

Test Series: August, 2017

MOCK TEST PAPER -1

FINAL COURSE: GROUP – I

PAPER – 4: CORPORATE AND ALLIED LAWS

SUGGESTED ANSWERS/HINTS

1. (a) Section 123 of the Companies Act, 2013 provides for declaration of dividend. According to this section, Dividend shall be declared or paid by a company for any financial year only—
- out of the profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of section 123(2), or
 - out of the profits of the company for any previous financial year or years arrived at after providing for depreciation in accordance with the provisions of that sub-section and remaining undistributed, or
 - out of both; or
 - out of money provided by the Central Government or a State Government for the payment of dividend by the company in pursuance of a guarantee given by that Government.

In the light of the above provisions we can conclude that Construction limited can pay dividends out of the money provided by the Central Government.

- (b) **Reporting of frauds by auditor and other matters:** As per section 143 read with rule 13 of the Companies (Audit and Auditors) Rules, 2014, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of rupees one crore or above, is being or has been committed against the company by its officers or employees, the auditor shall report the matter to the Central Government.

The auditor shall report the matter to the Central Government as under:-

- (i) **the auditor shall report the matter to the Board or the Audit Committee**, as the case may be, immediately but not later than two days of his knowledge of the fraud, seeking their reply or observations within forty-five days;
- (ii) **on receipt of such reply or observations**, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within fifteen days from the date of receipt of such reply or observations;

- (iii) **in case the auditor fails to get any reply or observations from the Board or the Audit Committee** within the stipulated period of forty-five days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;
- (iv) **the report shall be sent to the Secretary, Ministry of Corporate Affairs** in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same;
- (v) **the report shall be on the letter-head of the auditor** containing postal address, e-mail address and contact telephone number or mobile number and be signed by the auditor with his seal and shall indicate his Membership Number; and
- (vi) The report shall be in the form of a statement as specified in **Form ADT-4**.

Details of each of the fraud reported to the Audit Committee or the Board during the year shall be disclosed in the Board's Report:-

- (a) Nature of Fraud with description;
- (b) Approximate Amount involved;
- (c) Parties involved, if remedial action not taken; and
- (d) Remedial actions taken.

- (c) **Tenure of office of Presiding Officer and other Members of Securities Appellate Tribunal (Section 15N)**- According to the provision, the Presiding Officer or every Judicial or Technical Member of the Securities Appellate Tribunal(SAT) shall hold office for a term of five years from the date on which he enters upon his office, and shall be eligible for reappointment for another term of maximum five years.

Provided that no Presiding Officer or the Judicial or Technical Member shall hold office after he has attained the age of seventy years.

As per the given provision, during re-appointment, Mr. Z was of 69 years. As per the section he shall be eligible for reappointment for another term of maximum five years but as per the proviso no Presiding Officer or the Judicial or Technical Member shall hold office after he has attained the age of seventy years.

Accordingly, in the given case Mr. Z can be re-appointed but only for one year.

- (d) **Tenure [Section 149(10) & (11)]:**

Subject to the provisions of section 152 (Appointment of directors), an independent director shall hold office for a term up to five consecutive years on the Board of a company. He shall be eligible for re-appointment on passing of a special resolution by the company and disclosure of such appointment in the Board's report.

No independent director shall hold office for more than two consecutive terms. However, such independent director shall be eligible for appointment after the expiration of three years of ceasing to be an independent director:

Provided that during the said period of three years, such independent director shall not, be appointed in or be associated with the company in any other capacity, either directly or indirectly.

As per the given fact, Mr. Azad, an independent director, was appointed in the AGM for a period of three years. After the expiry of 3 years he was re-appointed for a period of 5 years. Since he has completed two tenures but hasn't completed ten years in total, therefore X company thought to appoint Mr. Azad as independent director in the upcoming AGM for another 2 years to complete his total term of 10 years.

As per the above provision, since the sections 149(10) provides for a term upto 5 years for an independent director which means that an independent director can be appointed for a term less than 5 years. Further section 149(11) states that no independent director shall hold office for more than two consecutive terms but he shall be eligible for appointment after expiration of 3 years of ceasing to become an independent director. Therefore as Mr. Azad has already completed two consecutive terms, so he cannot be re-appointed for another 2 years so as to complete his total term of 10 years. So, reappointment of Mr. Azad for further term in the X Company is not valid.

2. (a) (i) As per section 233 (1) Notwithstanding the provisions of section 230 and section 232, a scheme of merger or amalgamation may be entered between,
- ✓ 2 or more small companies
 - ✓ a holding company and its wholly-owned subsidiary company. If 100% of its share capital is held by the holding company, except the shares held by the nominee or nominees to ensure that the number of members of subsidiary company is not reduced below the statutory limit as provided in section 187
 - ✓ such other class or classes of companies as may be prescribed.

The provisions given for fast track merger in the section 233 are in the optional nature and not a compulsion to the company. If a company wants to make application for merger as per section 232, it can do so.

Hence, here the Company Secretary of the XYZ limited has erred in the law and his contention is not valid as per law. The company shall have an option to choose between normal process of merger and fast track merger.

- (ii) As per section 212 of the Companies Act, 2013, the Central Government may assign the investigation into affairs of a company to the Serious Frauds Investigation Office on the basis of an opinion formed from the following:

1. After the inspection of books of account or papers or inquiry the Registrar shall submit a written report to the Central Government. The report may recommend the need for further investigation along with reasons in support. The Central Government on receipt of such report can order an investigation under Serious Frauds Investigation Office.
2. The company may pass a special resolution and can request Central Government to investigate into the affairs of the company.
3. The Central Government can order investigation under Serious Frauds Investigation Office, in public interest.
4. The departments Central Government and State Governments can request for investigation under Serious Frauds Investigation Office.

- (b) (i) As per the definition of the independent director (ID) given under section 149 of the Companies Act, 2013, an independent director means a director other than a managing director or a whole time director or a nominee director and who fulfills the criteria laid out u/s 149(6).

Therefore, if ID meets the above qualifications, then the same person can be appointed as an ID in the company or its holding, subsidiary or associate company. So Mr. Khan can be appointed in the Board of a Company, in its subsidiary or its holding or associate company.

- (ii) As per section 160, a company shall refund amount deposited along with the candidature of a person who has been elected as a director or who has received more than 25% of total votes. Since in the given case, Mr. D though failed to be appointed but acquired 30% of the total votes, so he is eligible for the refund of the deposit amount of 1lac rupees.

3. (a) (i) As per Section 165(1) of the Companies Act no person shall hold office as a director, including any alternate directorship, in more than 20 companies at the same time.

As the section uses the term “company” therefore while counting the limit of 20, all companies will be included. However, it may be inferred that foreign body corporates, whether a holding, subsidiary or otherwise, will not be included in the said limit of holding directorship in 20 companies. Further, as per the notification dated 5th June 2015, section 165(1) shall not apply to section 8 companies. Therefore, the directorships in section 8 companies will be excluded while calculating the limit of 20 companies

- (ii) As per section 173(5), OPC, small company and dormant company shall be deemed to have complied with the provisions of this section if at least one meeting of the board of ‘directors’ has been conducted in each half of a calendar year and the gap between the two meetings is not less than 90 days.

Therefore, the meetings held on 1st January, 2016 and 31st December 2016 have complied with the above provision and will be deemed to be proper board meetings. However, the meeting held on 1st January 2017 will not be considered as board meeting required for the purpose of the meeting the criteria of holding minimum 2 Board meetings with a gap of 90 days. Hence, while the Board meeting held on 1st January 2017 will be valid, however, the next board meeting must be held between April-June, 2016 i.e., after a gap of 90 days from 31st December, 2016.

- (b) (i) According to clause (b) of section 179(3), The Board of Directors of a company shall exercise the power to authorise buy-back of securities under section 68, on behalf of the company by means of resolutions passed at meetings of the Board.

According to section 68(2), No company shall purchase its own shares or other specified securities, unless—

- (a) the buy-back is authorised by its articles;
- (b) a special resolution has been passed at a general meeting of the company authorising the buy-back:

However, nothing contained in this clause shall apply to a case where—

- (1) the buy-back is, 10% or less of the total paid-up equity capital and free reserves of the company; and
- (2) such buy-back has been authorised by the Board by means of a resolution passed at its meeting,

Thus, we can say that in the case of buy-back of shares of the Company, for the first time, upto 10% of the paid up share capital, a special resolution will not be required if such buy-back has been authorised by the Board by means of a resolution passed at its meeting.

- (ii) According to clause (e) of section 179(3), the Board of Directors of a company shall exercise the power to invest the funds of the company, on behalf of the company by means of resolutions passed at meetings of the Board.

The board may under the proviso to section 179(3) of the Companies Act, 2013 delegate the power to invest the funds of the company by a Board Resolution passed at a duly convened Board Meeting. However, the investment in shares of other companies will be governed by the applicable provisions of the Companies Act, 2013 (i.e. section 186 of the Companies Act, 2013). Since the investment of funds is governed by section of the Companies Act, 2013, thus, specific provisions of section 186 will be applicable for such investment. According to section 186(5), No investment shall be made or loan or guarantee or security given by the company unless the resolution sanctioning it is passed

at a meeting of the Board with the consent of all the directors present at the meeting and the prior approval of the public financial institution concerned where any term loan is subsisting, is obtained. Thus, a unanimous resolution of the Board is required. Section 186 does not provide for delegation. Hence, the proposed delegation of power to the Managing Director to invest surplus funds of the company in the shares of some other companies, is not in order.

4. (a) (i) In terms of Section 135(5) of the Companies Act, 2013, the Board of every company to which section 135 is applicable, shall ensure that the company spends, in every Financial year at least 2 per cent of average net profits of the company made during the three immediately preceding financial years, in pursuance of its CSR policy. There is no provision for carry forward of excess expenditure to the next year(s). The words used in the section are 'at least'. Therefore, any expenditure over 2% would be considered as voluntary higher spending.
- (ii) Here in the given case, as per section 129 of the Companies Act, 2013, A Ltd. will consolidate financial statement of both B and C Ltd. A Ltd. shall also attach the financial statement of B Ltd. along with filing of consolidated financials of A Ltd. Also a statement containing the salient features of the financial statement of a company's subsidiary, associate or joint venture shall be filed as an annexure to the board's report. The word 'Subsidiary' includes Associate Company and joint venture.
- (b) **Oppression:** Oppression, according to the Dictionary meaning of the word, is any act exercised in a manner burdensome, harsh and wrongful. The meaning of the term 'oppression' was explained by Lord Cooper in the Scottish case of *Elder v. Elder and Watson Ltd*, as given below:

"The conduct complained of should be at the lowest involve a feasible departure from the standards of fair dealing and the violation of the conditions of fair play on which every shareholder entrusting his money to the company is entitled to rely.

 - (i) **Oppression of a member as a director:** The oppression dealt with by section 241 of the Companies Act, 2013, is only oppression of members in their character as such; and it is only in that character they can invoke section 241. The harsh treatment, for instance, of a member who is a director or other officer or employee, by the Board of directors or management does not come within section 241. It has been held in *Re. Bellador Silk Ltd.* that if the majority of the Board of directors override the minority directors the latter cannot resort to section 241 and hence the minority directors will not succeed in getting relief from Tribunal on the ground of oppression.
 - (ii) **Right not confined to minority:** According to section 244, the right to apply for relief under section 241/242 is given to 100 members or 1/10th of the total number of members or any member or members holding not less than 1/10th of

the issued share capital of the company. There is nothing in this section which suggests even indirectly that unless the application is made by minority shareholders, it is not maintainable. The right to apply is, therefore, not confined to oppressed minority of the shareholders alone. It was held by Calcutta High Court in *Re. Sindhri Iron Foundry (P) Ltd.* that the oppressed majority also might apply for relief under section 241. Therefore, the petitioners are likely to succeed in getting relief provided the other condition laid down in section 242 (i.e. that to wind up the company would unfairly prejudice such members, but that otherwise the facts would justify the making of a winding-up order on just and equitable ground) is satisfied, even though the Delhi High Court held a contrary view in *Suresh Kumar Sanghi v. Supreme Motors Ltd.*

5. (a) Apex Limited failed to repay the amount borrowed from the bankers, ACE Bank Limited, which is holding a charge on all the assets of the company. The bank took over management of the company in accordance with the provisions of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 by appointing four persons as directors. The company is managed by a Managing Director, Mr. X.

Here, Apex Limited is a borrower and ACE Bank Limited is a secured creditor.

Compensation to Managing director (Mr. X) for loss of office:

According to section 16 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, irrespective of anything contained in any contract or in any other law for the time being in force, no managing director or any other director or a manager or any person in charge of management of the business of the borrower shall be entitled to any compensation for the loss of office or for the premature termination under this Act. However any such managing director or any other director or manager or any such person in charge of management has the right to recover from the business of the borrower, moneys recoverable otherwise than by way of such compensation.

Effect of takeover on rights of the shareholders:

Where the management of the business of a borrower, being a company as defined in the Companies Act is taken over by the secured creditor, then, notwithstanding anything contained, such borrower in the said Act or in the memorandum or articles of association of such company -

- (1) it shall not be lawful for the shareholders of such company or any other person to nominate or appoint any person to be a director of the company;
- (2) no resolution passed at any meeting of the shareholders of such company shall be given effect to unless approved by the secured creditor;

- (3) no proceeding for the winding up of such company or for the appointment of a receiver in respect thereof shall lie in any court, except with the consent of the secured creditor.

The secured creditor is under an obligation to restore the management of the business of the borrower, on realisation of his debt in full, in case of takeover of the management of the business of a borrower by such secured creditor.

"Provided that if any secured creditor jointly with other secured creditors or any asset reconstruction company or financial institution or any other assignee has converted part of its debt into shares of a borrower company and thereby acquired controlling interest in the borrower company, such secured creditors shall not be liable to restore the management of the business to such borrower."

- (b) **Establishment of special court:** As per section 435 of the Companies Act, 2013, the Central Government may, for the purpose of providing speedy trial of offences punishable under this Act with imprisonment of two years or more, by notification, establish or designate as many Special Courts as may be necessary.

Provided that all other offences shall be tried, as the case may be, by a Metropolitan Magistrate or a Judicial Magistrate of the First Class having jurisdiction to try any offence under this Act or under any previous company law.

Appointment of judge: A Special Court shall consist of a single judge who shall be appointed by the Central Government with the concurrence of the Chief Justice of the High Court within whose jurisdiction the judge to be appointed is working. A person shall not be qualified for appointment as a judge of a Special Court unless he is, immediately before such appointment, holding office of a Sessions Judge or an Additional Sessions Judge.

Since in the given case, Mr. A who is a judicial magistrate in a lower court, was appointed to hold the office of the special court for the speedy disposal of the pending cases under the Act. As per the above provision, person shall be qualified for appointment as a judge of a Special Court if he, immediately before such appointment, holding office of a Sessions Judge or an Additional Sessions Judge. Here Mr A. was not complying with the eligibility criteria, so his appointment as a judge of special court is not tenable.

6. (a) As per section 276 of Insolvency & Bankruptcy Code, 2016, the Tribunal may, on a reasonable cause being shown and for reasons to be recorded in writing, remove the provisional liquidator or the Company Liquidator, as the case may be, as liquidator of the company on any of the following grounds, namely:—
- (a) misconduct;
 - (b) fraud or misfeasance;

- (c) professional incompetence or failure to exercise due care and diligence in performance of the powers and functions;
- (d) inability to act as provisional liquidator or as the case may be, Company Liquidator;
- (e) conflict of interest or lack of independence during the term of his appointment that would justify removal.

On removal, the Tribunal may transfer the work assigned to him or it to another Company Liquidator for reasons to be recorded in writing. In case of loss or damage, the Tribunal may recover or cause to be recovered such loss or damage from the liquidator and pass such other orders as it may think fit. The Tribunal shall, before passing any order under this section, provide a reasonable opportunity of being heard to the Company Liquidator.

In the given case, there seems to be lack of independence during the term of his appointment as of existence of a relationship of Mr. X the company liquidator and the company due to being the relative of the director of the company. However as per section 275 of the IB Code, on appointment as Company Liquidator, as the case may be, such liquidator shall file a declaration within seven days from the date of appointment disclosing conflict of interest or lack of independence in respect of his appointment, if any, with the Tribunal and such obligation shall continue throughout the term of his appointment.

- (b) As per Section 27 of the Insolvency & Bankruptcy Code, the Committee of Creditors may at a meeting, by a vote of 75% of voting shares propose to replace the insolvency resolution professional with another resolution professional.

The Committee of Creditors shall forward the name of the insolvency professional proposed by them to the Adjudicating Authority and after the confirmation of the proposed insolvency resolution professional by the Board he shall be appointed in the same manner as laid down in Section 16.

Where any disciplinary proceedings are pending against the proposed resolution professional then the resolution professional appointed under section 22 shall continue till the appointment of another resolution professional under this section.

key tasks to be performed by a Resolution Professional

The following are the key tasks to be performed by a resolution professional:-

- (a) Obtaining Valuation of the entity
- (b) Preparation of Information Memorandum
- (c) Preparation of Resolution plan
- (d) Obtaining consent of the Committee of Creditors for the Resolution plan
- (e) Periodic reporting to the Board

7. (a) Given problem is based on the section 2CB of the Insurance Act, 1938. Said section deals with the Indian properties not to be insured with foreign insurers. According to the section, no person shall take out or renew any policy of insurance in respect of any property in India or any ship or other vessel or aircraft registered in India with an insurer whose principal place of business is outside India, without the permission of the IRDAI.

In the given case, act of registration of aircraft of M/s Samrat which is an Indian property, with an insurer in Europe, is an invalid act.

- (b) Section 376 of the Companies Act, 2013 provides the law related to the power of wind up Foreign Companies, although dissolved. Provision states that where a body corporate incorporated outside India which has been carrying on business in India, ceases to carry on business in India, it may be wound up as an unregistered company under this Part (i.e., Part I of the Chapter 21 which deals with the companies authorized to register under this Act), notwithstanding that the body corporate has been dissolved or otherwise ceased to exist as such under or by virtue of the laws of the country under which it was incorporated.

As per the facts given in the question, Universal, a foreign company, incorporated in Australia ceased to exist as per the law of the country, also ceased to carry on business in Delhi. Accordingly, Universal Company may be wound up as an unregistered company although it ceased to exist in Australia.

- (c) **Persons not entitled to make application.**

The following persons shall not be entitled to make an application to initiate corporate insolvency resolution process -

- (a) a corporate debtor undergoing a corporate insolvency resolution process; or
- (b) a corporate debtor having completed corporate insolvency resolution process twelve months preceding the date of making of the application; or
- (c) a corporate debtor or a financial creditor who has violated any of the terms of resolution plan which was approved twelve months before the date of making of an application under this Chapter; or
- (d) a corporate debtor in respect of whom a liquidation order has been made.

In this section, a corporate debtor includes a corporate applicant in respect of such corporate debtor. **[Section 11]**

As per the facts corporate applicant Mr. X seems to be a independent individual and not a corporate applicant in relation to such corporate debtor who is undergoing a corporate insolvency resolution process. So, he shall be entitled to make an application to initiate corporate insolvency resolution process.

- (d) **Effect of usage:** Usage or practice developed under the statute is indicative of the meaning recognized to its words by contemporary opinion. A uniform notorious practice continued under an old statute and inaction of the Legislature to amend the same are important factors to show that the practice so followed was based on correct understanding of the law. When the usage or practice receives judicial or legislative approval it gains additional weight.

In this connection, we have to bear in mind two Latin maxims:

- (i) '*Optima Legum interpretest consuetudo*' (the custom is the best interpreter of the law); and
- (ii) '*Contempranea expositoest optima et fortissima in lege*' (the best way to interpret a document is to read it as it would have been read when made). Therefore, the best interpretation/construction of a statute or any other document is that which has been made by the contemporary authority. Simply stated, old statutes and documents should be interpreted as they would have been at the time when they were enacted/written.

Contemporary official statements throwing light on the construction of a statute and statutory instruments made under it have been used as contemporanea exposition to interpret not only ancient but even recent statutes in India.

Example: Documents issued by the Government simultaneously with the notification under section 16(1) of the Securities Contracts (Regulation) Act, 1956 were used as contemporanea expositio of the notification. [*Desh Bandhu Gupta & Co. v. Delhi Stock Exchange Association Ltd.*, AIR 1979 SC]

- (e) Moratorium has been explained in Section 14 of the Code, during the moratorium period the following acts shall be prohibited:

- The institution of suits or continuation of any pending suits or proceedings against the corporate debtor including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority;
- Transferring, encumbering, alienating or disposing of by the corporate debtor any of its assets or any legal right or beneficial interest therein;
- Any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property including any action under the SARFAESI Act, 2002

The recovery of any property by an owner or lessor where such property is occupied by or in the possession of the corporate debtor.