

PAPER – 4 : CORPORATE LAWS AND SECRETARIAL PRACTICE

Question Nos. 1, 2 and 3 are compulsory. Answer any **four** questions from the rest of the question.

Question 1

Answer any **two** of the following:

- (a) ABC Ltd. has 12 directors on its board and has the following clause in its Articles of Association:

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

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

You are required to state with reference to the provisions of the Companies Act, 1956 whether the motion was carried or not. (5 marks)

- (b) Mr. Patel has transferred his shares of a listed company registered in his name to Mr. Mehta. Mr. Mehta has failed to get the shares registered in his name before the company declared and paid the dividend on the shares.

Examine with reference to the provisions of Securities Contracts (Regulation) Act, 1956, whether Mr. Patel is entitled to retain the dividend even though he has transferred the shares before declaration of dividend. (5 marks)

- (c) The Rural Electrification Corporation, New Delhi issued 6 years bonds to public directly and not through any Stock Exchange. Whether the Rural Electrification Corporation can do so? Is it not a violation of Securities Contracts (Regulation) Act, 1956? (5 marks)

Answer

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

In the problem given in the question, the similar articles exist in the Articles of Association of ABC Ltd. In the given case, only 8 directors out of a total strength of 12 directors are present and out of those 8 directors present only 5 directors have exercised their votes. In such a case, only those directors who are present and vote on a motion are considered for determining whether the motion is carried or not. That means, only 5 directors who voted on the motion are to be considered. Accordingly, since number of directors who voted in favour of the motion being 3 is higher than the number of directors who voted against the motion being 2, the motion is carried or is considered to be passed by majority, unless it is a matter requiring unanimous voting as in the case of a resolution under Section 372A(2).

- (b) Section 27(1) of Securities Contracts (Regulation) Act, 1956 provides that a holder of security whose name appears on the books of the company, can legally receive and retain any dividend declared by the company even if he has transferred the security for a valuable consideration. However, he (holder) cannot receive or retain the dividend if the transfer deed with all other documents required for transfer is lodged with the company within 15 days of the date on which the dividend became due.

The period of 15 days shall be extended as follows:-

- (1) In case of death of the transferee, by the actual period taken by his legal representative to establish his claim to the dividend.
- (2) In case of loss of the transfer deed by theft or any other cause beyond the control of the transferee, by the actual period taken for the replacement thereof and
- (3) In case of delay in the lodging of any security and other documents relating to the transfer due to causes connected with the post, by the actual period of delay. [Explanation to Section 27(1)].

Further according to Section 27(2)(a), a company can pay any dividend, which has become due to any person whose name is for the time being registered in the books of the company as the holder of the security.

In view of the above Mr. Patel is entitled to retain the dividend received by him if the transferee Mr. Mehta has not lodged the transfer deed with the company within 15 days of the date on which the dividend became due or the extended period as per Explanation of Section 27(1).

However, Section 27(1) will not affect the right of the transferee to enforce his rights if any against the transferor or any other person if the company refuses to register, the transfer of security in the name of transferee. [Section 27(2)(b)].

- (c) In order to prevent undesirable transactions in securities and to promote healthy stock market, the Securities Contract (Regulation) Act, 1956 was enacted. Stock Exchanges are recognized under the Act. Section 73 of the Companies Act, 1956 lays down that offer of shares or debentures to public for subscription shall be only after the permission of the Stock Exchange. Section 28 of the Securities Contract (Regulation) Act, 1956 says that the provisions of the Act shall not apply to the Government, the Reserve Bank of India, any local authority or any corporation set-up by a special law or any person who has effected any transaction with or through the agency of any such authority as stated above. The Rural Electrification Corporation is a corporation established under a special statute enacted by the Parliament. Therefore, the Corporation need not require permission of any Stock Exchange. It is exempted. There is no violation of the provisions of the Securities Contract (Regulation) Act of 1956 because according to section 28 provisions are not applicable to this corporation.

Question 2

Answer any two of the following:

- (a) (i) Tomco Ltd., a vehicles manufacturing company in India has received an order from a transport company in Italy for supply of 100 Trucks on lease. You are required to state, how the said Tomco Ltd. can accept such an order. (3 marks)
- (ii) Forex Dealers Ltd. is an Authorised Person within the meaning of Foreign Exchange Management Act, 1999. Reserve Bank of India issued certain directions to the said Authorised Person to file certain returns, which it failed to file. You are required to state the penal provisions to which the said Authorised Person has exposed itself. (4 marks)
- (b) (i) Mr. Sekhar resided for a period of 150 days in India during the Financial year 2003-2004 and thereafter went abroad. He came back to India on 1st April, 2004 as an employee of a business organization. What would be his residential status during the financial year 2004-2005? (3 marks)
- (ii) Mr. Atul, an Indian National desires to obtain Foreign Exchange for the following purposes:
- (a) Remittance of US Dollar 10,000 for payment for goods purchased from a party situated in Nepal.
- (b) US Dollar 10,000 for remitting as commission to his agent in U.S.A. for sale of commercial plot situated near Bangalore, consideration in respect of which was received by Mr. Atul by way of foreign currency inward remittance amounting to US Dollar 1,00,000.

Advise him, if he can get the Foreign Exchange and under what conditions. (4 marks)

- (c) Poly Ltd., (hereinafter referred to as "Seller"), manufacturer of footwears entered into an agreement with City Traders (hereinafter referred to as "purchaser"), for sale of its products. The agreement includes, among others, the following clauses:
- (i) That the Purchaser shall not deal with goods, products, articles, by whatever name called, manufactured by any person other than the Seller.
- (ii) That the Purchaser shall not sale the goods manufactured by the Seller outside the municipal limits of the city of Secunderabad.
- (iii) That the Purchaser shall sale the goods manufactured by the Seller at the price as embossed on the price label of the footwear. However, the purchaser is allowed to sale the footwear at prices lower than those embossed on the price label.

You are required to examine with relevant provisions of the Competition Act 2002, the validity of the above clauses. (7 marks)

Answer

- (a) (i) "Export," means the taking out of India to a place outside India any goods (Section

2(1) of Foreign Exchange Management Act, 1999). Hence sending 100 trucks on lease to Italy is an 'export' within the meaning of Section 2(1).

Under provisions of section 7 of the Foreign Exchange Management Act, 1999 rules have been made governing export of goods and services. Regulation 14-A of the Foreign Exchange Management (Export of Goods and Services) Regulations, 2000 prescribes that no person shall except with prior permission of the Reserve Bank of India, take or send out by land, sea or air any goods from India to any place outside India on lease or hire or under any arrangement or in any other manner other than sale or disposal of such goods.

Based on the above provisions, it can be concluded that if the company, namely, Tomco Ltd. wants to accept the order for despatching 100 trucks to Italy on lease, it has to take prior permission of the Reserve Bank of India.

- (ii) Section 11(3) of the Foreign Exchange Management Act, 1999 states that where any Authorised person contravenes any direction given by the Reserve Bank of India under the said Act or fails to file any return as directed by the Reserve Bank of India, the Reserve Bank of India may, after giving reasonable opportunity of being heard, impose on Authorised Person a penalty which may extend to ten thousand rupees and in the case of continuing contraventions with an additional penalty which may extend to two thousand rupees for every day during which such contravention continues.

Since as per the facts given in the question, the Authorised person, namely, Forex Dealers Ltd., has failed to file the returns as directed by the Reserve Bank of India. According to the above provisions, it has exposed itself to a penalty which may extend to ten thousand rupees and in the case of continuing contraventions in the nature of failure to file the returns, with an additional penalty which may extend to two thousand rupees for every day during which such contravention continues.

- (b) (i) According to the provisions of section 2(v) of the Foreign Exchange Management Act, 1999, a person in order to qualify for the purpose of being treated as a "Person Resident in India" in any financial year, must reside in India for a period of more than 182 days during the preceding financial year. In the given case, Mr. Sekhar has resided in India for a period of only 150 days, i.e., less than 182 days, during the financial year 2003-2004. Hence he cannot be considered as a "Person Resident in India" during the financial year 2004-2005 irrespective of the purpose or duration of his stay.
- (ii) Under provisions of section 5 of the Foreign Exchange Management Act, 1999 certain rules have been made for drawal of Foreign Exchange for Current Account transactions. As per these rules, drawal of Foreign Exchange for some of the Current Account transactions is prohibited. As regards some other Current Account transactions, Foreign Exchange can be drawn with prior permission of the Central Government while in case of some Current Account transactions prior permission of Reserve Bank of India is required.

- (a) In respect of item (a), i.e. remittance to Nepal, such remittance is prohibited and the same is included in First Schedule to the Foreign Exchange Management (Current Account Transactions) Rules, 2000. Hence Mr. Atul cannot withdraw Foreign Exchange for this purpose unless specifically exempted by RBI by general or special order.
- (b) The type of payment as envisaged in item (b) is covered under Third Schedule to the Foreign Exchange Management (Current Account Transactions) Rules, 2000 and for withdrawing foreign Exchange exceeding 5% (five percent) of the inward remittance as commission to agent abroad for sale of commercial plot in India, Mr. Atul will require the prior permission of the Reserve Bank of India.

Current Account Transactions have been liberalized by RBI, Foreign Exchange Department with effect from 24.02.2004 vide A.P. (DIR Series) Circular No.76 dated 24.02.2004. Now authorized persons (authorized dealers) are authorized to allow freely such remittances ((i.e.) commission to agents abroad for sale of commercial plots) up to USD 25000 or 5 per cent of inward remittance per transaction, whichever is higher. As the amount to be remitted is only USD 10,000, authorized person (authorized dealer) may be approached for permission.

- (c) Provisions of section 3(1) of the Competition Act, 2002 prohibits any agreement for goods and/or services that may have an appreciable adverse effect on competition in India.

Provisions of section 3(2) of the said Act states that any agreement entered into in contravention of provision of section 3(1) of the said Act shall be void.

Sections 3(3) and 3(4) of the said Act enumerates the types of the agreements which are to be treated as contravening the provisions of the said section 3(1). According to section 3(4) of the said Act, any agreement among enterprises or persons at different stages of the production chain in different markets, in respect of production, supply, distribution, storage, sale or price of, or trade in goods or provision of services including the following shall be treated as agreements in contravention of the said section 3(1):

- (a) tie-in-arrangement ;
- (b) exclusive supply agreement ;
- (c) exclusive distribution agreement ;
- (d) refusal to deal
- (e) re-sale price maintenance

The clauses of the agreement given in the question are covered by above mentioned provisions Clause at Sr. No.(i) comes under exclusive supply agreement; Clause at Sr. No.(ii) comes under exclusive distribution agreement and Clause at Sr. No.(iii) is covered by re-sale price maintenance.

Explanations to said section 3(4) explains the above terms.

According to Explanation (b), exclusive supply agreement includes any agreement restricting in any manner, the purchaser in the course of his trade from acquiring or otherwise dealing in any goods other than those of the seller or any other person.

According to Explanation (c), exclusive distribution agreement includes any agreement to limit, restrict or withhold the output or supply of any goods or allocate any area or market for the disposal or sale of the goods.

According to Explanation (e), "resale price maintenance" includes any agreement to sell goods on condition that the prices to be charged on the resale by the purchaser shall be the price stipulated by the seller unless it is clearly stated that prices lower than those prices may be charged.

In view of the above provisions of the Competition Act, 2002, validity of the clauses of the agreement as given in the question can be determined as follows:

- (i) Clause (i) restricts the purchaser to deal in the goods of manufacturers other than the seller. Hence this is in contravention of the provisions of section 3(1) of the said Act.
- (ii) Clause (ii) restricts the purchaser to sell the goods within a specified area. Hence this is in contravention of the provisions of section 3(1) of the said Act
- (iii) Clause (iii) stipulates the resale price, but it allows the purchaser to sell the goods at lower prices than the stipulated prices. Hence this is a valid clause.

But, the law states that any such agreement containing any of the prohibited clause shall be void. Therefore, even if the agreement contains some valid clauses, it shall still be termed as void if it contains even one prohibited clause.

Question 3.

Answer any **two** of the following:

- (a) The last three years' Balance Sheets of RBS Ltd., contains the following information and figures:

	As at 31.03.2002 Rs.	As at 31.03.2003 Rs.	As at 31.03.2004 Rs.
<i>Paid up Capital</i>	50,00,000	50,00,000	75,00,000
<i>General Reserve</i>	45,00,000	50,00,000	60,00,000
<i>Debenture Redemption Reserve</i>			
<i>Reserve</i>	15,00,000	20,00,000	25,00,000
<i>Reserve Secured Loans</i>	10,00,000	15,00,000	30,00,000
<i>Net Profit for the year</i> (as calculated in accordance with the provisions of Section 349 and 350 of the Companies Act, 1956)	12,50,000	19,00,000	34,50,000

In the ensuing Board Meeting scheduled to be held on 5th November 2004, among other items of agenda, following item is also appearing:

“To decide about borrowing from financial institutions on long-term basis.”

Based on above information, you are required to find out as per the provisions of the Companies Act, 1956, the amount upto which the Board can borrow from financial institutions without seeking the approval in general meeting. (8 marks)

- (b) *The Annual Accounts of CALM Ltd., a listed company from for the year ended 31st March, 2003 were finalized on 31st May, 2004. The Company had a paid up capital of Rs.50.00 Lacs and free reserves of Rs.100.00 Lacs. The Company did not have any accumulated losses. The Board of Directors of the Company wishes to make a public issue of Equity Shares amounting to Rs. 10.00 Crores comprising of offer to public through offer document, firm allotment and promoters contribution. State, how this can be done under SEBI Guidelines.*

What would be your answer in the following cases:

- (a) *If CALM Ltd. was a Private Sector Bank known as CALM Bank Ltd.*
- (b) *If the issue of above mentioned Rs.10.00 Crores was a right issue. (8 marks)*
- (c) *Explain briefly the distinction between “Mandatory” and “Directory” provisions in a statute. How the Court deals with them differently? (8 marks)*

Answer

- (a) As per section 293 (1)(d) of the Companies Act, 1956, the Board of Directors of a public company or a private company which is a subsidiary of a public company, without obtaining the approval of shareholders in a general meeting, can borrow the funds including funds already borrowed upto an amount which does not exceed the aggregate of paid up capital of the company and its free reserves. Such borrowing shall not include temporary loans obtained from the company's bankers in ordinary course of business. Here, free reserves do not include the reserves set apart for specific purpose.

Since the decision to borrow is to be taken in a meeting to be held on 5th November, 2004, the figures relevant for this purpose are the figures as per the Balance Sheet as at 31.03.2004. According to the above provisions, the Board of Directors of RBS Ltd. can borrow, without obtaining approval of the shareholders in a general meeting, upto an amount calculated as follows:

Paid up capital	Rs. 75,00,000/-
General Reserve (being free reserve)	Rs. 60,00,000/-
Debenture Redemption Reserve (This reserve is not to be considered since it is kept apart for specific purpose of debenture redemption)	_____
Aggregate of paid up capital and free reserve	<u>Rs. 1,35,00,000/-</u>

Total borrowing power of the Board of Directors of the company. i.e., 100% of the aggregate of paid up capital and free reserves	Rs. 1,35,00,000/-
Less amount already borrowed as secured loans	<u>Rs. 30,00,000/-</u>
Amount upto which the Board of Directors can further borrow without the approval of shareholders in a general meeting.	<u>Rs 1,05,00, 000/-</u>

It is presumed that the amount already borrowed as secured loans are not "temporary loans" obtained from the company's bankers in the ordinary course of business within the meaning of Explanation II to Section 293.

- (b) As per DIP Guidelines issued by SEBI (Para 2.3.1) a listed company shall be eligible to make a public issue of equity shares or any security convertible at later date into equity share provided that the aggregate of proposed issues and all previous issues made in the same financial year in terms of size (i.e) offer through offer document + firm allotment + promoters' contribution through the offer documents), issue size does not exceed five (5) times its pre-issue net worth as per audited balance sheet of the last financial year (Clause 2.3.1.)

The said Guidelines further provide that a listed company which does not fulfil the condition given above, shall be eligible to make a public issue subject to complying with the conditions specified in clause 2.2.2 (Clause 2.3.2)

The Board of Directors of CALM Ltd. proposed to make a public issue during the financial year 2004 – 2005. The eligibility is to be determined with reference to the balance sheet of the last financial year (i.e) balance sheet as at 31st March 2004. But the latest available audited balance sheet is balance sheet as at 31st March 2003. The proposed issue (Rs. 10 crores) exceeds 5 times the net worth on 31st March 2003 (net worth Rs.1.5 crores). The company must take efforts to get accounts for the financial year 2003 – 2004 audited. If the proposed issue exceeds 5 times the net worth on 31st March 2004 also, the company has to comply with the conditions specified in Clause 2.2.2. The company can choose any one of the 2 alternative methods specified in Clause 2.2.2. They are

- (i) The issue is made through book building process with at least 50% of the issue being allotted to the qualified institutional buyers.
- (ii) Get the 'project' appraised and see that there is at least 15% participation by financial institutions/scheduled commercial banks, of which at least 10% comes from the appraisers. In addition to this, at least 10% of the issue size shall be allotted to qualified institutional buyers. (Clause 2.2.2)

As the proposed public issue is equity shares amounting to Rs.10 crores, the post-issue face value of capital of the company is more than Rs.10 crores. If it is less than Rs.10

crores, the company must make arrangement for compulsory market making for at least 2 years from the date of listing of shares in the manner specified in Clause 2.2.2 (b)(ii).

The restriction imposed under SEBI Guidelines on public issue by a listed company is not applicable to a private sector bank set up under sub-section (c) of section 5 of the Banking Regulation Act, 1949 and which has received licence from the Reserve Bank of India. Similarly the restriction is not applicable to a right issue by a listed company. Hence in both cases Calm Ltd., would have been free to make issue of Rs.10.00 crores (Para 2.4.1)

- (c) The distinction between a provision which is mandatory and one which is ' directory' is that when it ' mandatory' , it must be strictly complied with, when it is ' directory' , it would be sufficient that it substantially complied with. Non-observance of mandatory provisions involves the consequences invalidating. But non-observance of directory provision does not entail the consequence of invalidating, whatever other consequences may occur.

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

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

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

Question 4

- (a) *Mr. Doubtful was appointed as Managing Director of Carefree Industries Ltd. for a period of five years with effect from 1.4.2000 on a salary of Rs.12 lakhs per annum with other perquisites. The Board of Directors of the company on coming to know of certain questionable transactions, terminated the services of the Managing Director from 1.3.2003. Mr. Doubtful termed his removal as illegal and claimed compensation from the company. Meanwhile the company paid a sum of Rs.5 lakhs on ad hoc basis to Mr. Doubtful pending settlement of his dues. Discuss whether:*
- (i) *The company is bound to pay compensation to Mr. Doubtful and, if so, how much.*

- (ii) *The company can recover the amount of Rs. 5 lakhs paid on the ground that Mr. Doubtful is not entitled to any compensation, because he is guiding of corrupt practices.* (8 marks)
- (b) *Excellent Technical Consultants Ltd. has approached you seeking your opinion on the following appointments relating to directors and their relatives*
- (i) *Appointment of Mr. Sonata (relative of one of the directors) as the Managing Director of the Company on a monthly remuneration of Rs.40,000 and other perquisites as are currently being allowed to other executives of the Company.*
- (ii) *Appointment of Mr. Romesh (relative of one of the directors) as the General Manager – Marketing of the Company on a consolidated monthly remuneration of Rs.30,000.*
- (iii) *Appointment of Mr. Kamal (relative of one of the directors) as an Accounts Manager of the Company on a consolidated monthly remuneration of Rs.18,000.*
- Express your opinion explaining the relevant provisions of the Companies Act, 1956.* (7 marks)

Answer

- (a) According to Section 318 of the Companies Act, 1956, compensation can be paid only to a Managing or Whole-time Director. Amount of compensation cannot exceed the remuneration which he would have earned if he would have been in the office for the unexpired term of his office or for 3 years whichever is shorter. No compensation shall be paid, if the director has been found guilty of fraud or breach of trust or gross negligence in the conduct of the affairs of the company.

In light of the above provisions of law, the company is not liable to pay any compensation to Mr. Doubtful, if he has been found guilty of fraud or breach of trust or gross negligence in the conduct of affairs of the company. But, it is not proper on the part of the company to withhold the payment of compensation on the basis of mere allegations. The compensation payable by the company to Mr. Doubtful would be Rs.25 Lacs calculated at the rate of Rs.12 Lacs per annum for unexpired term of 25 months.

Regarding adhoc payment of Rs.5 Lacs, it will not be possible for the company to recover the amount from Mr. Doubtful in view of the decision in case of *Bell vs. Lever Bros. (1932) AC 161* where it was observed that a director was not legally bound to disclose any breach of his fiduciary obligations so as to give the company an opportunity to dismiss him. In that case the Managing Director was initially removed by paying him compensation and later on it was discovered that he had been guilty of breaches of duty and corrupt practices and that he could have been removed without compensation.

- (b) As per provisions of section 314(1) of the Companies Act, 1956, except with the consent of the company accorded by way of a special resolution, no director or relative of a director shall hold any office or place of profit, which carried a monthly remuneration of Rs.10000/- or more, except that of Managing Director or Manager of the Company.

Further, as per the provisions of Section 314(1B) of the Companies Act, 1956, no relative of a director can be appointed to any office or place of profit under the company which carries a monthly remuneration of not less than Rs.50,000/- (as per Notification vide 5th February, 2003) except with the prior consent of the company by way of a special resolution and the approval of the Central Government.

In the light of above legal provisions the opinion on the appointments of various persons as stated in the question can be expressed as follows:

- (i) Mr. Sonata is being appointed as the Managing Director of the Company, the provisions of section 314(1) are not attracted even though he is a relative of a director. This is because the appointment of Managing Director or Manager is outside the provisions of section 314 of the Companies Act, 1956. If Mr. Sonata is not already a director of the company, steps must be taken to appoint him first as an additional director/director. Thereafter he may be appointed as Managing Director by complying with the requirements under section 269 read with Schedule XIII to the Companies Act. The appointment can be made by the Board subject to the approval of the company in general meeting as the proposed remuneration is within the limits laid down in Schedule XIII.
- (ii) Since the remuneration proposed to be paid to Mr. Romesh does exceed Rs.50,000/- per month, provisions of section 314(1B) are not attracted and approval of the Central Government is not required. However, as the proposed remuneration exceeds Rs.10,000/- his appointment shall require the passing of special resolution by the company. The special resolution is required to be passed at a general meeting of the company held for the first time after such appointment.
- (iii) In case of Mr. Kamal, since the remuneration proposed to be paid to him exceeds Rs.10,000/- but does not exceed Rs.50,000/- per month, his appointment shall require the passing of special resolution by the company only and the no approval of the Central Government is required. The special resolution according to the consent may be passed at a general meeting of the members of the company held for the first time after such appointment.

Question 5

- (a) *Mr. Weldon was appointed as a Director of Esquire Engineering Ltd., with effect from 1st October, 2002. Since the Company, namely, Esquire Engineering Ltd. wanted to take full advantage of the wisdom and expertise of Mr. Weldon, it offered him remuneration payable on monthly basis and made an application to the Central Government for approval for payment of such remuneration. Anticipating the approval of the Central Government, Esquire Engineering Ltd. started paying such remuneration from the date of appointment and continued to do so till 31st March, 2003. The Central Government did not fully approve the remuneration proposed by the company and restricted the same to a lower amount. On scrutiny of the accounts, it was established that the company, till 31st March, 2003, has paid to Mr. Weldon a total sum of Rs.1.20 Lacs in excess of the remuneration sanctioned by the Central Government.*

You are required to:

- (i) State with reference to the provisions of the Companies Act, 1956 in respect of recovery and waiver of recovery of the excess remuneration so paid, whether Mr. Weldon can keep the excess remuneration so received and under what conditions.
- (ii) Draft a resolution for waiver of recovery of the excess remuneration so paid by the Company. (8 marks)
- (b) (i) The Articles of Association of MKP Limited incorporated with an Authorised Share Capital of Rs.50 crores divided into 5 crore Equity Share of Rs.10 each contained the following clause:

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

Examine the validity of the above clause in the light of the provisions of the Companies Act, 1956.
- (ii) Redraft the above clause which would conform to the provisions of the Companies Act, 1956. (7 marks)

Answer

- (a) (i) Mr. Weldon was appointed as a non-executive director. The services to be rendered by him are not stated to be of a professional nature. Hence, the provisions of Section 309 (4) are attracted in this case. According to Section 309(4) of the Companies Act, 1956 a non-executive director may be paid remuneration by way of monthly, quarterly or annual payment basis with the approval of the Central Government.

Section 309(5A) of the Companies Act, 1956 states that if any director draws or receives, directly or indirectly, by way of remuneration any sum in excess of the limits prescribed by section 309 of the Companies Act, 1956 or without the prior approval of the Central Government, wherever required, then such director shall refund such excess remuneration to the company and until such refund is made, he shall hold such sum in trust for the company.

Section 309(5B) of the Companies Act, 1956 states that the company shall not waive the recover of any sum refundable under section 309(5A) of the Companies Act, 1956 unless permitted by the Central Government.

In light of the above mentioned provisions of the Companies Act, 1956, Mr. Weldon is under obligation to refund the excess remuneration of Rs.1.20 Lakhs received by him from the company and till the same is refunded, he shall hold the said sum in trust for the company. Similarly, the company is also not eligible to waive the recovery of such excess sum. However, the company can waive the recovery and Mr. Weldon can keep such excess sum, if the permission from the Central

Government as envisaged in section 309(5B) of the Companies Act, 1956 is obtained.

- (ii) Board Resolution for waiver of recovery of excess remuneration paid to a director:

"RESOLVED that subject to the approval of the Central Government, the Board does hereby decides to waive the recovery of a sum of Rs.1.20 Lacs paid to Mr. Weldon, a director of the company during the period from 1st October, 2002 to 31st March, 2003 in excess of the remuneration sanctioned by the Central Government in terms of section 309 of the Companies Act 1956."

"RESOLVED FURTHER that an appropriate application under section 309(5B) of the Companies Act, 1956 be made to the Central Government and that Mr, the Secretary of the company be and is hereby authorized to take necessary action in this regard."

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

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

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

Based on the provisions of section 270 of the Companies Act, 1956 as explained above, the clause in the Articles of Association as given in the question is void since it stipulates the obtaining of the qualification shares within a period of 30 days which is shorter than two months. Moreover the clause also violates the maximum limit of share qualification by prescribing the same to be 1,000 shares of Rs.10 each totaling Rs.10,000 which is more than the limit of Rs.5,000 as prescribed in the said section.

- (ii) The clause to be included in the Articles of Association regarding qualification of directors conforming to the provisions of the Companies Act, 1956 may be as follows:

"The qualification of a director shall be the holding of at least 500 equity shares in the company and such a director if not already so qualified shall have to obtain his

qualification within a period of two months from the date of his appointment as a director.”

Question 6

- (a) (i) *An Interstate Cooperative Society has been incorporated on 1st May, 2004 as a Producer Company under the provisions of the Companies Act, 1956. Give your comments on its proposal to have 18 directors on its Board after incorporation as a Producer Company.*
- (ii) *A Producer Company wants to issue bonus shares. You are required to state the relevant provisions of the Companies Act, 1956 in this regard.*
- (iii) *What are the modes of investment, from and out of its general reserves, available to a Producer Company formed and registered under Section 581C of the Companies Act, 1956. (8 marks)*
- (b) *Mr. Raj, a director of POL Ltd., submitted his resignation from the post of director to the Board of Directors on 30th June, 2004 and obtained a receipt therefore on the same day. The Board of Directors of POL Ltd. neither accepted the resignation nor did it file Form No.32 with the Registrar of Companies. You are required to state whether Mr. Raj ceases to be the Director of POL Ltd. and if yes, since when? (7 marks)*

Answer

- (a) (i) As per provisions of section 581O of the Companies Act, 1956, any Producer Company can not have more than fifteen directors. However, by way of a proviso, the said section further provides that in the case of an inter-State co-operative society which is incorporated as a Producer Company, may have more than fifteen directors for a period of one year from the date of its incorporation as a Producer Company.
- In view of the above provisions of the Companies Act, 1956 the proposal to have 18 directors by the Producer Company after its incorporation as such, is a valid proposition, but since it is incorporated on 1st May, 2004, it can have more than 15 directors for one year only from the date of its incorporation
- (ii) As per provisions of section 581ZJ of the Companies act 1956, any Producer Company may, upon recommendation of the Board and passing of resolution in the general meeting, issue bonus shares by capitalisation of amounts from general reserves referred to in section 581ZI in proportion to the shares held by the Members on the date of the issue of such shares.
- (iii) As per Producer Companies (General Reserves) Rules. 2003 issued by the Department of Company Affairs, Ministry of Finance, Government of India on 7th August, 2003 a producer company formed and registered under section 581C of the Companies Act, 1956, shall make investments from and out of its general reserves in the following manner, namely:-

- (a) in approved securities, fixed deposits, units and bonds issued by the Central or State Governments or cooperative societies or scheduled bank; or
 - (b) in a co-operative bank, state co-operative bank, co-operative land development bank or central co-operative bank; or
 - (c) with any other scheduled bank; or
 - (d) in any of the securities specified in section 20 of the Indian Trusts Act, 1882; or
 - (e) in the shares or securities of any other multi-state co-operative society or any co-operative society; or
 - (f) in the shares, securities or assets of a public financial institutions specified under section 4A of the Companies Act, 1956.
- (b) There is no provision in the Companies Act, 1956 relating to resignation from his office by a director. If there is any provision in the articles giving the right to a director to resign at any time, the resignation will take effect without any need for its acceptance by the Board of Directors or the company in general meeting. In absence of a specific provision in the articles of association, a director can resign without being required to give reasonable notice. In *T. Murari Vs. State* [(1976) 46 Comp. Cas. 613] the Madras High Court held that even in the absence of a provision in respect of resignation under the Companies Act, 1956 or under the articles of association of the company, the resignation tendered by a director or a managing director unequivocally in writing will take effect from the time when such resignation is tendered.

The said judgement was followed by the same court in the case of *S.S. Lakshman Pillai Vs. ROC* (1997) 47 Comp. Cas. 652.

In a recent judgement in the case of *Mother Care (India) Ltd Vs. Prof. Ramaswamy P. Aiyar* [(2004) 51 SCL 243] the Karnataka High Court observed that as the appointment of a director is not a bilateral character, the question of acceptance of the request to relinquish the office would arise and filing of Form No.32 in terms of section 303(2) of the Companies Act, 1956 is only a consequential act to be performed by the company in obedience of the statutory provision, but it is not an act to be complied with in order to make a resignation valid.

Where the resignation letter states that it is to take effect on acceptance, or where the articles so require, acceptance is necessary to end the tenure of office of a director.

In view of the above legal position, Mr. Raj has ceased to be a director of POL Ltd. with effect from 30th June, 2004, provided his resignation letter does not state that the resignation is to take effect on acceptance or the articles of POL Ltd. does not so require.

Question 7

- (a) (i) As per provisions of the Companies Act, 1956, what is the status of XYZ Ltd., a Company incorporated in London, U.K., which has a Share Transfer Office at Mumbai?

- (ii) *ABC Ltd., a foreign company having its Indian principal place of business at Kolkata, West Bengal is required to deliver various documents to Registrar of Companies under the provisions of the Companies Act, 1956. You are required to state, where the said company should deliver such documents.*
- (iii) *In case, a foreign company does not deliver its documents to the Registrar of Companies as required under Section 597 of the Companies Act, 1956, state the penalty prescribed under the said Act, which can be levied. (8 marks)*
- (b) *M/s BEF Ltd., a public limited company is having a paid up share capital of Rs.2.50 crores. Whether it is obligatory for the company to have a whole-time secretary? Will it make any difference, if the capital of the said BEF Ltd. was Rs.1.50 crores? If yes, what other formality would have to be complied by it under the provisions of the Companies Act, 1956. (7 marks)*

Answer

- (a) (i) According to section 591 of the Companies Act, 1956, a company incorporated outside India and having a place of business in India is treated as a "Foreign Company". As per clause (c) of section 602 of the said Act, the expression ' place of business' includes a Share Transfer office. Thus, according to the provisions of the Companies Act, 1956, the status of XYZ Ltd. incorporated in London, U.K., which has a Share Transfer office in Mumbai, shall be that of a ' Foreign Company' .
- (ii) According to section 597 of the Companies Act, 1956, any document which a foreign company is required to deliver to the Registrar of Companies shall be delivered to the Registrar having jurisdiction over New Delhi and also to the Registrar of the State in which the principal place of business of the foreign company is situate.
- In light of the above provisions of the Companies Act, 1956, ABC Ltd. is required to deliver the requisite documents to the Registrar of Companies having jurisdiction over New Delhi and also to the Registrar of Companies, West Bengal.
- (iii) Section 598 of the Companies Act, 1956 prescribes the penalty for non-compliance of the provisions of section 597 of the said Act. According to the provisions of the said section 598, the foreign company and its every officer or agent, who is in default, shall be punishable with a fine upto Rs.10,000/- and in case of continuing offence, additional fine upto Rs.1,000/- per day for the period during which the default continues.
- (b) Section 383A of the Companies Act, 1956 provides that every company having a paid up capital not less than the prescribed limit (presently the limit being Rs.2.00 crores) shall have a whole time secretary. The Secretary must be a member of the Institute of Company Secretaries of India.

In view of the provision of the said section 383A, the Company, namely, BEF Ltd is under statutory obligation to have whole time Secretary since its paid up capital exceeds

Rs.2.00 crores. In case, the paid up capital of BEF Ltd is less than Rs.2.00 crores, it is not necessary for it to have whole-time secretary.

Since, its capital, as per second part of question, is Rs.1.50 crores, it is not required to have whole-time secretary.

However, the proviso to section 383A(i) of the Companies Act, 1956 requires that in case of a company having paid up share capital of Rs.10.00 Lacs or more, it has to file with Registrar of Companies, a certificate obtained from a Secretary in whole time practice. This certificate is called Compliance Certificate. This is to be attached to the Report of Board of Directors under Section 217 of the Companies Act, 1956. The certificate is to be filed with Registrar of Companies within 30 days from the date of holding of the Annual General Meeting each year.

Question 8

- (a) *Mr. Kailash, an employee of M/s Sweetwill Ltd. met with an accident and died. The accident occurred when Mr. Kailash was on company's duty. He held one hundred shares partly paid. Normally the company has a first and permanent lien on the shares. The Board of Directors however, relaxed the said provision with regard to these shares as a goodwill gesture on the part of the company. Is the action of the Company valid? State the reasons. Whether company's lien can be extended to dividends payable on such shares?* (8 marks)
- (b) *State the procedure for the following, explaining the relevant provisions of the Companies Act, 1956:*
- (i) *Appointment of First Auditor, when the Board of Directors did not appoint the First Auditor within one month from the date of registration of the company.*
 - (ii) *Removal of Statutory Auditor (appointed in last Annual General Meeting) before the expiry of his term.*
- What difference it would make, if the Auditor was First Auditor appointed by the Board of Directors?* (7 marks)

Answer

- (a) A company cannot have lien on shares unless provided in the Articles of Association. Therefore provision to this effect should be in the Articles. As per Regulation 9 of Table A, the Company has first and paramount lien on every share(which has not been fully paid up) for all monies (whether presently payable or not) called or payable at a fixed time in respect of that share and on all shares which are not fully paid up standing registered in the name of a single person, for all moneys presently payable by him or his estate to the company.

The Board of Directors may, however, at any time declare any share to be wholly or in part exempted from the said provision. Hence, exempted Mr. Kailash's estate from the provision of the said clause is in order and valid. [Regulation 9 of Table A].

Further the company's lien is extended to all dividends payable on such shares as per Regulation 9(2) of Table A.

- (b) (i) Section 224(5) of the Companies Act, 1956 lays down that the first auditor of a company shall be appointed by the Board of Directors within one month of the date of registration of the company.

If the Board of Directors fails to exercise its power, the company in general meeting may appoint the first Auditor or Auditors.

Subsequently Auditor or Auditors of a company are appointed every year by the shareholders in annual general meeting by passing an ordinary resolution.

- (ii) Auditor appointed in an Annual General Meeting may be removed from office before the expiry of his term only by the company in general meeting, after obtaining the previous approval from the Central Government in that behalf [Section 224 (7)].

Further the company has to follow the following procedure prescribed in Section 225 (2) and (3) as explained below:

1. No special notice under section 225 (1) is required for a resolution in the general meeting to remove the auditor. But decision must be taken at a Board meeting to remove the auditor, hold the general meeting etc.
2. The auditor shall be informed of the Board's decision immediately. [Section 22(2)].
3. The auditor can make a representation. The copy of the representation should be sent to all the members to whom notice of meeting is sent. If the copy of the representation is not sent as it was received late or because of the company's fault, the auditor may insist that the representation may be read at the meeting. [Section 225(3)].
4. If company does not wish to send the representation to the members or read at the general meeting, the company has to apply to Central Government/Company Law Board. If Central Government/Company Law Board is satisfied that the right of representation is being misused by auditor to secure needless publicity for defamatory matter, the Central Government/Company Law Board may order that the representation need not be sent and the representation need not be read at the meeting. (Proviso to Section 225(3)).
5. An ordinary resolution is to be passed at the general meeting for the removal of the auditor.

The first auditors appointed by Board can be removed by the company at a general meeting. (Proviso (a) to Section 224 (5)). The provisions in respect of removal as contained in Section 225 (2) & (3) are applicable for removal of first auditors also. (Section 225 (4)). However, in case of removal of first auditor appointed by the

Board of Directors, only an ordinary resolution is sufficient to remove the auditor and Central Government's approval is not required.

Question 9

- (a) Following information is available from the audited Balance Sheet as at 31st March, 2004 of ASK Ltd.:

<i>Share Capital:</i>	<i>Rs.</i>
<i>Equity Share Capital (5,00,000 shares of Rs. 10 each fully Paid up in cash)</i>	<i>50,00,000</i>
<i>Less: Calls in arrear</i>	<i><u>50,000</u></i>
	<i>49,50,000</i>
<i>Preference Share Capital</i>	<i>15,00,000</i>
<i>Share Application Money</i>	<i>10,00,000</i>
 <i>Reserves and Surplus:</i>	
<i>Securities Premium</i>	<i>15,00,000</i>
<i>Capital Redemption Reserve</i>	<i>12,00,000</i>
<i>Fixed Assets Revaluation Reserve</i>	<i>10,50,000</i>
<i>Sinking Fund Reserve</i>	<i>11,00,000</i>
<i>General Reserve</i>	<i>40,00,000</i>
<i>Profit and Loss Account</i>	<i>22,00,000</i>
<i>Dividend Equalisation Reserve</i>	<i>6,00,000</i>
<i>Secured Loans:</i>	
<i>Cash Credit facility from Bank</i>	<i>1,00,00,000</i>

You are required to find out, explaining the relevant provisions of the Companies Act, 1956, the amount upto which the Board of Directors can invest in securities of other bodies corporate and/or give loans. (8 marks)

- (b) Some small shareholders of TRG Ltd., a company listed with Mumbai Stock Exchange, want to appoint Mr. Raj, who is holding 1,000 Equity Shares of Rs.10 each in the Company as a Director as their representative on the Board of Directors of the said Company. You are required to state the relevant provisions of the Companies Act, 1956 in respect of such proposal to appoint Mr. Raj as a Small Shareholders' Director. (7 marks)

Answer

- (a) According to the provisions of section 372A of the Companies Act, 1956, a public company and a private company, which is a subsidiary of the public company shall not, directly or indirectly:
- (a) make any loan to any other body corporate

- (b) give any guarantee, or provide security, in connection with a loan made by any person to, or other person, by any body corporate; and
- (c) acquire, by way of subscription, purchase or otherwise the securities of any other body corporate exceeding 60% of its Paid up Share Capital and free reserves or 100% of its free reserves, whichever is more without prior authorization by way of a special resolution passed in a general meeting. (Section 372 A (1)).

In order to arrive at the conclusion whether the directors of ASK Ltd. can, make the proposed investments without seeking approval from the shareholders, the amount upto which they can invest has to be arrived at. In the given case, the Paid up Share Capital and free reserves are as follows:

Paid up Share Capital:

Equity Share Capital (500,000 shares of Rs.10/- each fully paid up in cash)	Rs. 50,00,000/-
Less: Calls in arrear	<u>Rs. 50,000/-</u>
	Rs.49,50,000/-
Add: Preference Share Capital	<u>Rs.15,00,000/-</u>
Total of Paid up Share Capital	<u>Rs.64,50,000/-</u>

Free-Reserves:

Securities Premium	Rs. 15,00,000/-
General Reserve	Rs. 40,00,000/-
Profit & Loss Account	Rs. 22,00,000/-
Dividend Equalisation Reserve	<u>Rs. 6,00,000/-</u>
Total Free Reserves	<u>Rs. 83,00,000/-</u>
Total of Paid up Share Capital and Free Reserves	<u>Rs. 1,47,50,000/-</u>

As per explanation to the said section, "Free Reserves" means those reserves, which, as per audited balance sheet of the company, are free for distribution as dividend and shall include balance to the credit of the securities premium account but shall not include share application money. (explanation (b) to section 372A).

Accordingly, for the purpose of calculating the amount of Free Reserves, the amounts lying in the accounts of Share Application Money and reserves not available for distribution as dividend being Capital Redemption Reserve, Fixed Assets Revaluation Reserve and Sinking Fund Reserve are excluded.

Ceiling limit for investments:

60% of Paid up Share Capital and free reserves	
(i.e. 60% of Rs.14,750,000/-)	Rs. 88,50,000/-
100% of Free Reserves (i.e.100% of Rs.83,00,000/-)	Rs. 83,00,000/-

Since 60% of Paid up Share Capital and free reserves is Rs.88,50,000/- which is higher than 100% of Free Reserves, the directors of ASK Ltd. can advance loans and make investments in other bodies corporate upto a total limit of Rs. 88,50,000/- without obtaining prior approval from the shareholders. It may be noted that the amount of secured loan given in question has no relevance in determining the limit up to which investments/loans can be made.

(b) The provisions of section 252 of the Companies Act, 1956, and the Companies (Appointment of Small Shareholders' Director) Rules, 2001 in respect of appointment of Small Shareholders' Director are as follows:

- (1) The provisions of appointment of Small Shareholders' Director are applicable to public companies having paid-up share capital of Rs.5.00 Crores or more and having 1000 or more small shareholders. In case, TRG Ltd. is fulfilling both these conditions, then only its shareholders shall be eligible to proceed in the direction of appointing Mr. Raj as a Small Shareholders' Director. {Proviso to section 252 (1)}
- (2) Small Shareholder for this purpose means a shareholder holding shares of nominal value of Rs. 20,000/- or less.[Explanation to section 252(1)].
- (3) Small Shareholders who intend to propose Mr. Raj as a Small Shareholders' Director have to leave a notice of their intention with TRG Ltd. at least 14 days before the meeting and such notice has to be signed by at least 100 small shareholders.
- (4) According to the rules, the person whose name is to be proposed for the post of Small Shareholders' Director should himself be a small shareholder. Since Mr. Raj is holding shares of nominal value of Rs.10,000/- only, which is less than Rs.20,000, he is eligible to be nominated as such.
- (5) The said notice shall contain the name, address, number of shares held, of Mr. Raj whose name is to be proposed as a Small Shareholders Director and also that of other shareholders proposing Mr Raj.
- (6) Before the meeting, Mr. Raj has to sign and file with TRG Ltd., his consent in writing to act as a director.
- (7) Since TRG Ltd. is a company, which is listed with Mumbai Stock Exchange, it shall elect small shareholders' nominee through the postal ballot.
- (8) On scrutinizing the postal ballot, if Mr. Raj secures the requisite number of votes, he will be elected as a director for a term of 3 years and on expiry of the term shall be eligible to be re-appointed if small shareholders so wish at that time. However, he need not have to retire by rotation.
- (9) Mr. Raj shall be treated as director for all other purposes except for appointment as whole time director or managing director.