mandatory in nature. Every company is required to audit its books of account. As per section 224(1), statutory auditors are appointed by the company at its annual general meeting.

Special Audit

Section 233A [Inserted by the Companies (Amendment) Act, 1960] empowers the Central Government to appoint either any Chartered Accountant or the company's own

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* Capital Issues (Control) Act, 1947 has been repealed and SEBI Act, 1992 has been enacted.

** MRTP Act, 1969 has been repealed and Competition Act, 2002 has been enacted.

*** Foreign Exchange Regulation Act, 1973 has been repealed and Foreign Exchange Management Act, 1999 has been enacted.

auditor to conduct a special audit in certain circumstances. Accordingly, Section 233A provides that where the Central Government is of the opinion —

(a) that the affairs of any company are not being managed in accordance with sound business principles or prudent commercial practices; or

(b) that the company is being managed in a manner likely to cause serious injury or damage to the interests of the trade, industry or business to which it pertains; or

(c) that the financial position of any company is such so as to endanger its solvency;

the Central Government may at any time by order direct a special audit of the company's accounts for such period as may be specified in the order.

Answer to Question No. 3(b)

'Subsidiary company' and 'holding company'

Section 4 of the Companies Act, 1956 gives the meaning of holding company and subsidiary company. Accordingly, section 4 of the Act provides that –

A company shall be deemed to be a subsidiary of another (holding company) if, but only if, —

(a) that other (holding company) controls the composition of its Board of directors;

or

(b) that other—

(i) where the first-mentioned company is an existing company in respect of which the holders of preference shares issued before the commencement of this Act have the same voting rights in all respects as the holders of equity shares, exercises or controls more than half of the total voting power of such company;

(ii) where the first-mentioned company is any other company, holds more than half in nominal value of its equity share capital; or

(c) the first-mentioned company is a subsidiary of any company which is that other's subsidiary.

Illustration

Company B is a subsidiary of company A, and company C is a subsidiary of company B. Company C is a subsidiary of company A, by virtue of clause (c) above. If company D is a subsidiary of company C, company D will be a subsidiary of company B and consequently also of company A, by virtue of clause (c) above, and so on.

So, the difference between a holding company and a subsidiary company has been made very clear by Section 4 of the Companies Act, 1956.

Answer to Question No. 3(c)

A comparison of a LLP with a Private Limited Company reveals that such companies have:

— *Limited Liability* : Similar to LLP.

— *Internal flexibility* : Company Law requires a formal board structure and decision making at validly constituted meetings, passing of resolutions and maintenance of minutes of meetings.

— *Privacy* : Similar to LLP.

— *Requirement of a LLP agreement* : Memorandum and Articles of Association are the default standard provisions doing away with the need for a separate agreement similar to a LLP agreement.

However, difference between a private company and LLP is as under:-

1. In case of LLP, the need for classifying the object clauses into main, ancillary and other objects as well as framing the Share Capital clause in the memorandum for incorporating a private company is reduced into a simple procedure of filling of the prescribed information in the Incorporation document and statement in Form No. 2.
2. In case of LLP, a 'limited liability partnership agreement' (LLPA) is prepared which is a variant of the 'articles of association' of a private company.
3. Whereas the memorandum of a private company is required to name the state in which it is required to be incorporated, there is no such obligation in the case of LLP.
4. In the LLP Act, there is no such stipulation for meeting of partners either periodically or compulsory at the year end as stipulated for directors and shareholders meetings in the Companies Act.
5. In case of a private company no individual director can conduct the business of the company but in an LLP, each partner has the authority to do so unless expressly prohibited by the partnership terms.
6. LLP can choose to maintain the accounts on cash basis/accrual basis whereas under the Companies Act, accrual method is compulsory.
7. Audit of a private company is compulsory. Conversely, the audit of LLP is not compulsory if the capital contributed does not exceed ₹ 25 lakh or if the turnover does not exceed ₹ 40 lakhs.

Question No. 4

Write Short Note on following

(i) Illegal Association

(ii) Alter Ego

(iii) Striking off name of a company

(iv) Employee Stock Option Scheme (ESOS)

(v) Registration of Charges. *(3 marks each)*

Answer to Question No. 4(i)

Illegal Association

An unincorporated company, association or partnership consisting of large number

of persons has been declared illegal. By virtue of Section 11 of the Companies Act, no company, association or partnership consisting of more than 20 persons (10 in the case of banking business) can be formed for the purpose of carrying on any business for gain, unless it is registered as a company under the Companies Act, or is formed in pursuance of some other Indian Law, or is a Joint Hindu Family carrying on business for gain.

Section 11 does not apply to the case of a single joint family carrying on any business whatever may be the number of its members. But if two or more Joint Hindu Family firms carry on business together and the combined number of members exceed 20, then their association will become illegal.

Associations, like charitable, religious or scientific, which are not formed for the purpose of acquisition of gain are excluded from the scope of the section. [*Inland Revenue Commissioners* v. *Korean Syndicate*, *(1920) K.B. 598*]. LLPs and Foreign companies are also excluded from the scope of this section.

Every member of such company, association or partnership carrying on business in contravention of section 11, shall be personally liable for all liabilities incurred in such business.

An illegal association has no existence in the eyes of law. As the law does not recognize it, no relief can be granted either to the association or to any of its members, as the contractual relationship on which it is founded is illegal.

Answer to Question No. 4(ii)

Doctrine of Alter Ego

It is used by the courts to ignore the status of shareholders, officers, and directors of a company in reference to their liability in their respective capacity so that they may be held personally liable for their actions when they have acted fraudulently or unjustly.

In *Lennard's Carrying Co. Ltd.* v. *Asiatic Petroleum Co. Ltd. [1915] AC 705*, Viscount Haldane propounded the "alter ego" theory and distinguished from vicarious liability. The House of Lords stated that the default of the managing director who is the "directing mind and will" of the company, would be attributed to him and he be held for the wrong doing of the company.

Answer to Question No. 4(iii)

Striking off name of a company

A company registered under the Act cannot be removed from the register of companies maintained by the Registrar nor can the certificate of incorporation be cancelled unless the company is dissolved by the process of law, either as a result of its winding up or its amalgamation with another company. However the Companies Act, 1956 provides a short cut to the dissolution, namely striking it off from the register of companies by the Registrar of Companies under section 560, in case the company is defunct company.

The term 'Striking-off' name of a company implies removal of the name of the company from the register of companies. As per section 560 of the Companies Act 1956, in case the Registrar of Companies has reasonable cause to believe that company

is not carrying on any business or not in operation or not functioning, he can, on his own exercise the powers conferred upon him by this section and remove the name of company from the register of companies by following the prescribed procedure.

Despite the striking off the liability, if any, of every director, manager or other officer who was exercising any power of management and of every member of the company, shall continue and may be enforced as if the company had not been dissolved.

Answer to Question No. 4(iv)

Employee Stock Option Scheme (ESOS)

As per Section 2 (15A) of the Companies Act, 1956, 'employee stock option' means the option given to the whole-time directors, officers or employees of a company, which gives such directors, officers or employees the benefit or right to purchase or subscribe at a future date, the securities offered by the company at a pre-determined price.

According to SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999, "Employee Stock Option Scheme" (ESOS) means a scheme under which the company grants option to its employees and option means a right but not an obligation granted to an employee in pursuance of ESOS to apply for shares of the company at a pre-determined price.

The issue of ESOPs would be subject to approval by shareholders through a special resolution. A minimum period of one year between grant of options and its vesting has been prescribed. After one year, the period during which the option can be exercised would be determined by the company.

The operation of the ESOP Scheme would have to be under the superintendence and direction of a Compensation Committee of the Board of directors.

Answer to Question No. 4(v)

Registration of Charges

A charge is a security given for securing loans or debentures by way of a mortgage on the assets of the company.

Section 125 of the Act requires a company to file, within 30 days after the date of the creation of a charge, with the Registrar, complete particulars together with the instrument, if any, creating, evidencing or modifying the charge, or a copy thereof verified in the prescribed manner for registration; otherwise the charge shall be void against the liquidator and creditors and on the charge becoming void, the money thereby shall immediately become payable.

However, the Registrar may allow the particulars and instrument or copy as aforesaid to be filed within thirty days next following the expiry of the said period of thirty days on payment of such additional fee not exceeding ten times the amount of fee specified in Schedule X as the Registrar may determine, if the company satisfies the Registrar that it had sufficient cause for not filing the particulars and instrument or copy within that period.

Question No. 5

(i) A house is allotted to the whole time director of the company. After the death of the whole time director, the house was occupied by his legal heirs. The company demanded the house from the legal heirs of whole time director. Whether the company will be successful?

(ii) The capital of ABC Ltd. is ₹ 50 lakhs, consisting of Equity Share Capital of ₹ 40 lakhs and Redeemable Preference Share Capital of ₹ 10 lakhs. The preference share capital is to be redeemed before 31st December, 2012. The company wants to borrow ₹ 20 lakhs from Financial Institutions to improve its working and also to redeem the preference share capital. Advise.

(iii) An auditor appointed at the Annual General Meeting of XYZ Ltd. resigned within 2 months of appointment. State the legal position.

(iv) The board of directors of Raj Kiran Ltd. passed a resolution for issue of rights shares. However, certain shareholders of the company raised an objection as to whether the company needed additional capital. Discuss the validity of the counter-move taken by the shareholders and resolution passed by the Board.

(5 marks each)

Answer to Question No. 5(i)

In the case of *Gopika Chandrabhushan Saran & Anr.* v. *M/s. XLO India Ltd. & Anr. [(2009) 148 Com Cases 130 (SC)]* where the facts in the present were similar, it was held that section 630 of the Companies Act, 1956 will cover within its ambit not only the employee or officer but also the past employee or the past officer or the heirs of the deceased employee or anyone claiming under them in possession of the property. The legal heirs or representatives in possession of the property acquire the right of occupancy in the property of the company, by virtue of being family members of the employee or the officer during the employment of the employee or the officer and not on any independent account. They, therefore, derive their colours and content from the employee or the officer only and have no independent or personal right to hold on to the property of the company.

Therefore, the company should be successful in demanding the house from the legal heirs of whole time director.

Answer to Question No. 5(ii)

According to section 80, redemption of preference share capital is permitted only out of-

(i) profits of the company which are available for dividend, or

(ii) out of the proceeds of fresh issue of shares made for the purposes of redemption.

Thus, borrowing from financial institutions for redemption of preference shares shall not be permissible. The amount may, however, be raised for improving its working.

Answer to Question No. 5(iii)

The auditor may vacate his office by tendering a resignation. Where the auditor

resigns his office, the vacancy arising therefrom can be filled only by the company at a general meeting [proviso to section 224(6)(a)]. The board has no power to fill casual vacancy caused by resignation. The auditor appointed to fill the casual vacancy caused by the resignation holds office until the conclusion of the next annual general meeting of the company [Section 224(6)(b)]. Besides, the remaining auditor or auditors, if any, may act while any such casual vacancy continues.

Therefore, in the present case, the casual vacancy caused by resignation in the office of auditor shall be filled by the company at a general meeting. The auditor so appointed shall hold office until the conclusion of the next annual general meeting.

Answer to Question No. 5(iv)

In the case of *Arjun Tukaram Shetgaonkar* v. *Urmila Vaikunth Desai (2001) 105 Com Cases 722*, a shareholder had questioned a resolution of the Board of Directors to increase the share capital of the company. The shareholder had the right to do so because his shareholding was going to be reduced percentage wise.

In *Needle Industries (India) Ltd.* v. *Needle Industries Newey (India) Holding Ltd. (1981) 51 Com Cases 743 (SC), AIR 1981 SC 1298*, the Supreme Court pointed out: that the directors of a company must exercise their powers for the benefit of the company. The directors are in a fiduciary position and if they does not exercise powers for the benefit of the company but simply and solely for personal interest and benefits to the detriment of the company, the court will interfere and prevent the directors from doing so. Thus the counter move taken by the shareholders is valid.

Question No. 6

(a) "A private company can accept deposits only from its members, directors and their relatives." Comment.

(b) What are the conditions required to be satisfied by a company issuing equity shares with differential rights as to dividend, voting or otherwise?

(c) "A floating charge remains dormant till it crystallizes". Discuss this statement.

(5 marks each)

Answer to Question No. 6(a)

Section 3(1)(iii)(d) of the Companies Act, 1956 prohibits a private company from making any invitation or acceptance of deposits from persons other than its members, directors or their relatives.

The Articles of Association of a private company should contain one more prohibition for any invitation or acceptance of deposits from persons other than its members, directors or their relatives. It must be borne in mind that an invitation is not prohibited but invitation to the public is prohibited. If a company invites a selected few people e.g. employees, friends or relatives of directors, then it will not be invitation to public.

Answer to Question No. 6(b)

In accordance with rule 3 of the Companies (Issue of Share capital with differential voting Rights) Rules, 2001, every company limited by shares may issue equity shares with differential rights as to dividend, voting or otherwise, if —

(1) The company has distributable profits in terms of Section 205 of the Companies

Act, 1956 for preceding three financial years preceding the year in which it was decided to issue such shares.

(2) The company has not defaulted in filing annual accounts and annual returns for three financial years immediately preceding the financial year of the year in which it was decided to issue such share.

(3) The company has not failed to repay its deposits or interest thereon on due date or redeem its debentures on due date or pay dividend.

(4) The Articles of Association of the company authorises the issue of shares with differential voting rights.

(5) The company has not been convicted of any offence arising under, Securities Exchange Board of India Act, 1992, Securities Contracts (Regulation) Act, 1956, Foreign Exchange Management Act, 1999.

(6) The company has not defaulted in meeting investors' grievances.

(7) The company has obtained the approval of shareholders in General Meeting by passing resolution as required under the provision of sub-clause (a) Sub-section(1) of Section 94 read with Sub-section (2) of the said section.

(8) The listed public company obtained approval of shareholders through Postal Ballot.

(9) The notice of the meeting at which resolution is proposed to be passed is accompanied by an explanatory statement stating—

(a) the rate of voting right which the equity share capital with differential voting right shall carry;

(b) the scale or in proportion to which the voting rights of such class or type of shares will vary;

(c) the company shall not convert its equity capital with voting rights into equity share capital with differential voting rights and the shares with differential voting rights into equity share capital with voting rights;

(d) the shares with differential voting rights shall not exceed 25% of the total share capital issued;

(e) that a member of the company holding any equity share with differential voting rights shall be entitled to bonus shares, right shares of the same class.

Answer to Question No. 6(c)

Floating charge attaches to the company's property generally and the security remains dormant until it is fixed or crystallized. But a floating security is not a future security. It is a present security.

A floating security is an equitable charge on the assets for the time being of a going concern. Such a charge remains dormant until the undertaking charged ceases to be a going concern, or until the person in whose favour the charge is created intervenes. [*Government Stock Investment Company Ltd.* v. *Manila Rly. Company Ltd.*, *(1897) A.C. 81*]

The company has a right to carry on its business with the help of assets having a

floating charge till the happening of some event which determines this right. A floating charge crystallises and the security becomes fixed in the following cases:

(a) when the company goes into liquidation;

(b) when the company ceases to carry on the business;

(c) when the creditors or the debenture holders take steps to enforce their security e.g. by appointing receiver to take possession of the property charged;

(d) on the happening of the event specified in the deed.