GROUP - III
PAPER 13- CORPORATE LAWS & COMPLIANCE

SECTION A - CORPORATE LAWS

Q.1.(a) The object clause of the Memorandum of a company empowers it to carry on distillery business and any other business that is allied to it. The company wants to alter its Memorandum so as to include the cinema business in its objects clause. Advise the company.

(b) Amit buys 500 shares in a company from Namit on the faith of a share certificate issued by the company. Amit tenders to the company a transfer deed, duly executed, along with Namit's share certificate for transferring the shares in his name. The company discovers that the certificate in the name of Namit has been fraudulently obtained and refuses to register the transfer. Advise Amit. Is Amit entitled to get the shares transferred in his name?

(c) Pareek Carriers Limited appointed Mr. Rohan as its auditor in the Annual General Meeting held on 30th September, 2012. Initially, he accepted the appointment. But he resigned from his office on 31st October, 2012 for personal reasons. The Board of Directors seeks your advice for filling up the vacancy by appointment of Mr. Albert as auditor. Advise.

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

Answer 1(a):

Section 17(1) of the Companies Act, 1956 permits alteration of Memorandum by passing a special resolution to carry on some business which under existing circumstances may conveniently or advantageously be combined with the business of the company.

Thus section 17(1) does not prohibit a company to diversify in areas other than those specified in the Memorandum. But, the business sought to be added must be such which can conveniently or advantageously be combined with the business of the company. The Punjab High Court in Punjab Distilling Industries Ltd. V. Registrar of Companies [1963] 83 Comp. Cas. 811 held that the cinema business could not be either conveniently or advantageously combined with the distillery business and, therefore, disallowed change of objects. Accordingly, alteration shall not be allowed.

Answer 1(b):

The facts of the problem are similar to the case of Re, Otto Kopie Diamond Mills (1893) 1 Ch. 618.

In this case, 'A' bought from 'B' 4,000 shares in a company on the faith of share certificate issued by the company. 'A' tendered to the company a transfer deed from B to himself duly executed, together with the share certificate. The company discovered that the certificate in the name of 'B' had been fraudulently obtained and refused to register the transfer. It was held that although the certificate was not a warranty of title upon which 'A' could maintain an action against the company, it estopped the company from disputing A's right to be registered. 'A' could claim damages from the company to the extent of the value of the shares at the time of the refusal to register the transfer.

Thus, in the given problem as the circumstances are similar to the case cited above, Amit is entitled to get the shares registered in this name and claim damages from the company to the extent of the value of shares at the time of the refusal to register the transfer by the company.

Answer 1(c):

The Board may fill any casual vacancy in the office of an auditor. However, where a casual vacancy is caused by the resignation of an auditor, the vacancy shall be filled by the shareholders in general meeting.

In the present case, Mr. Rohan has resigned from his office after accepting the appointment. This results in a casual vacancy in the office of auditor. Since the reason for casual vacancy is the resignation of the auditor, it can only be filled by the shareholders in general meeting. The Board should call an Extraordinary General Meeting for the purpose of appointing Mr. Albert as an auditor to fill up the resulting casual vacancy. If an ordinary resolution is passed for appointment of Mr. Albert as an auditor, then, Mr. Albert shall be the auditor of the company till the conclusion of the next Annual General Meeting.

In case Mr. Albert is appointed as an auditor in the Extraordinary General Meeting, he may be removed from his office even before the expiry of his term, viz. the conclusion of next Annual General Meeting. The procedure for removing Mr. Albert from his office before the expiry of his term is explained below:

1. An ordinary resolution is required for the removal.
2. Previous approval of the Central Government is also required.
3. Procedure prescribed under section 225(2) and (3) must be followed, as explained below:
   (a) The notice for removal of an auditor shall be sent forthwith by the company to Mr. Albert.
   (b) Mr. Albert shall have the following rights:
   (i) Right to be heard orally at the meeting.
   (ii) Right to make a representation in writing to the company (not exceeding a reasonable length).
   (iii) Right to get his representation circulated amongst the members.
   (c) Where a request is made by Mr. Albert to circulate the representation, it shall be the duty of the company:
   (i) to send a copy of the representation to every member of the company; and
   (ii) to state the fact of the representation having been made in the notice given to the members.

Q.2.(a) A public company proposes to purchase its own shares. State the source of funds that can be utilized by the Company for purchasing its own shares and the requirements to be complied with, before and after the shares are so purchased.

(b) State the provisions related to maintenance of records as per The Companies (Cost Accounting Record) Rules, 2011.

(c) X, who does not hold any shares in his name is appointed as Director in PUMP Company on 1st April, 2012. His wife holds 10,000 Equity Shares in the company in her name singly. Certain members of the Company objects to X's appointment on the ground that since he does not hold any shares in his own name, his appointment is violative of the provisions of the Companies Act, 1956. Articles of the Company are silent on the issue of holding any shares by a Director.

Examine the provisions of the Act and decide

(i) Whether contention of the members is tenable?
(ii) Whether X's wife's shareholding in the company can be the ground for X's continuation as a director in the company?
(iii) What would be your answer in case 'X' is one of the subscriber of the Memorandum of Association?

Answer 2(a):

Section 77(1) of the Companies Act provides that a company limited by shares or a company limited by guarantee having a share capital cannot buy its own shares. The restriction is applicable to all companies having share capital, whether public or private. However, the Companies (Amendment) Act, 1999, vide sections 77A, 77AA and 77B and the guidelines issued by SEBI and the Deptt. Of Company Affairs, in this regard, allow companies to purchase their own shares or other securities subject to certain conditions:

SOURCES OF FUNDS FOR BUY-BACK [SECTION 77 A(1)]:

A company may purchase its own shares or other specified securities out of:

(i) its free reserves; or

(ii) the securities premium account; or

(iii) the proceeds of any shares or other specified securities;

Provided that no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

CONDITIONS FOR BUY-BACK [SECTION 77A(2)]:

1. **Authorised by Articles**: The buy-back must be authorized by the **Articles.**
2. **Special Resolution/Board's Resolution**: The **special resolution** must be passed in the General Meeting of shareholders.

   OR

   The Board must pass a resolution at its meeting where the buy-back does not exceed 10% of the total equity paid up capital and free reserves of the company.

3. **Minimum Time Interval between Two buy-back**: No offer of buy back must be made within a period of 365 days from the date of preceding offer of buy-back.
4. **Overall Maximum Limit**: The buy-back of the shares must not exceed 25% of total paid-up capital and free reserves.
5. **Maximum Limit of Buy-back in any Financial Year**: The buy-back of equity shares in any financial year must not exceed 25% of its total paid up equity capital.
6. **Maximum Debt-Equity Ratio**: The debt-equity ratio must not be more than 2:1 after such buy-back.

   Here Debt = Secured + Unsecured Debt and Equity = Capital + Free Reserves Free Reserves = Free Reserves as per Sec 372A + Securities Premium as per Sec 78.

7. **Fully Paid Shares**: All the shares for buy-back must be fully paid-up.
8. **Time Limit**: The buy-back must be completed within 12 months from the date of passing the Special Resolution/Board's Resolution.
9. **Solvency Declaration**: The company must file solvency declaration with the Registrar and SEBI in the form of an affidavit signed by at least two directors of the company. The affidavit must state that the Board has made full inquiry into the affairs of the company as a result of which they have formed an opinion that the company is capable of meeting its liabilities and will not render insolvent within a period of one year from the date of declaration adopted by the Board [77A(6)].
10. **Transfer of Certain Sums to Capital Redemption Reserve Account**: Where a company purchases its own shares out of free reserves, than a sum equal to the nominal value of the shares so purchased shall be transferred to the capital redemption reserve account referred to in Clause (d) of the proviso to Sub-section (1) of Section 80 and details of such transfer shall be disclosed in the balance sheet.
11. **As per SEBI Guidelines**: Buy-back must be as per SEBI Guidelines.

MODE OF BUY-BACK [SECTION 77A(5)]:

The buy-back may be:

(a) from the existing security holders on a proportionate basis; or

(b) from the open market; or

(c) from odd lots, that is to say, where the lot of securities of a public company, whose shares are listed on a recognised stock exchange, is smaller than such marketable lot, as may be specified by the stock exchange; or

(d) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

POST BUY-BACK:

1. **Extinguishment of Certificates within 7 days [Sec 77A(7)]**: Where a company buys-back its own shares, it must extinguish and physically destroy the securities so bought back within 7 days of the last date of completion of buy-back in the presence of merchant bankers or Registrar or Statutory auditor.

2. **No Further issue within a Period of 6 Months [Section 77A(8)]**: Where a company completes a buy-back of its shares or other specified securities under this section, it must not make further issue of same kind of shares (including allotment of further shares under section 81 (1)(a) or other specified securities within a period of 6 months except by way of bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares.
3. **Register of Buy-back Securities [Section 77A(9)]**: Where a company buys back its securities under this section, it must maintain a register of the securities so bought, the consideration paid for the securities bought-back, the date of cancellation of securities, the date of extinguishing and physically destroying of securities and such other particulars as may be prescribed.
4. **Filing of Buy-back Return [Section 77(A)(10)]**: A company must, after completion of the buy-back under this section, file with the Registrar and the SEBI, a return containing prescribed particulars.

   Provided that no return is to be filed with the SEBI by a company whose shares are not listed on any recognised stock exchange.

5. **Penalty for Default [Section 77A(11)]:** In case of default the company or its officer in default shall be punishable with imprisonment for a term upto 2 years, or with fine upto ₹ 50,000 or with both.

Answer 2(b):

The provisions related to maintenance of records as per The Companies (Cost Accounting Record) Rules, 2011 are as follows:

1. Every company to which these rules apply, including all units and branches thereof shall, in respect of each of its financial year commencing on or after the 1st day of April, 2011, keep cost records.
2. The cost records referred to in sub-rule (1) shall be kept on regular basis in such manner so as to make it possible to calculate per unit cost of production or cost of operations, cost of sales and margin for each of its products and activities for every financial year on monthly/quarterly/half-yearly/annual basis.
3. The cost records shall be maintained in accordance with the generally accepted cost accounting principles and cost accounting standards issued by the Institute; to the extent these are found to be relevant and applicable. The variations, if any, shall be clearly indicated and explained.
4. The cost records shall be maintained in such manner so as to enable the company to exercise, as far as possible, control over the various operations and costs with a view to achieve optimum economies in utilization of resources. These records shall also provide necessary data which is required to be furnished under these rules.
5. All such cost records and cost statements, maintained under these rules shall be reconciled with the audited financial statements for the financial year specifically indicating expenses or incomes not considered in the cost records or statements so as to ensure accuracy and to reconcile the profit of all product groups with the overall profit of the company. The variations, if any, shall be clearly indicated and explained.

6. All such cost records, cost statements and reconciliation statements, maintained under these rules, relating to a period of not less than eight financial years immediately preceding a financial year or where the company had been in existence for a period less than eight years, in respect of all the preceding years shall be kept in good order.
7. It shall be the duty of every person, referred to in sub-section (6) and (7) of section 209 of the Companies Act, 1956 (1 of 1956), to take all reasonable steps to secure compliance by the company with the provisions of these rules in the same manner as he is liable to maintain accounts required under sub-section (1) of section 209 of the said Act.

Answer 2(c):

The given problem relates to section 270 of the Companies Act, 1956.

- As per section 270, there is no statutory requirement that a director must hold qualification shares. Share qualification is to be obtained by a director only if the articles of the company so require.
- Where the articles require a director to hold the qualification shares, a director who is not already qualified, shall obtain the qualification shares within 2 months of his appointment as a director.
- As per section 28, Table A shall apply to any company limited by shares, in so far as the articles of the company do not exclude or modify the provisions contained in Table A. As per Regulation 66 of Table A, the share qualification of every director shall be holding of at least 1 share.

The answer to the given problem is as follows:

(i) X has been appointed as a director. The members object to the appointment on the ground that X does not hold any shares in the company.
   - As per section 274, a person is disqualified for directorship on 7 grounds specified in the said section. However, the ground of 'not holding any shares in the company' is not contained in the grounds of disqualification specified under section 274.
   - Further, as per section 270, a director can continue, without obtaining the qualification shares, for a period of 2 months after his appointment.
   - Also, as per section 283, the office of a director becomes vacant only if he fails to obtain the qualification shares within 2 months after his appointment as a director.
   - Thus, the contention of the members is not correct in view of the provisions of section 270, 274, and 283.

(ii) Wife of X holds 10,000 equity shares in her own name. The issue in the question is as to whether the shares held in wife's name can be regarded as share qualification for X.
   - As per section 270, where the articles require holding of qualification shares, a director must hold the qualification shares within a period of 2 months. The word 'hold' used under section 270 clearly suggests that the director must become the registered holder of shares, i.e. the shares must get registered in the name of the director.
   - In other words, the qualification shares are to be held in the name of the director himself. If the shares are held in the name of wife or any other person, the director cannot be said to be a holder of qualification shares.
   - Thus, X cannot continue in office after a period of 2 months after his appointment as a

director on the ground that wife of X holds the shares in her name.

(iii) In this case, X is a Subscriber to the memorandum of association.

- As per section 12, every subscriber to the memorandum of association has to subscribe for at least one share.
- Since the articles of PUMP Company are silent, the share qualification of every director shall be holding of at least 1 share in the company (Regulation 66 of Table A).
- X, being a subscriber to the memorandum of association, must have subscribed to at least one share.
- Therefore, the share(s) subscribed to by X in the capacity of subscriber to the memorandum of association would be the share qualification of X, and would entitle him to continue as a director.

Q.3.(a) A case has been filed against a director for negligence/misfeasance in discharge of his duties. The director has an agreement with the company indemnifying him against such prosecution/suits and thus claim funds from the company to defend the case. Advise.

(b) A company increased the authorized share capital by a special resolution. However, the notice in Form No. 5 was not filed with the Registrar of Companies nor the requisite fee paid on the increase. After 2 years, the earlier resolution raising the share capital was rescinded and share capital brought back to its original level. Whether the company committed any offence and, if so, was it a continuing offence?

(c) PQR Limited had taken a loan of ₹2 crores from a bank secured by some of its assets. The company has defaulted in the matter of payment of some installments of loan as per terms of the loan agreement. The bank has filed a petition in the High Court on the ground that the company is unable to pay its debts.

The company opposes the petition for winding up on the ground that it has employed 1,000 workers, paid their salaries regularly and that it has paid all the tax dues to the Government. The company has further contended that if the company is compelled to repay the loan immediately, it will cripple the company causing hardship to employees and other persons having business dealings with the company. The company is also supported by some major creditors.

Explain the circumstances under which a company may be ordered to be wound up by the Court on the ground of inability to pay its debts and whether the bank will succeed in this case.

Answer 3(a):

Any agreement between a company and a director indemnifying him against any liability in respect of negligence, default, misfeasance, breach of duty or breach of trust of which he may be guilty in relation to the company, shall be void. However, a company may, in pursuance of any such agreement, indemnify the director against any liability incurred by him in defending any proceedings, whether civil or criminal, if he is acquitted or discharged from the charge of negligence, default, etc. or is discharged by the Court under section 633.

Thus, in the given case, it is not permissible for the company to make the funds available to the director in connection with the misfeasance proceedings filed against him. However, if he is acquitted by the Court, the company can reimburse the funds spent by him only after the misfeasance proceedings have been terminated in favour of the director. Further, such reimbursement shall be in accordance with the agreement entered into with the director.

Answer 3(b):

According to section 97 of the Companies Act, 1956 where a resolution has been passed increasing the share capital beyond the authorized capital, notice of increase in Form No. 5 must be given to the Registrar within 30 days after the passing of the resolution authorizing the increase. If any default is made in complying with this section, the company and every officer of the company who is in default shall be punishable with fine which may extend to five hundred rupees for every day during which the default continues.

The given facts are similar to the case of Amison Foods Ltd. v. ROC [1999] 1 Comp. LJ 115: [1999] 33 CLA 46(Ker.) in which it was held that the failure to file with the Registrar of Companies Form No. 5 for giving notice of increase of capital within 30 days of passing of the resolution to increase capital is a continuing offence. A subsequent resolution to rescind the earlier resolution would not absolve anybody of the duty to file notice and deposit requisite fee on the basis of the resolution as first passed. But, if the company has rescinded the resolution soon after it was passed without giving effect to or acting thereon, no fee need be paid.

Answer 3(c):

The Court may order the winding up of a company under any of the circumstances mentioned under section 433(a) to (f). Section 433(e) provides that a company may be wound up by the Court if it is unable to pay its debts. As per section 434, a company shall be deemed to be unable to pay its debts in the following circumstances:

1. When a company fails in paying its debts exceeding ₹500 within 3 weeks from the date of demand by its creditors.
2. When the company fails to satisfy a Court decree, in favour of a creditor, whether whole or in part.
3. When it is proved that the company is unable to pay its debts.

Applying the principles laid down in Tata Iron and Steel Co. v Micro Forge (India) Ltd. 2000 CLC 1669 to the given case, it is very unlikely that the Court would order winding up of the company because of the following reasons:

(a) Section 433 is indicative of the fact that even if one or more grounds mentioned in section 433 exist, it is not obligatory for the Court to make an order of winding up. The Court has discretionary power. The Court must in each case exercise its discretion in deciding whether in the circumstances of the case, it would be in the interest of justice to wind up the company. The Court would take into consideration the entire status and position of the company in the market, and the element of public policy.

(b) The company has employed 1,000 workers and is paying their salaries regularly. Winding up the company would mean loss of employment to the existing employees. It would also result in diminishing employment opportunities.

(c) The company is paying taxes to the Government regularly. Winding up order would result in loss of revenue to the Government.

(d) The other creditors of the company have opposed the winding up petition which means that winding up order would not benefit the company's creditors in general. Therefore, winding up order shall not be made on a creditor's petition.

(e) The company seems to be in a temporary cash crisis. The Court would give the company some time to come out of the momentary financial crisis.

(f) The company is an ongoing concern having regular business and employment of employees. The effect of winding up would be of putting an end to the business resulting in loss of employment to several employees and loss of production and effect on the larger interest of the society.

Q.4.(a) 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, 2013. The company is running in losses and its accumulated losses aggregated to ₹15 lakhs. The company wants to borrow ₹20 lakhs from Financial Institutions to improve its working and also to redeem the preference share capital. Advise.

(b) Whether CARO, 2003 (as amended) would be applicable to ABC Producer Company Limited?

(c) The articles of association of DEF Ltd. mentioned in it that Mr. X and Mr. Y will act as directors of the company from the date of incorporation. The company was incorporated on 2nd January, 2012. The articles also provided that the directors will have to obtain qualification shares within one month from the date of appointment as director. Mr. X purchased the shares of the company on 28th February, 2012 and Mr. Y purchased on 28th March, 2012 thus violating the provisions contained in the articles. Having regard to the provisions of the Companies Act, examine the validity of the appointments of Mr. X and Mr. Y as directors.

Answer 4(a):

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

(i) profits of the company, or

(ii) out of a 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. The limits to deposits do not apply to borrowing from financial institutions since the same is excluded from the expression 'deposit' as per rule 2(b)(ii) of the Companies Acceptance of Deposits Rules, 1975.

Answer 4(b):

Companies (Auditor's Report) Order, 2003 [CARO] shall apply to every company including a foreign company as defined in section 591 of the Act, except the following:

- a Banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);
- an insurance company as defined in clause (21) of section 2 of the Act;
- a company licensed to operate under section 25 of the Act; and
- a private limited company with a paid-up capital and reserves not more than ₹50 lakh and does not have loan outstanding exceeding ₹25 lakhs from any bank or financial institution and does not have a turnover exceeding ₹5 crores at any point of time during the financial year.

Therefore, CARO, 2003 (as amended) would be applicable to ABC Producer Company Limited just like it is applicable to private limited companies since as per section 581C(5) of the Companies Act, 1956, a producer company on registration as such, will be treated as a private limited company under the Act.

Answer 4(c):

The given problem relates to sections 254 and 270 of the Companies Act, 1956, as discussed below:

The provisions relating to first directors are contained in section 254 of the Companies Act, 1956. As per section 254, the directors named in the articles shall be the first directors of the company.

As per section 270, every director shall obtain share qualification within 2 months of appointment. Further, the articles cannot require a person to hold qualification shares before appointment. Similarly, the articles cannot require that a director shall obtain the qualification shares within a shorter time than 2 months. Any provision in the articles shall be void in so far as it requires a person to hold the qualification shares before his appointment as a director or to obtain them within a shorter time than 2 months.

Applying the provisions of sections 254 and 270 to the given case, -

(a) Mr. X and Mr. Y are named in the articles as first directors. Accordingly, w.e.f. 02.01.12, they are the first directors of DEF Ltd.
(b) The articles are void in so far as the articles require the directors to obtain the qualification shares within 1 month. Accordingly, Mr. X and Mr. Y must acquire the qualification shares within 2 months of incorporation of DEF Ltd.
(c) Mr. X can continue in office since he has obtained the qualification shares within 2 months.
(d) Mr. Y shall vacate his office since he failed to obtain the qualification shares within 2 months of incorporation of DEF Ltd.

Q.5.(a) State the documents which is required to be furnished by a "'Foreign Company" to the ROC, initially, i.e. upon establishment of place of business in India.

(b) Discuss the applicability of The Companies (Cost Audit Report) Rules, 2011.

(c) The shareholding of LIC and UTI increased from 23% to 27% of the subscribed share capital of the company after issue of notice of the Annual General Meeting. Explain how will the appointment of auditors be made.

(d) State the additional requirements stipulated in clause 49 of the Listing Agreement which are silent in section 292A of the Companies Act, 1956.

Answer 5(a):

Documents to be furnished by a "'Foreign Company" to the ROC, initially, i.e. upon establishment of place of business in India [Sec. 592] are as follows:

1. Foreign Companies which establish a place of business within India shall, within 30 days of the establishment of the place of business, deliver to the ROC for registration:
   (a) Certified copy of - (i) Charter, (ii) Statutes, (iii) Memorandum and Articles, or (iv) other instrument constituting or defining the constitution of the Company, and, if the instrument is not in the English language, a certified translation thereof,
   (b) Full Address of the Registered or Principal Office of the Company,
   (c) List of Directors and Secretary of the Company, containing the prescribed particulars,
   (d) Name(s) and Address(es) of person(s) resident in India, authorised to accept on behalf of the Company service of process and any notices or other documents required to be served on the Company, and
   (e) Full Address of the Office of the Company in India which is to be deemed its principal place of business in India.
2. Prescribed Particulars in respect of Directors and Secretary are as under:

Situation	Each Director	Each Secretary
In the case of an Individual	• Present Name and Surname in full, • Any former Name(s)' and Surname(s) in full, • Usual Residential Address, • Nationality, and Nationality of Origin, where applicable, • Business Occupation, if any, or • If he has no business occupation but holds any other Directorship(s), particulars of that Directorship(s)	• Present Name and Surname in full, • Any former Name(s) & Surname(s) in full, • Usual Residential Address.
In the case of a Body Corporate	• Corporate Name, • Registered or Principal Office, and • Full Name, Address, Nationality, and Nationality	• Corporate Name, & • Registered or Principal Office.

	of Origin, where applicable, of each of its Directors.	

Notes:

- Where all Partners in a Firm are Joint Secretaries of the Company, the Name and Principal Office of the Firm may be stated.
- For determining "Surname", the principles in Sec. 303(l) Explanation (2) & (3) shall apply.
- "Certified" means certified in the prescribed manner to be a true copy or a correct translation.
- "Director", in relation to a Company, includes any person in accordance with whose directions or instructions the Board of Directors of the Company is accustomed to act.
- "Secretary" includes any person occupying the position of Secretary, by whatever name called.

3. Ceasing to have Place of Business [Sec.597]: If any Foreign Company ceases to have a place of business in India, it shall forthwith give notice of the fact to the ROC. As from the date on which notice is so given, the obligation of the Company to deliver any document to the ROC shall cease, provided it has no other place of business in India.

Answer 5(b):

Applicability of the Companies (Cost Audit Report) Rules, 2011:

1. These rules shall apply to every company in respect of which an audit of the cost records has been ordered by the Central Government under sub-section (1) of section 233B of the Act.
2. Every company as specified in sub-rule (1) shall, within 90 days of the commencement of every financial year, file an application with the Central Government seeking prior approval for appointment of the cost auditor, through electronic mode, in the prescribed form, along with the prescribed fee as per the Companies (Fees on Applications) Rules, 1999, and requisite enclosures.
3. Every cost auditor appointed under sub-rule (2) shall, within 30 days of receipt of letter of appointment, inform his appointment to the Central Government through electronic mode, in the prescribed form, along with the requisite enclosures.
4. Notwithstanding anything contained in sub-rule (2) and (3) above, every company and every cost auditor shall follow the procedure prescribed vide Ministry of Corporate Affairs' General Circular No. 15/2011 [File No. 52/5/CAB-2011] dated April 11, 2011.

Answer 5(c):

Section 224A requires a company to appoint an auditor by passing a special resolution where 25% or more of its subscribed capital is held by the Government or its instrumentalities. However, it does not specify the date on which 25% of the subscribed share capital must be held by the government instrumentalities, i.e., whether the date of notice of the meeting or the date of passing the special resolution shall be the effective date.

Ordinarily, there will be no difference in the shareholding as on the date of issue of notice and the date of the Annual General Meeting. However, in exceptional cases, where the shareholding as on these two dates differ, the material date is the date of the annual general meeting. In such a case, the company has two options, as discussed below:

Option 1: The Company may adjourn the Annual General Meeting and later issue the required notice in accordance with the provisions of the Act. The special resolution appointing the auditors shall be passed in the adjourned Annual General Meeting.

Option 2: The Company may omit or pass over the item on the agenda regarding the appointment of auditors. The auditors shall be appointed by the Central Government in such a case [Department Circular No. 2/76, 1/1/76-CL-V, dated 5.6.1976].

Answer 5(d):

Additional requirements stipulated as per Clause 49:

The following additional requirements are stipulated as per Clause 49 of the Listing Agreements which are silent in Section 292A of the Companies Act, 1956 :

(i) The audit committee should invite such of the executives, as it considers appropriate (and particularly head of the finance function) to be present at the meeting of the committee, but on occasions it may also meet without the presence of any executive of the company,
(ii) The company secretary shall act as secretary to the committee,
(iii) The audit committee shall meet at least thrice a year. Once meeting shall be held before finalization of annual accounts and once in every six months,
(iv) The quorum of the audit committee shall be two members or one-third of the members of the audit committee-whichever is higher and minimum of two independent directors,
(v) The powers and role of the audit committee are elaborately contained in sub-paragraphs C&D of paragraph II.

Q.6.(a) The managing director of the company withdrew a sum of money from the company's bank account and used it to pay bribes for obtaining contracts in favour of the company. The company sued the managing director. The managing director contends that the company has benefited substantially on account of the contract obtained. Advise.

(b) In what way does the Companies Act, 1956 regulate the issue of shares at a Premium? State the purposes for which share premium so charged can be utilized.

(c) XYZ Co. Ltd. has its subsidiary company PRM Ltd., which is formed to carry out some of the objectives of XYZ Co. Ltd. XYZ Ltd. suspends one of its several businesses, by passing a resolution at the company's Extraordinary General Meeting with effect from 1st January, 2012. The business so suspended continues to be suspended until March, 2012. On 1st April, 2012 a group of shareholders of XYZ Ltd. file a petition in the Court for winding of the company on the ground of suspension of business by the company. Referring to the provisions of the Companies Act, 1956 decide;

(i) Whether the shareholder's contention shall be tenable?
(ii) What would be your answer in case XYZ Ltd. suspends all its business?

Can shareholders of PRM Ltd. file a petition in the Court for winding up their company (PRM Ltd.) on the ground that the holding company viz. XYZ Ltd. has suspended its entire businesses, though PRM Ltd. has not suspended its business?

Answer 6(a):

The directors must act in good faith in what they believe to be the best interest of the company. They must not exercise the powers conferred upon them for purposes different from those for which they were conferred.

The courts do not interfere in the directors' discretion as to the way in which the company's funds are to be applied provided it is within the powers of the company [Taunton v Royal Insurance Co. (1864)2 Hem and M 135]. It therefore follows that where the funds are applied ultra vires the memorandum or the application of funds involves an illegal act, the courts would interfere.

Where the managing director of the company used the funds of the company for paying bribes, the Court held that he had no authority to sue the company's money for an illegal purpose, and the fact that the company had benefited from the payment did not provide the director with any defence [Hannibal (E) and Co. v Frost (1988) 4 BCC 3 (CA)].

The facts of the given case are identical to the case referred above and so the company can recover the money from the managing director.

Answer 6(b):

Shares are said to be issued at a premium when they are issued at a price higher than the face value. The excess of issue price over the face value is called as the amount of 'Securities Premium' e.g. if a share of ₹ 10 is issued at ₹ 15, it is said that the share has been issued at a premium of ₹ 5.

The Companies Act, 1956 does not stipulate any conditions or restrictions regulating the issue of securities by a company at a premium. A company may issue shares at a premium even though there is no express authority in its Articles since the company has an implied power to issue shares at a premium. Where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount or value of the premiums on those shares must be transferred to an account, to be called the Securities Premium Account.

Purposes for which Securities Premium can be utilized:

(a) Though there are no restrictions in the Companies Act, 1956 on the issue of shares at a premium but there are restrictions on the application of Securities Premium. According to Section 78 of the Companies Act, 1956, the Securities Premium may be applied only for the following purposes:
   (i) To issue fully paid bonus shares to the members;
   (ii) To write off preliminary expenses of the company;
   (iii) To write off the expenses of or the commission paid or discount allowed on any issue of shares or debentures of the company;

(iv) To provide for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company;

(b) According to Sec 77A, a company may buy back its own shares or other specified securities out of Securities Premium Account.

(c) The use of Securities Premium Account for purposes other than those mentioned above requires the compliance of the provisions of the Act relating to reduction of share capital.

Answer 6(c):

As per Section 433, if a company suspends its business for a whole year, it may be wound up by the Court.

(i) In this case the company has suspended one of its several businesses on 1.1.2012. As on 1.4.2012, a winding up petition on the ground of suspension would fail because of the following reasons:

(a) Only one of the businesses, and not all businesses of the company have been suspended.

(b) The suspension was only for a period of 3 months, i.e., less than one year as specified under section 433(c).

(ii) Even if XYZ Ltd. had suspended all its business, section 433(c) would not apply because of the following reasons:

(a) The suspension was only for a period of 3 months, i.e., less than one year as specified under section 433(c).

(b) Where a company ceases to carry on any business which it was previously doing, it would not amount to suspension of business if such business is carried on by any of its subsidiaries.

(iii) PRM Ltd. has not suspended its business and therefore, the shareholders of PRM Ltd. have no right to file a winding up petition. Section 433(c) does not envisage filing of a winding up petition by a company on the ground that its holding company has suspended its business.

Q.7.(a) Discuss the circumstances under which the Appropriate Government may revoke the licence under The Electricity Act, 2003.

(b) Your company has been approached by its foreign collaborators who have three U.K. based directors on your Board with the idea that they would appoint a single individual based in India to act as an alternate for all the three U.K. based directors. Advise by indicating the feasibility of the idea, the voting rights to be enjoyed by the proposed alternate director, and the sitting fees payable to him.

(c) ACE Automobiles Limited is a company engaged in the manufacture of Cars. The company's investment in the shares of other bodies corporate and the loans made to other bodies corporate exceed 60 percent of its paid up share capital and free reserves and also 100 percent of its free reserves. The company has obtained a term loan from the Industrial Credit and Investment Corporation of India Limited. The company proposes to increase its investment in the equity shares of ACE Forgings Limited from 60 percent to 70 percent of the equity share capital of ACE Forgings Limited purchase of shares from the Foreign Collaborator. State the legal requirements to be complied with by ACE Automobiles Limited under the

Companies Act to give effect to the above proposal. Will your answer be different if the company has defaulted in repayment of matured deposits accepted from the public?

Answer 7(a):

The circumstances under which the Appropriate Government may revoke the licence under The Indian Electricity Act, 2003 has been stated under section 19 of the Act as follows:

1. If the Appropriate Commission, after making an enquiry, is satisfied that public interest so requires, it may revoke a licence in any of the following cases, namely:
   (a) where the licensee, in the opinion of the Appropriate Commission, makes willful and prolonged default in doing anything required of him by or under this Act or the rules or regulations made thereunder;
   (b) where the licensee breaks any of the terms or conditions of his licence the breach of which is expressly declared by such licence to render it liable to revocation;
   (c) where the licensee fails, within the period fixed in this behalf by his licence, or any longer period which the Appropriate Commission may have granted therefore:
      (i) to show, to the satisfaction of the Appropriate Commission, that he is in a position fully and efficiently to discharge the duties and obligations imposed on him by his licence; or and obligations imposed on him by his licence; or
      (ii) to make the deposit or furnish the security, or pay the fees or other charges required by his licence;
   (d) where in the opinion of the Appropriate Commission the financial position of the licensee is such that he is unable fully and efficiently to discharge the duties and obligations imposed on him by his licence.
2. Where in its opinion the public interest so requires, the Appropriate Commission may, on application, or with the consent of the licensee, revoke his licence as to the whole or any part of his area of distribution or transmission or trading upon such terms and conditions as it thinks fit.
3. No licence shall be revoked under sub-section (1) unless the Appropriate Commission has given to the licensee not less than 3 months'notice, in writing, stating the grounds on which it is proposed to revoke the licence, and has considered any cause shown by the licensee within the period of that notice, against the proposed revocation.
4. The Appropriate Commission may, instead of revoking a licence under sub-section (1), permit it to remain in force subject to such further terms and conditions as it thinks fit to impose, and any further terms or conditions so imposed shall be binding upon and be observed by the licensee and shall be of like force and effect as if they were contained in the licence.
5. Where the Commission revokes a licence under this section, it shall serve a notice of revocation upon the licensee and fix a date on which the revocation shall take effect.
6. Where an Appropriate Commission has given notice for revocation of licence under sub-section (5), without prejudice to any penalty which may be imposed or prosecution proceeding which may be initiated under this Act, the licensee may, after prior approval of that Commission, sell his utility to any person who is found eligible by that Commission for grant of licence.

Answer 7(b):

An alternate director can be appointed only if any of the directors of the company is absent for not less than 3 months from the State in which Board meeting are ordinarily held (Section 313). But, section 313 does not contain any specific provision either prohibiting or authorising an individual to be appointed as an alternate director for more than one director.

The appointment of one person as an alternate director for three U. K. based directors would not be in the interest of good corporate governance. Also, it would adversely affect the interests of company, since this would limit the deliberations in the Board meeting. Moreover, only one person would exercise three votes and this would probably result in giving of all the three votes either in favour of the resolution or against the resolution.

In the given case if one individual is appointed as an alternate director for the three foreign directors, he will have three votes. However, he shall be entitled to receive the sitting fees in respect of one director only.

Answer 7(c):

As per section 372A(8), any loans, investments etc. made by a holding company in its wholly owned subsidiary are outside the purview of Section 372A. However, ACE Forgings Ltd. is not a wholly owned; subsidiary of ACE Automobiles Ltd and hence investment in ACE Forgings Ltd. is not covered by the exemption under section 372(8).

The aggregate of loans and investments already made by ACE Automobiles Ltd. exceeds the two limits of 60% and 100% specified under section 372A. Therefore, the company can make new inter-corporate investments only by passing a special resolution.

The proposed investment can be made as follows:

(a) A resolution shall be passed at a Board meeting with the consent of all the directors present.
(b) A special resolution shall be passed in the general meeting. The notice of special resolution must indicate clearly the specific limits, the particulars of the body corporate in which the investment is proposed to be made, the purpose of the investment, specific source of funding and other similar details.
(c) ICICI Ltd. is a Public Financial Institution within the meaning of section 4A. Since, the aggregate investments exceed the limit of 60%, prior approval of ICICI Limited shall be obtained.
(d) The company shall enter the prescribed particulars of the investment in the register maintained for this purpose within 7days of making the investment.
(e) The company shall ensure that no default in compliance with section 58A (relating to pubic deposits) is subsisting.

If the company has defaulted in repayment of public deposits, the company cannot make any investments even if special resolution and resolution of Board is passed. The investments can be made only after the default has been made good.

Q.8.(a) Jai, an existing rotational director of MRN Company Limited whose term expired at the company's Annual General Meeting held on 30th September, 2012, was re-appointed at the same meeting. Jai accepted the reappointment and resumed the office without filing his consent with the concerned registrar of companies on his reappointment. A group of members of the company object to Jai's continuation as director, since Jai did not file his consent with the Registrar within the stipulated period as required under the Companies Act, 1956. Examining the provisions of the Act, decide:

(i) Whether the members' contention is correct and whether Jai has violated the provisions of the Companies Act, 1956 in this regard?

(ii) What would be your answer in case Jai is a person named as director of the company in the Company's articles of association registered with the registrar of companies?

(b) Mr. Sharma is a legal advisor of M/s. ABC Ltd. and in that capacity he has rendered legal advice by way of a written communication to the company. The registrar of companies, Mumbai, issues an order, under section 234 of the Companies Act, 1956 to Mr. Sharma to disclose and furnish a copy of the communication made by him. Examine the power of the registrar to call for the said document from Mr. Sharma.

(c) Explain the powers of the Commission to approve, modify or disapprove a combination as per The Competition Act, 2002.

Answer 8(a):

No person shall act as a director unless he has filed his consent within 30 days with the registrar. However, following persons need not file their consent with the registrar:

- A director reappointed after retirement.
- Additional director, alternate director or a person filling a casual vacancy when appointed as a director or reappointed as an additional or alternate director.
- A person named as a director in the articles as first registered.

The present case can be discussed as follows:

(i) Jai has been reappointed after retirement by rotation. Therefore, Jai is not required to file his consent to act as director with the registrar. Jai has, therefore not violated any of the provisions of the Act.

(ii) In the second case, Jai has been named as a director in the articles as first registered. Therefore, he is not required to file his consent to act as director with the registrar. Jai has, therefore not violated any of the provisions of the Act.

Answer 8(b):

Section 251 of the Companies Act, 1956 constitutes a basic norm of professional communication incorporated in the Indian Evidence Act, 1872. Sections 126 to 129 of the Indian Evidence Act, 1872 lay down the principle that no advocate or legal advisor shall be compelled to disclose as to what communication was made by the client to him. The rule of professional communication is based on public policy and protects the interest of the client.

Section 251 grants professional immunity to legal advisers and bankers. The provisions of section 251 shall apply notwithstanding anything contained in sections 234 to 250 (relating to power of registrar to call for information, seizure of documents by the registrar, investigation, inspector's power to call for documents and evidence etc.). As per section 251:

(a) A legal adviser is not bound to disclose any privileged communication made to him except the name and address of his client.
(b) A banker of company is not required to disclose any information relating to the affairs of its customers except the name of the company and the related companies under investigation.

Answer 8(c):

The Powers of the Commission to approve, modify or disapprove a combination are explained below:

1. **Where combination does not have any adverse effect on competition**
   Where the Commission is of the opinion that any combination does not, or is not likely to, have an appreciable adverse effect on competition, it shall, by order, approve that combination including the combination in respect of which a notice has been given under section 6(2).
2. **Combination not to take effect if it has any adverse effect on competition**
   Where the Commission is of the opinion that the combination has, or is likely to have, an appreciable adverse effect on competition, it shall direct that the combination shall not take effect.
3. **Modification of combination to eliminate the adverse effect**

   (a) When can Commission propose modification?
   Where the Commission is of the opinion that the combination has, or is likely to have, an appreciable adverse effect on competition but such adverse effect can be eliminated by suitable modification to such combination, it may propose appropriate modification to the combination, to the parties to such combination.

   (b) Acceptance of modification
   The parties, who accept the modification proposed by the Commission, shall carry out such modification within the period specified by the Commission.

   (c) Failure to carry out accepted modification - Consequences
   If the parties to the combination, who have accepted the modification, fail to carry out the modification within the period specified by the Commission, such combination shall be deemed to have an appreciable adverse effect on competition and the Commission shall deal with such combination in accordance with the provisions of this Act.

   (d) Refusal of parties to accept modification
   - The parties to the combination may not accept the modification proposed by the Commission.
   - In such a case, the parties may, within next 30 working days, submit amendment to the modification proposed by the Commission.
   - However, if the parties do not accept the modification proposed by the Commission

within 30 days, and also do not submit amendment to the modification proposed by the Commission, the combination shall be deemed to have an appreciable adverse effect on competition.

(e) Commission may agree to the amendments

If the Commission agrees with the amendment submitted by the parties, it shall, by order, approve the combination.

(f) Refusal of Commission to agree to amendments

- If the Commission does not accept the amendment submitted by the parties, then, the parties shall be allowed a further period of 30 working days within which such parties shall accept the modification proposed by the Commission.
- If the parties fail to accept the modification proposed by the Commission within next 30 working days, the combination shall be deemed to have an appreciable adverse effect on competition.

4. Consequences where the Commission declares that combination has adverse effect on competition

Where the Commission has directed that the combination is deemed to have an appreciable adverse effect on competition, then, without prejudice to any penalty which may be imposed or any prosecution which may be initiated under this Act, the Commission may order that the combination shall not be given effect to.

Q.9.(a) Examine with reference to the provisions of the Companies Act, 1956 the validity of the following:

(i) A scheme provides for amalgamation of a 'foreign company' with a company registered under the Companies Act, 1956.

(ii) The statement forwarded with the notice convening a meeting of its members pursuant to Court's direction under Section 391 contains only 'exchange ratio' without details of its calculation.

(iii) At the time of filing of the petition for amalgamation, the object clause of both the transferor and transferee Companies does not contain power to amalgamate.

(b) Board of Directors of M/s. RPP Ltd in its meeting held on 29th May, 2012 declared an interim dividend payable on paid up Equity Share Capital of the Company. In the Board Meeting scheduled for 10th June, 2012, the Board wants to revoke the said declaration. You are required to state with reference to the provisions of the Companies Act, 1956 whether the Board of Directors can do so.

(c) Mr. Ram, a citizen of India, left India for employment in U.S.A. on 1st June 2010. Mr. Ram purchased a flat at New Delhi for ₹15 lakhs in September, 2011. His brother, Mr. Gopal employed in New Delhi, also purchased a flat in the same building in September, 2011 for ₹15 lakhs. Mr. Gopal's flat was financed by a loan from a Housing Finance Company and the loan was guaranteed by Mr. Ram. Examine with reference to the provisions of Foreign Exchange Management Act, 1999 whether purchase of flat and guarantee by Mr. Ram are Capital Account transactions and whether these transactions are permissible.

Answer 9(a):

(i) For effecting amalgamation of two or more companies, an application shall be made to the Court under section 391 (Section 394). The benefit of section 394 is available only if the transferee company (i.e., new company) is a company within the meaning of Companies Act, 1956. However, the transferor company may be any body corporate, whether a company within the meaning of the Companies Act, 1956 or not. As such, a foreign company can be a 'transferor company' but not a 'transferee company'. Therefore, a scheme of amalgamation may provide for transfer of foreign companies to Indian companies.

(ii) For effecting amalgamation of two or more companies, an application shall be made to the Court under section 391 (Section 394). On receipt of such an application, the Court may order that a meeting of the creditors or members or any class of them be called, held and conducted in the manner directed by the Court. Where a meeting of creditors or members is called, the notice given to them contain:

- the terms of the compromise or arrangement;
- an explanatory statement explaining the effect of the compromise or arrangement;
- a statement explaining any material interests of the directors, managing director, or manager of the company. The effect of those interests on the scheme should be explained stating if and how their interests are different from the like interests of other persons; and
- if the debentureholders are also affected by the scheme, the interest of the trustees should also be similarly disclosed.

In the present case, the notice convening a meeting of members contains only 'exchange ratio' without details of its calculation. As is evident, the terms of the compromise or arrangement have not been disclosed. Therefore, the notice given to members is not valid.

(iii) The memorandum of association explains the scope of operations of a company beyond which the company cannot go. Anything done by a company outside the objects clause of memorandum is *ultra vires* the company.

However, to amalgamate with another company is a power of the company, and not an object of the company. Therefore, no power to amalgamate is required in the memorandum of a company before making an application to the Court for effecting amalgamation. Also, the power to amalgamate has been given by the statute under section 394. Since there is a statutory provision dealing with amalgamation of companies (which does not require that such a provision must be present in the memorandum or articles of the company), no special power in the objects clause of the memorandum is necessary for its amalgamation with another company. Section 394 is a complete code which gives full jurisdiction to the Court to sanction amalgamation of companies, even though there may be no power in the objects clause of memorandum [Re, EITA India Ltd., AIR 1997 Cal 208; United Bank of India v United India Credit & development Co. Ltd. (1977) 47 Comp Cas 689, 730 (Cal)].

Answer 9(b):

As per section 2(14A), dividend includes any interim dividend. Therefore, all the provisions applicable to final dividend shall equally apply to interim dividend.

Thus, interim dividend once declared, like final dividend, is a debt due from the company. Accordingly, once declared, interim dividend cannot be revoked except under the same circumstances in which the final dividend can be revoked.

The amount of interim dividend is to be compulsorily deposited in a separate bank account, within 5 days of passing the Board resolution declaring the interim dividend [Section 205(1A)].

The provisions contained in sections 205, 205A, 205C, 206, 206A and 207 shall, as far as may be, also apply to any interim dividend [Section 205(1C)].

As per section 207, dividend must be paid within 30 days of its declaration. Thus, interim dividend must also be paid within 30 days of its declaration, i.e., within 30 days of date of passing the Board resolution declaring the interim dividend.

In the instant case, on declaration of interim dividend by the Board in a Board Meeting held on 29th May, 2012, the Liability of the company to pay the interim dividend has become certain, and the payment of interim dividend must be made within next 30 days, viz. on or before 28th June 2012.

Therefore, revocation of interim dividend in the Board Meeting held on 10th June is not possible.

Answer 9(c):

Capital account transaction means a transaction which alters the assets or liabilities, including contingent liabilities, outside India of persons resident in India or assets or liabilities in India of persons resident outside India. It also includes -

(a) acquisition or transfer of immovable property in India, other than a lease not exceeding 5 years, by a person resident outside India.
(b) giving of a guarantee or surety in respect of any debt, obligation or other liability incurred by a person resident outside India.

In general, a capital account transaction is not permissible, unless otherwise provided in the Act, rules or regulations made thereunder, or with the general or special permission of Reserve Bank of India.

In the given case Mr. Ram left India for employment in USA in June 2010. Therefore, he becomes a person resident outside India as from June 2010.

(i) The purchase of flat in India by Mr. Ram (a person resident outside India) is a capital account transaction, Therefore, this transaction shall be permissible in accordance with the regulations framed in this behalf, i.e., Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2000.

    Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2000 imposes restrictions on a person resident outside India from acquiring immovable property in India. However, Regulation 3 of these regulations permits a person resident outside India to acquire any immovable property in India provided he fulfills both the following conditions:

- The person resident outside India is a citizen of India.
- The immovable property acquired in India is not agricultural/plantation/farm house. Therefore, in the instant case, the purchase of flat by Mr. Ram is permissible under FEMA.

(ii) Guarantee involves a long term commitment which alters the assets and liabilities of a person, and therefore it is considered as a capital account transaction and thus restricted under FEMA.

Accordingly, Mr. Ram can give a guarantee to the Housing Finance Company in respect of purchase of flat by Mr. Gopal with the permission of Reserve Bank of India.

Q.10.(a) Mr. Gopal is a director in a Bank. The Reserve Bank of India terminates him on the ground that his conduct is detrimental to the interest of the depositors. Decide whether the Reserve Bank of India can do so under the Banking Regulation Act, 1949. Can the Reserve Bank of India appoint Additional Director in a Bank under the said Act?

(b) Industrial Finance Corporation of India, established under the Industrial Finance Corporation Act, 1948 having its Registered Office at Mumbai, issued 8% Redeemable Bonds redeemable after 7 years. These bonds were issued directly to the members of the public and not through the mechanism of Stock Exchanges. You are required to state with reference to the provisions of Securities Contracts (Regulation) Act, 1956, whether such direct issue of bonds by the Industrial Finance Corporation of India is not violating the provisions of the said Act.

(c) The Accounts of CALM Ltd., a listed company for the year ended 31st March, 2011 were finalised on 31st May, 2012. The company had a paid up capital of ₹50 lakhs and free reserves of ₹100 lakhs. 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 ₹10 crores comprising of offer to public through offer document, firm allotment and promoters contribution. State, how this can be done under SEBI Guidelines.

Answer 10(a):

The Reserve Bank is empowered to remove the managerial and other persons as per the provisions of section 36AA, which is explained below:

1. Conditions for removal of managerial and other persons (Section 36AA(1)]

Where the Reserve Bank is satisfied that in the public interest or for preventing the affairs of a banking company being conducted in a manner detrimental to the interests of the depositors or for securing the proper management of any banking company it is necessary so to do, the Reserve Bank may, for reasons to be recorded in writing, by order, remove from office, with effect from such date as may be specified in the order, any chairman, director, chief executive officer (by whatever name called) or other officer or employee of the banking company.

2. Issue of show cause notice before removal [Section 36AA(2)]

No order under sub-section (1) shall be made unless the chairman, director or chief executive officer or other officer or employee concerned has been given a reasonable opportunity of making a representation to the Reserve Bank against the proposed order.

Note: Overriding effect of Section 36AA (Section 36AC)

Any removal of a director, chief executive officer or other officer or employee in pursuance of section 36AA shall have effect notwithstanding anything to the contrary contained in the Companies Act, 1956 or any other law for the time being in force or in any contract or any other instrument.

Answer 10(b):

As per section 28, the provisions of the Act shall not apply to any corporation set up under a special law.

Since, Industrial Finance Corporation of India has been set up under a special law (viz., the Industrial Finance Corporation Act, 1948), the provisions of Securities Contracts (Regulation) Act, 1956 shall not apply to it. Therefore, Industrial Finance Corporation of India can issue 7 years bonds to the public directly without requiring any permission of any stock exchange.

Answer 10(c):

Regulation 26 of Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009, contains the legal requirements for public issue by an issuer. As per Sub-Regulation (1) of Regulation 26, an issuer 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 the proposed issue and all previous issues made in the same financial year in terms of issue size (i.e. offer through offer document + firm allotment + promoters' contribution through the offer document), does not exceed 5 times its pre-issue net worth as per the audited balance sheet of the preceding financial year.

Sub-Regulation (2) of Regulation 26 further provides that an issuer not satisfying any of the conditions specified in Sub-Regulation (1), shall be eligible to make an initial public offer if -

An issuer not satisfying the condition stipulated in sub-regulation (1) may make an initial public offer if the issue is made through the book-building process and the issuer undertakes to allot, at least seventy five per cent of the net offer to public, to qualified institutional buyers and to refund full subscription money if it fails to make the said minimum allotment to qualified institutional buyers.

The Board of Directors of CALM Ltd. proposed to make a public issue during the financial year 2012-2013. 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, 2012). But the latest available audited balance sheet is balance sheet as at 31st March, 2011. The proposed issue of ₹10 crores exceeds 5 times the net worth of ₹1.5 crores as on 31st March, 2011. The company must make efforts to get accounts for the financial year 2011-2012 audited. If the proposed issue exceeds 5 times the net worth as on 31st March, 2012 also, the company has to comply with the conditions specified in Sub-Regulation (2) of Regulation 26.

Q.11.(a) SEBI received complaints from some investors alleging that ABS Limited and some brokers are indulging in price 'manipulation in the shares of ABS Limited. Explain the powers that can be exercised by SEBI under the Securities and Exchange Board of India Act, 1992 in case the allegations are found to be correct.

(b) Mantop is a London based company having several business units all over the world. It has a manufacturing unit called Laptop with headquarters in Bengaluru. It has a branch in Seoul, South Korea which is controlled by the headquarters in Bengaluru. What would be the residential status under FEMA 1999 of Laptop in Bengaluru and that of Seoul branch?

(c) Mr. Zen an expert in modern agriculture practices is willing to lend his services as a director of M/s Lord Krishna Cotton Producer Company Ltd. registered under Section 581C of the Companies Act, 1956. Advise Mr. Zen as to how he can be appointed as a director including (1) The total number of directors that can be appointed (2) The tenure of the Directors (3) The time limit within which the appointment should be made (4) The co-option of directors and (5) The voting powers of such co-opted directors.

Answer 11(a):

The given problem relates to Sections 11, 12A, 15HA and 15HB of the Securities and Exchange Board of India Act, 1992.

Price manipulation in the shares of ABS Ltd. can be considered as fraudulent and unfair trade practice relating to securities market. Therefore, under section 11, SEBI is empowered to exercise the following powers:

(a) Suspend the trading of any security in a recognised stock exchange.
(b) Restrain persons from accessing the securities market and prohibit any person associated with securities market to buy, sell or deal in securities.

As per section 15HB, SEBI may impose penalty upto ₹1 crore on any person who fails to comply with any provision of the Act, for which no separate penalty has been provided.

As per Section 12A, no person shall directly or indirectly -

(a) use or employ, in connection with the issue, purchase or sale of any securities listed or proposed to be listed in a recognised stock exchange, any manipulative or deceptive device or contrivance in contravention of the provisions of this Act or the rules or the regulations made thereunder;
(b) employ any device, scheme or artifice to defraud in connection with issue or dealing in securities which are listed or proposed to be listed on a recognised stock exchange;
(c) engage in any act, practice, course of business which operates or would operate as fraud or deceit upon any person, in connection with the issue, dealing in securities which are listed

or proposed to be listed on a recognised stock exchange, in contravention of the provisions of this Act or the rules or the regulations made thereunder.

(d) engage in insider trading;
(e) deal in securities while in possession of material or non-public information or communicate such material or non-public information to any other person, in a manner which is in contravention of the provisions of this Act or the rules or the regulations made thereunder;
(f) acquire control of any company or securities more than the percentage of equity share capital of a company whose securities are listed or proposed to be listed on a recognized stock exchange in contravention of the regulations made under this Act.

As per section 15HA, if any person indulges in fraudulent and unfair trade practices relating to securities, he shall be liable to a penalty of ₹25 crores or 3 times the amount of profits made out of such practices, whichever is higher.

In the given case, ABC Limited and the brokers who indulged in price manipulation in the shares of ABC Limited are liable to penalty of ₹25 crores or 3 times the amount of profits made out of such practices, whichever is higher.

Answer 11(b):

Section 2(u) defines a 'person'. As per this definition, the following shall be covered in the definition of a 'person'.

(a) A company
(b) Any agency, office or branch owned by a 'person'.

Section 2(v) defines a 'person resident in India'. As per this definition, the following shall be covered in the definition of a 'person resident in India':

(a) An office, branch or agency in India owned or controlled by a person resident outside India.
(b) An office, branch or agency outside India owned or controlled by a person resident in India.

In the given case, Mantop (London), its headquarters in Bengaluru as well as Seoul Branch is a 'person'. Therefore, residential status under FEMA shall be determined for each of them separately.

- Mantop (London) does not fall under any of the clauses of the definition of a 'person resident in India'. Therefore, Mantop (London) is a person resident outside India.
- The Bengaluru Headquarters of Mantop (London) is a 'person resident in India' since it falls under the clause 'an office, branch or agency in India owned or controlled by a person resident outside India'.
- The Seoul branch of Mantop (London), though not owned, is controlled by the Bengaluru headquarters. The Seoul branch is a 'person resident in India' since it falls under the clause 'an office, branch or agency outside India owned or controlled by a person resident in India'.

Answer 11(c):

The given problem relates to sections 581O and 581P of the Companies Act, 1956, as discussed below:

1. Total number of directors that can be appointed in a producer company is 15. However, if a Producer Company is formed by way of conversion of a society into a Producer Company, all the directors of the erstwhile society as on the transformation date shall continue in office for a period of 1 year from the transformation date (Section 581O).
2. Tenure of directors is minimum 1 year and maximum 5 years (Section 581P).
3. As per section 581P, the time limit for appointment of directors is 90 days from the date of registration of the Producer Company. However, the election of directors shall be conducted within 1 year, if:
   (a) the Producer Company is formed by conversion of a society into a Producer Company; and
   (b) at least 5 directors held office as on the date of conversion of society into Producer Company.
4. The co-option of directors is possible. The Board may co-opt one or more expert directors or additional directors. These directors shall not exceed 1/5th of the total number of directors (Section 581P).
5. The expert directors shall not have the right to vote in the election of the chairman but shall be eligible to be elected as chairman, if so provided by its articles (Section 581P).

Q.12.(a) Poly Ltd., (hereinafter referred to as 'Seller'), manufacturer of footwears entered into an agreement with City Traders (hereinafter referred to as 'Purchaser'), for the 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 sell the goods manufactured by the Seller outside the municipal limits of the city of Secunderabad.
(iii) That the Purchaser shall sell 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. Section 3(1) prohibits entering into any agreement in respect of production, supply, distribution, storage, acquisition or control of goods or provision of services, which causes or is likely to cause an appreciable adverse effect on competition within India. Any such agreement, if made, shall be void.

(b) Working of City Stock Exchange Association Ltd. is not being carried on by its Governing Board in public interest. On receipt of representations from various Investors and Investors' Association, the Central Government is thinking to withdraw the recognition granted to the said Stock Exchange. You are required to state the circumstances and procedure for withdrawal of such recognition as per the provisions of Securities Contracts (Regulation) Act, 1956 in this regard. Also state the effect of such withdrawal on the contracts outstanding on the date of withdrawal.

(c) Mr. Dan is a citizen of America. He came to India for the first time on October 5, 2008 for employment and stayed in India till 31.03.2010. What would be his residential status during

the financial years 2008-09, 2009-10 and 2010-11? What would be the conditions in which he may be treated as a person resident outside India in the financial year 2010-11?

Answer 12(a):

The following agreements shall be deemed to be prohibited under section 3(1), if such agreements cause or are likely to cause an appreciable adverse effect on competition:

(a) Tie-in arrangement, i.e., an agreement requiring a purchaser of goods, as a condition of such purchase, to purchase some other goods.
(b) Exclusive supply agreement, i.e., an 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.
(c) Exclusive distribution agreement, i.e., an 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.
(d) Refusal to deal, i.e., an agreement which restricts, or is likely to restrict, by any method the persons or classes of persons to whom goods are sold or from whom goods are bought.
(e) Resale price maintenance, i.e., an agreement to sell goods on condition that the prices to be charged on the resale by the purchaser shall be the prices stipulated by the seller unless it is clearly stated that prices lower than those prices may be charged.

The answers to the given problems are given hereunder:

(i) The Purchaser is prohibited from dealing with goods, products, articles, by whatever name called, manufactured by any person other than the Seller. This clause falls under 'Exclusive Supply Agreement' and is deemed to be prohibited under section 3(1), if it causes or is likely to cause an appreciable adverse effect on competition.
(ii) The Purchaser is prohibited from selling the goods manufactured by the Seller outside the municipal limits of the city of Secunderabad. This clause falls under 'Exclusive Distribution Agreement' and is deemed to be prohibited under section 3(1), if it causes or is likely to cause an appreciable adverse effect on competition.
(iii) The Purchaser has been directed by the seller to sell the goods manufactured by the Seller at the price as embossed on the price label of the footwear, or at a price lower than what is embossed on the price label. Since the agreement clearly states that the prices lower than the price stipulated by the Seller can be charged, the agreement does not fall under the clause 'Resale Price Maintenance', and is therefore valid.

Answer 12(b):

Section 5 empowers the Central Government to withdraw the recognition granted to a stock exchange. The procedure for withdrawal of recognition is as follows:

(a) If, considering the interest of the trade or the public interest, the Central Government is of the opinion that the recognition granted to a stock exchange should be withdrawn, it shall serve a written notice on the governing body of the stock exchange.
(b) The notice shall specify the reasons for the proposed withdrawal of recognition.
(c) The Central Government shall give an opportunity of being heard to the governing body of the stock exchange.

(d) If the Central Government is satisfied that the recognition should be withdrawn, it may, by notification in the Official Gazette, withdraw the recognition granted to the stock exchange.
(e) No withdrawal of recognition shall affect the validity of any contract entered into or made before the date of the notification. In respect of any contract which is outstanding as on the date of notification, the Central Government may, after consultation with the stock exchange, make such provision as it deems fit.

Note: Delegation of powers to SEBI

The powers of Central Government under section 5 have been concurrently delegated to SEBI [Notification No. F. No. 1/57/SE/93, dated 13.09.1994]

Answer 12(c):
The given problem can be answered as follows:

(a) Financial year 2008-09. Mr. Dan came to India for the first time on October 5, 2008. It means he did not reside in India for anytime in the financial year 2007-2008. Therefore, for the financial year 2008-09 he is a 'Person resident outside India'.
(b) Financial year 2009-10. He resided in India for less than 183 days in the financial year 2008-09. Therefore, for the financial year 2009-10 he is a 'Person resident outside India'.
(c) Financial year 2010-11. Since he resided in India for more than 182 days in the financial year 2009-10, he shall be a 'Person resident in India' for the financial year 2010-11.

He shall be regarded as a 'Person resident outside India' for the financial year 2010-11 if he goes out of India:

- for taking up employment outside India; or
- for carrying on outside India a business or vocation outside India; or
- for any other purpose, in such circumstances as would indicate his intention to stay outside India for an uncertain period.

Q.13.(a) The Balance Sheet of International Operators Ltd. as at 31.03.2012 discloses the following position:

Particulars	₹ (in crores)
Share Capital	100
Reserves & Surplus	400
Secured Loans	150
Unsecured Loans	100
Current Liabilities	70

Mr. Ayan, the Managing Director of the company approaches the Royal Bank for a secured loan of ₹600 crores to finance the new projects to be taken up shortly. The Bank seeks your advice whether it can grant the loan of ₹600 crores on the application of Mr. Ayan. Advise the Royal Bank having regard to the provisions of the Companies Act, 1956.

(b) Under what circumstances can a company reduce its Share Capital? Describe the formalities to be complied with & procedure to be followed in this respect.

(c) The Banking Companies, Financial Institutions and Intermediaries of securities market are under some obligations under the Prevention of Money Laundering Act, 2002. State in brief, these obligations.

Answer 13(a):

The given problem relates to sections 292(1)(c) and 293(1)(d) of the Companies Act, 1956.

As per section 292, the powers relating to borrowing of money, otherwise than by issue of debentures shall be exercised by the Board at a Board meeting only. However, such power may be delegated by the Board, subject to the following 3 conditions:

(a) The powers may be delegated to a committee of directors, managing director, manager, a principal officer of the company or a principal officer of the branch office.
(b) The delegation of power is made by passing a resolution at a Board meeting.
(c) The resolution passed at the Board meeting shall specify the total amount outstanding at any one time upto which moneys may be borrowed.

As per section 293(1)(d), without the prior consent of the shareholders in general meeting, the Board of directors of a public company shall not borrow moneys where the borrowings (already made plus proposed) exceed the aggregate of the paid up capital and free reserves. However, temporary loans obtained from the company's bankers in the ordinary course of business shall not be considered as borrowings.

'Free reserves' means those reserves which are not set apart for any specific purpose.

In the given case, the aggregate of paid up capital and free reserves comes to ₹500 crores (₹100 crores + ₹400 crores). The company has already borrowed ₹250 crores (₹150 crores + ₹100 crores). It has been assumed that secured loans of ₹150 crores and unsecured loans of ₹100 crores are not temporary loans. Current liabilities shall not be included in the amount already borrowed.

The amount already borrowed (₹250 crores) and amount proposed to be borrowed (₹600 crores) would exceed the aggregate of paid up capital and free reserves (₹500 crores). Therefore, the Board is not entitled to borrow ₹600 crores, without the consent of the members in the general meeting, as per the provisions of section 293.

Accordingly, our advice to the Royal Bank is as follows:

(a) The Bank should make sure that the company has obtained the consent of the members by means of a resolution passed in the general meeting. The resolution should specify the maximum amount upto which moneys may be borrowed by the Board, and the amount so specified should be ₹850 crores or more [Section 293(1)(d)].

(b) The Bank should make sure that the power to borrow money has been delegated to the Managing Director and the resolution specifies the maximum amount outstanding at any one time upto which the Managing Director is authorised to borrow, and the amount so specified should be ₹850 crores or more [Section 292(1)(c)].

Answer 13(b):

1. **Meaning of Reduction of Share Capital [Section 100]:**

   Reduction of share capital may involve reduction in respect of that portion of:

   (a) issued capital which has been subscribed, called up and paid up, or
   (b) issued capital which has been subscribed but not called up.

2. **To which Company the Restriction as to Reduction of Share Capital applies:**

   The restriction as to reduction of share capital apply to the following two companies:

   (a) A company limited by shares
   (b) A company limited by guarantee having share capital.

   Thus, such restrictions do not apply to unlimited companies whether having share capital or not and companies limited by guarantee not having share capital.

3. **Manner of Capital Reduction:**

   A company may reduce its share capital in any way and in particular:

   (a) by extinguishing or reducing the liability of members in respect of capital not paid up. e.g. where the shares of ₹ 100 each with ₹ 75 paid up are reduced to ₹ 75 fully paid up shares, the shareholders are relieved from liability on the uncalled capital of ₹ 25 per share.
   (b) by cancelling any paid up share capital which is lost or is unrepresentated by available assets, with or without extinguishing or reducing liability of members.
   (c) by paying off any paid up share capital which is in excess of the wants of the company with or without extinguishing or reducing liability.

4. **Procedure for Reduction of Capital**

   The procedure for reducing the capital is given below:

   (a) Authorised by Articles The articles must authorise the company to reduce the share capital. If the articles do not so authorise, then these must be altered by a special resolution first.
   Note: It is not enough to provide this authority in the Memorandum.
   (b) Special Resolution A special resolution must be passed at a general meeting.
   (c) Court's Confirmation After passing the special resolution, the company has to apply to the court [now Tribunal vide Companies (Second Amendment) Act, 2002] for an order confirming the reduction.

Answer 13(c):

The obligations of Banking Companies, Financial Institutions and Intermediaries with respect to maintenance of accounts is explained below:

1. **Duties of Banking companies, Financial Institutions and Intermediaries [Section 12(1)]** Every banking company or financial institution and intermediary shall -

(a) maintain a record of all transactions, the nature and value of which may be prescribed, whether such transactions comprise of a single transaction or a series of transactions integrally connected to each other, and where such series of transactions take place within 1 month;

(b) furnish information of transactions referred to in clause (a) to the Director within such time as may be prescribed;

(c) verify and maintain the records of the identity of all its clients, in such a manner as may be prescribed.

2. **Furnishing of information where transaction(s) below the prescribed value are suspicious [Proviso to Section 12(1)]**

Where the principal officer of a banking company or financial institution or intermediary, as the case may be, has reason to believe that a single transaction or series of transactions integrally connected to each other have been valued below the prescribed value so as to defeat the provisions of this section, such officer shall furnish information in respect of such transactions to the Director within the prescribed time.

3. **Period of maintenance of records [Section 12(2)]**

(a) The records referred to in clause (a) of sub-section (1) shall be maintained for a period of 10 years from the date of transactions between the clients and the banking company or financial institution or intermediary, as the case may be.

(b) The records referred to in clause (c) of sub-section (1) shall be maintained for a period of 10 years from the date of cessation of transactions between the clients and the banking company or financial institution or intermediary, as the case may be.

The Central Government may, in consultation with the Reserve Bank of India, prescribe the procedure and the manner of maintaining and furnishing information under sub-section (1) of section 12 for the purpose of implementing the provisions of this Act (Section 15).

Q.14.(a) Write short note on Audit Committee under clause 49 of the Listing Agreement of SEBI.

(b) Mr. X, a duly qualified cost auditor, consented to the company for his appointment as cost auditor, and accordingly, government approval for his appointment was obtained. The cost auditor, later on, did not accept the offer. Advise the company how to proceed in the matter.

(c) Explain briefly the powers of the Central Government to issue directions to the Authority under The Insurance Regulatory & Development Authority Act, 1999.

Answer 14(a):

Clause 49 of the Listing Agreement with SEBI lays down the following in respect of Audit Committee:

1. **Applicability:**

An audit committee shall be set up – (a) All companies seeking listing for the first-time, at the time of seeking in-principle approval for such listing, and (b) all existing listed Companies with a

Paid-up Capital of ₹3 crores or more, or Net Worth of ₹25 crores or more, at any time in the history of the Company.

2. Composition

A qualified and independent Audit Committee shall be set up giving the terms of reference, and subject to the following:

(a) The audit committee shall have minimum 3 directors as members. 2/3rd of the members of audit committee shall be independent directors.

(b) All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.

(c) The Chairman of the Audit Committee shall be an independent director;

(d) The Chairman of the Audit Committee shall be present at Annual General Meeting to answer shareholder queries;

(e) The audit committee may invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit and a representative of the statutory auditor may be present as invitees for the meetings of the audit committee;

(f) The Company Secretary shall act as the secretary to the committee.

3. Meeting of Audit Committee

The audit committee should meet at least four times in a year and not more than four months shall elapse between two meetings. The quorum shall be either two members or one third of the members of the audit committee whichever is greater, but there should be a minimum of two independent members present.

4. Powers of Audit Committee

The audit committee shall have powers, which should include the following:

(a) To investigate any activity within its terms of reference.

(b) To seek information from any employee.

(c) To obtain outside legal or other professional advice.

(d) To secure attendance of outsiders with relevant expertise, if it considers necessary.

5. Review of Information

The Audit Committee shall mandatorily review the following:

(a) Management discussion and analysis of financial condition and results of operations,
(b) Statement of significant Related party Transactions, submitted by management,
(c) Management Letters/Letters of Internal Control Weaknesses issued by the Statutory Auditors,
(d) Internal Audit Reports relating to Internal Control Weaknesses, and

(e) Appointment, removal and terms of remuneration of the Chief Internal Auditor.

Answer 14(b):

On the cost auditor's refusal to accept the appointment, the position is similar to a situation of no cost auditor having been appointed. As such the Board of Directors shall have to appoint another cost auditor with the approval of the Central Government. This position is based on the analogy of the statutory auditor not accepting the appointment after due appointment by the company.

Answer 14(c):

The provisions of section 18 may be explained as follows:

1. **Nature of directions and their binding effect [Section 18(1)]**

   Without prejudice to the foregoing provisions of this Act, the Authority shall, in exercise of its powers or the performance of its functions under this Act, be bound by such directions on questions of policy, other than those relating to technical and administrative matters, as the Central Government may give in writing to it from time to time:

   Opportunity to Authority before giving directions [Proviso to Section 18(1)]. The Authority shall, as far as practicable, be given an opportunity to express its views before any direction is given under this sub-section.

2. **'Question of policy or not' to be decided by the Central Government [Section 18(2)]**

   The decision of the Central Government, whether a question is one of policy or not, shall be final.

Q.15.(a) A resolution was passed by the shareholders in an annual general meeting approving final dividend @20% for the financial year 2011-12 and one month later the Board of Directors decided to pay further dividend @5% for the financial year 2011-12.

(b) What is E-Governance? What are the advantages of e-Filing?

(c) State with reference to the relevant provisions of the Companies Act, 1956 whether the following persons can be appointed as a director of a public company:

(i) Mr. A, who has huge personal liabilities far in excess of his assets and properties, has applied to the court for adjudicating him as an insolvent and such application is pending.

(ii) Mr. B, who was caught red-handed in a shop lifting case two years ago, was convicted by a Court and sentenced to imprisonment for a period of eight weeks.

(iii) Mr. C, a former bank executive, was convicted by a Court eight years ago for embezzlement of funds and sentenced to imprisonment for a period of one year.

(iv) Mr. D is a director of DLT Limited, which has not filed its annual returns pertaining to the annual general meetings held in the calendar years 2010, 2011 and 2012.

Answer 15(a):

Section 173(1) of the Companies Act, 1956 requires that the declaration of the dividend should be shown as an ordinary business at an annual general meeting of a company and it is usually declared at an annual general meeting of the company. However, a company which could not declare dividend at an annual general meeting may do so at a subsequent general meeting. But if a dividend is so declared at the general meeting, neither the company nor the directors can declare a further dividend for the same year [Circular No. 22, issued by Department of Company Affairs, dated 25-10-1975). Also, there can be no declaration of dividend for past years, in respect of which the accounts have already been closed at previously held annual general meeting – Raghu Nandan Neotia v. Swadeshi Cloth Dealers Ltd. (supra).

Therefore, in the given case, the decision of the Board of Directors to pay a further dividend @5% for the same financial year is not valid.

Answer 15(b):

Electronic Governance is the application of information technology to the Government functioning in order to bring about Simple, Moral, Accountable, Responsive and Transparent (SMART) Governance. E-Governance is a highly complex process requiring provision of hardware, software, networking and re-engineering of the procedures for better delivery of services.

Traditionally, the interaction between citizens or business and Government agency takes place in a Government office. In E-Governance, the interaction takes place virtually using Internet based technology, thus reducing time and cost involved. Even better, E-Governance enhances the citizens and business access to Government information and services and provides new ways to increase citizen participation in the democratic process.

Advantages of e-Filing

- **Business** shall be enabled to register a company and file statutory documents quickly and easily.
- **Public** to get easy access to relevant records and get their grievances redressed effectively.
- **Professionals** to be able to offer efficient services to their client companies.
- **Financial institutions** to find registration and verification of charges easy.
- **Government** to ensure proactive and effective compliance of relevant laws and corporate governance.
- **MCA employees** shall be enabled to deliver best of services.

Answer 15(c):

As per section 274, following persons are disqualified to become a director:
(a) A person who has been found to be of unsound mind by a Court of competent jurisdiction.
(b) A person who is an undischarged insolvent.

(c) A person who has applied to be adjudicated as an insolvent.
(d) A person who has been convicted by a Court of any offence involving moral turpitude and sentenced to imprisonment for 6 months or more for such offence, and 5 years have not elapsed from the date of expiry of the sentence.
(e) A person who has not paid any call on shares and 6 months have elapsed from the last day fixed for the payment of the call.
(f) A person who is disqualified by an order of the Court under section 203 on the ground of fraud or misfeasance in relation to a company.
(g) A director of a public company which has committed any of the following two defaults:
    (i) Failure to file the annual accounts and annual returns for any continuous 3 financial years commencing on and after 1.4.1999.
    (ii) Failure to repay its deposit or interest thereon on due date or redeem its debentures on due date or pay dividend and such failure continues for 1 year or more.

However, the disqualification specified under section 274(1)(g) shall remain in force for a period of 5 years only. Also, such disqualification shall apply only in respect of an appointment in a public company, i.e., even if a director has incurred such disqualification, he can be appointed as a director in a private company.

The given problems are discussed as under:

(i) A person is disqualified if he himself applies to the Court for adjudicating him as an insolvent [Section 274(1)(c)]. Since, Mr. A has himself applied to the court for adjudicating him as an insolvent; he is disqualified for directorship even if his application is pending.
(ii) A person is disqualified only if he is convicted by a Court of any offence involving moral turpitude and sentenced to imprisonment for 6 months or more [Section 274(1)(d)]. In the present case Mr. B was caught red-handed in a shop lifting case and was sentenced to imprisonment for a period of 8 weeks, i.e., less than 6 months. Since the requirements of section 274(1)(d) are hot satisfied, he is not disqualified for directorship.
(iii) A person is disqualified if he is convicted by a Court of any offence involving moral turpitude and sentenced to imprisonment for 6 months or more. However, such disqualification shall remain in force for a periodof5years only [Section 274(1)(d)]. In the present case Mr. C was convicted 8 years ago.
    Since the requirements of section 274(1)(d) are not satisfied, he is, at present, eligible to become a director.
(iv) Disqualification specified under section 274(1)(g) applies only if the default is in filing of annual accounts as well as annual returns for 3 continuous financial years commencing on and after 01.4.1999. In the present case the public company, in which Mr. D is a director, has not filed its annual returns for three continuous financial years. However, the information relating to filing of annual accounts for these 3 financial years has not been provided. Assuming that the company has filed annual accounts in respect of at least one financial year out of the given 3 financial years, the requirements of section 274(1)(g) are not satisfied. Therefore, Mr. D is not disqualified for directorship.

Comment: The articles of a private company may provide additional grounds for disqualification of a director.

Therefore, in cases (i), (ii) and (iii) above, the concerned person shall be disqualified for directorship if:

(a) the company is a private company; and

(b) it has inserted in its articles, additional grounds for disqualification of a director, and such additional ground covers the situation given in case (i), (ii) or (iii) above.

Q.16.(a) Is it necessary for every company issuing debentures to create a Debenture Redemption Reserve? State the provisions in this regard.

(b) The Articles of Association of MKP Limited incorporated with an authorized share capital of ₹50 crores divided into 5 crore equity shares of 10 each contained the following clause:

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

(i) 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.

(c) The maximum number of directors of each of the following companies as per their Articles of Association is 11:

(i) BSS Company Ltd.

(ii) DDP Trading Private Ltd.

(iii) Hind Traders Association (a company registered under section 25 of the Companies Act,1956).

(iv) Hindustan Paper Ltd. (a Government company under section 617 of the Companies Act, 1956).

The Board of directors of the company wants to increase the number of directors to 15. State with reference to the provisions of the Companies Act, 1956 whether the directors can do so.

Answer 16(a):

- Section 117C of the Companies Act, 1956 requires that every company issuing debentures should create Debenture Redemption Reserve (DRR) for the purpose of redemption of debentures to which adequate amounts should be credited from the profits of the company until debentures are redeemed. This is a mandatory provision. SEBI regulations also require companies issuing debentures to provide for Debenture Redemption Reserve (DRR) as required under the Companies Act.
- The Act, however, does not stipulate the time period for creation of security. SEBI regulations provides for creation of security within 6 months from the date of issue of debentures and if a company fails to create the security within 12 months, it shall be liable to pay 2% penal interest to the debenture holders. If the security is not created even after 18 months, a meeting of the debenture holders will have to be called to explain the reasons thereof.

Further, the issue proceeds will be kept in escrow account until the documents for creation of securities are executed between the Trustees and the company.

- Even where debentures are compulsorily convertible into the equity shares of the debenture issuing company, as in the case of FEMA, creation of DRR is unavoidable till the date of conversion. However, after conversion of debentures, the amount in the DRR may be transferred to general reserve or in such other manner as the Board thinks fit and proper. The amount credited to DRR cannot be utilized except for the redemption of debentures.
- It is also clarified by the DCA that since DRR will have to be carved out of profits of the company, there is no obligation to create DRR if there is no profit in a particular year. DRR is an insurance and it enables the issuer of security to redeem the debentures and fulfill its obligation. If, for any reason, the issuer of security fails to redeem the debentures, the aggrieved party may approach CLB/Tribunal which will issue a direction to the company to redeem the debentures forthwith together with interest. Failure to do so is punishable with imprisonment extending upto 3 years and fine of not less than ₹500 for each day of default (Section 117C of the Act).

Answer 16(b):

There is no statutory requirement that a director must hold qualification shares. Share qualification is to be obtained by a director only if the articles of the company so require. Where the articles require a director to hold qualification shares, a director who is not already qualified, shall obtain the qualification shares within 2 months of his appointment as a director. Any provision in the articles shall be void in so far as it requires a person to hold the qualification shares before his appointment as a director or to obtain them within a shorter time than 2 months. Further, the nominal value of qualification shares shall not exceed ₹5,000.

The answer to the given problem is as follows:

(i) The above clause is not valid because of the following reasons:
  (a) The nominal value of qualification shares as per the articles is ₹10,000. Since this amount exceeds the maximum amount (viz., ₹5,000) as laid down under section 270, the articles are inconsistent with the Act, and therefore void.
  (b) The articles require holding of qualification shares within 30 days of appointment as directors. Section 270 clearly states that any provision in the articles shall be void in so far as it requires a person to hold the qualification shares within a shorter period of 2 months.

  However, the articles are valid in so far as a director is required to hold equity shares.

(ii) The given clause is redrafted as follows:
  "The qualification of a director shall be the holding of 500 equity shares in the company and such a director, if not already qualified shall have to obtain his qualification within a period of 2 months from the date of his appointment as a director."

Answer 16(c):

The increase in number of directors is dealt with by sections 258 and 259, which are explained hereunder:

- The number of directors can be increased by passing an ordinary resolution in general meeting (Section 258).

- The increase in the number of directors must be within the limits fixed by the articles. Where a company intends to increase its number of directors beyond the limits fixed by the articles, a special resolution shall be necessary to first amend the articles [Ram Kissendas Dhanuka v Satya Charan Law (1950) 20 Comp Cas 133].
- An increase in number of directors beyond 12 shall not have any effect unless approved by the Central Government. However, no approval of the Central Government is required if the number of directors as increased do not exceed the maximum number of directors specified in the articles as first registered (Section 259).
- Section 259 does not apply to:
  (i) a private company;
  (ii) a Government company; and
  (iii) a company formed under section 25.

The answer to the given problem is given as under:

- All the companies, viz., BSS Company Ltd., DDP Trading Private Ltd., Hind Traders Association and Hindustan Paper Ltd. shall be required to amend the articles (increasing the number of directors to 15 or more) by passing a special resolution.
- In addition, BSS Company Ltd. is required to obtain the approval of the Central Government. However, BSS Company Ltd. would not require the approval of the Central Government if the number of directors specified in the articles as first registered were 15 or more. The approval of Central Government is not required in case of companies DDP Trading Private Ltd., Hind Traders Association and Hindustan Paper Ltd. since these companies are exempted from the provisions of section 259.

Q.17.(a) Clark, a director of ABC Ltd. made default in filing of annual accounts and annual returns with the Registrar of Companies for a continuous period of three financial years ending 31st March, 2012. Referring to the provisions of the Companies Act, 1956 examine the validity of the following:

(i) Whether Clark can continue to be a director of ABC Ltd., and also EF Ltd., where he is a director. Also state whether he can be reappointed as a director in ABC Ltd. as well as EF Ltd.

(ii) Would your answer be still the same in case Clark is a nominee director of a Public Financial Institution?

(iii) What would be your answer in case the defaulting company (i.e. ABC Ltd.) is a private company?

(b) Is it possible for a retiring director to continue in his office beyond the date of the annual general meeting which had to be adjourned due to disturbances at the meeting? Explain.

(c) The Board of directors of M/s. ABC Limited, an unlisted company having a paid-up capital of ₹6 crores consisting of equity share capital of ₹5 crores and preference share capital of ₹1 crore and also 1100 'Small Shareholders' holding equity shares seeks your advice on the following:

(i) Is it necessary for the company to appoint a director to represent the 'Small Shareholders'?

(ii) In case the company decides to appoint such a director, the procedure to be followed by the company for such appointment and the period for which such appointment can be made.

(iii) Can such a director be removed by the company before the expiry of his period of appointment without the consent of the 'Small Shareholders'?

Advise explaining the relevant provisions of the Companies Act and the Rules.

Answer 17(a):

The legal position

1. A director of a public company shall be disqualified from being appointed as a director in any other public company, if the public company of which he is already a director:

   (i) does not file the annual accounts and annual returns for any continuous 3 financial years commencing on and after 1.4.1999; or

   (ii) fails to repay its deposit or interest thereon on due date or redeem, its debentures on due date or pay dividend and such failure continues for 1 year or more.

   Such disqualification shall remain in force for a period of 5 years.

2. A director to whom disqualification under section 274(1)(g) has been attracted, shall not be eligible to be appointed in any other public company. Also, he shall be disqualified from being reappointed in any other public company in which he is already a director. However, he shall not be disqualified for reappointment in the defaulting company.

3. The disqualification under section 274(1)(g) shall apply if:

   (i) the company which has committed any of the two defaults mentioned under section 274(1)(g) is a public company (i.e., the defaulting company is a public company); and

   (ii) the company in which the director is seeking appointment or reappointment is a public company, other than the defaulting company (i.e., the appointing company is a public company).

4. Defaults under section 274(1)(g) results in incurring a disqualification. However, a director is not required to vacate his office in the companies in which he is already a director.

5. The Department of Company Affairs (Now Ministry of Corporate Affairs') has clarified that nominee directors appointed by the Financial Institutions having non-obstante provisions over the Companies Act, 1956 like IDBI, LIC, UTT, etc., in their respective statutes, shall not be liable to be disqualified under section 274(1)(g) [Department Circular No. 11/2001, dated 25.5.2001].

The Given Case

A public company namely ABC Ltd. has made default in filing of annual accounts and annual returns for 3 consecutive financial years ending 31st March, 2012. Mr. Clark is a director in ABC Ltd.

Conclusion

(i) Non-filing of annual accounts and annual returns for 3 consecutive financial years results in incurring disqualification for appointment or reappointment as a director, but it does not result in vacation of office. Therefore, Clark can continue to be a director in ABC and also in EF Ltd.
Clark cannot be reappointed as a director in EF Ltd. since a director disqualified under section 274(1)(g) is not eligible for reappointment in any other public company. However, he can be reappointed as a director in ABC Ltd. since a director disqualified under section 274(1)(g) is not disqualified for reappointment in the defaulting company.

(ii) Nominee directors appointed by the Financial Institutions are not liable to be disqualified under section 274(1)(g). Accordingly, Mr. Clark shall not be disqualified under section 274(1)(g). Also, in such a case, he shall be eligible to be reappointed as a director in ABC Ltd. as well as EF Ltd.

(iii) Disqualification under section 274(1)(g) is not attracted if the defaulting company is a private company. In other words, no director of a private company shall be disqualified under section 274(1)(g) even though such private company fails to file annual accounts and annual returns for 3 consecutive financial years. Accordingly, Mr. Clark shall not be disqualified under section 274(1)(g). Also, in such a case, he shall be eligible to be reappointed as a director in ABC Ltd. as well as EF Ltd.

Answer 17(b):

At every annual general meeting, $1/3^{rd}$ (or nearest to $1/3^{rd}$) of rotational directors shall retire from office. If the place of retiring director is not filled and the meeting has not resolved not to fill the vacancy, meeting shall be adjourned automatically to the next week at the same time and place or if that day is a public holiday, then to next succeeding day which is not a public holiday. If at the adjourned meeting also, the place of retiring director is not filled and the meeting has not resolved not to fill the vacancy, the retiring directors shall be deemed to be reappointed (Section 256).

Where the company does not hold annual general meeting, the directors liable to retire at the annual general meeting cannot continue in office [B.R. Kundra v Motion Pictures Association (1976) 46 Comp Cas 339].

In the given case the annual general meeting has been duly convened and therefore the directors have fulfilled their obligation of convening the annual general meeting. So, pending the decision in the annual general meeting, a retiring director can continue in office even after the date of annual general meeting. His reappointment depends upon the decision taken in the adjourned annual general meeting and may be discussed as follows:

(a) If the adjourned meeting resolves to reappoint him, he shall be reappointed.

(b) If the resolution for the reappointment of retiring director is defeated in the adjourned annual general meeting, he shall not be reappointed.

(c) If no resolution is passed at the adjourned meeting relating to his appointment and the adjourned meeting does not resolve not to fill the vacancy, he shall be automatically reappointed. However, the automatic reappointment shall not apply in the following cases:
  (i) Where a resolution for his appointment was put and lost.
  (ii) Where a resolution is required for his appointment.
  (iii) Where he is disqualified for appointment.
  (iv) Where the retiring director has, in writing, expressed his unwillingness to be reappointed.
  (v) Where a resolution in contravention of section 263 is passed.

Answer17(c):

The answers to the given problems are given as under:

(i) The provisions relating to Small Shareholders' Director were inserted by the Companies (Amendment) Act, 2000 by inserting a Proviso to Section 252(1). However, Proviso to Section 252(1) shall apply to a company only if all the following conditions are satisfied:

  (a) The company is a public company.
  (b) The paid up capital of company is ₹5 crores or more.
  (c) The number of small shareholders in such company is 1,000 or more (A 'Small shareholder' means a shareholder holding shares of nominal value of ₹20,000 or less).

  In the given case, M/s ABC Limited satisfies all the conditions specified under Proviso to section 252(1). Therefore, appointment of Small Shareholders' Director is to be made by M/s ABC Limited as follows:

  (a) A 'Small Shareholders' Director' may be elected by the company suo motu, i.e., the appointment of Small Shareholders' Director is not mandatory.
  (b) A 'Small Shareholders' Director' may also be elected at the option of small shareholders. The small shareholders may serve a notice on the company and the company shall be bound to act on such notice, i.e., appointment of Small Shareholders' Director is mandatory in such a case.

(ii) The procedure for appointment of a Small Shareholders' Director is as follows:
  (a) A notice shall be served on the company by the small shareholders.
    - The notice shall be given at least 14 days before the meeting.
    - The notice shall be given by at least 1/10th in number of small shareholders.
    - The notice shall be signed by at least 100 small shareholders.
    - The notice shall specify the name, address and number of shares held and folio numbers of:
    (i) shareholders proposing the resolution; and
    (ii) the person whose name is proposed as a 'Small Shareholders' Director'.
  (b) The person proposed as a 'Small Shareholders' Director' shall file his consent in writing to act as a director.
  (c) Only a small shareholder can be appointed as a 'Small Shareholders' Director'.
  (d) The person proposed to be appointed as a Small Shareholders' Director shall be elected as a 'Small Shareholders' Director' if a majority of small shareholders recommend his

candidature for the post of the director, in their meeting.

(e) A 'Small Shareholders' Director' shall hold his office for a maximum period of 3 years. He may be re-elected for another period 3 years.

(iii) As per Rule 6(viii) of the Companies (Appointment of the Small Shareholders' Director) Rules, 2001, a Small Shareholders' Director shall vacate his office if he is removed in pursuance of section 284. As per section 284, a director shall be removed if an ordinary resolution is passed in the general meeting after compliance of the procedural requirements of section 284. There is nothing in Proviso to section 252(1) or in the Companies (Appointment of the Small Shareholders' Director) Rules, 2001 which requires obtaining the consent of small shareholders before removing the Small Shareholders' Director from directorship under section 284.

Therefore, a Small Shareholders' Director can be removed by the company before the expiry of his tenure without the consent of the Small Shareholders.

Q.18.(a) Notice has been received from a member proposing himself for appointment as a director after the issue of notice convening the annual general meeting. As a secretary of a public company, how will you deal with the above situation?

(b) Raj and Co. Ltd. having paid-up share capital of ₹40 lakhs appointed on 1st January, 2010 Viraj and Co. Pvt. Ltd. as sole selling agent for a period of 5 years w.e.f 1st January, 2010 with the approval of the company in general meeting. The directors of Viraj and Co. Pvt. Ltd. were holding 40,000 equity shares of 10 each fully paid-up in Raj and Co. Ltd. since 1st December, 2009. State with reasons whether the appointment is valid. Will your answer be different if Viraj and Co. Pvt. Ltd. had acquired the aforesaid shares only on 1st December, 2010?

(c) Pouny Ltd. is a public company which was being mismanaged due to which certain parties applied to the CLB for relief. The Central Government, pursuant to a recommendation by the CLB, by its order under section 408, appointed Mr. Pureesh (an IAS officer) as a director of the company for a period of four years. The said Mr. Pureesh is a member of a joint Hindu family in which Mr. Paresh who is a director of the company is also a member.

Mr. Ramesh another director on the Company's Board, challenges the action of the Central Government on the ground that the consent of the company by a special resolution was not obtained before appointing Mr. Pureesh (as he is a relative of Mr. Paresh) and therefore the Government nominee should forthwith vacate his office and refund the remuneration received till date. Examine the provisions of law applicable to the facts of the case, and give a well-deliberated answer.

Answer 18(a):

Section 257 recognises the right of a person, who is not a retiring director, to stand for directorship. A notice received under section 257 shall be valid, if it complies with the following requirements:

- It is given at least 14 days before the meeting.

- It is deposited at the registered office of the company.
- A sum of ₹500 is deposited along with the notice.

As per section 171, the notice of general meeting is to be sent to members at least 21 clear days before the meeting. Where a person gives a notice to the company to stand for directorship, the two possibilities which may arise are as follows:

First Possibility - Such notice is received by the company before sending the notice of the general meeting to its members. In such a case, the company may inform the candidature of the proposed candidate by incorporating the information relating to the proposed candidate in the notice of the general meeting. No separate notice to members or advertisement is required in this case.

Second Possibility - Such notice is received by the company after sending the notice of the general meeting to its members. The notice shall be valid only if it is received at least 14 days before the meeting. If a valid notice is received, the company shall inform its members about the candidature of the proposed director at least 7days before the meeting. This can be done -

- by serving individual notices on the members; or
- by advertising in two newspapers circulating in the district in which the registered office of the company is situated. One of such notices shall be published in the English language and the other in the Regional language of that place.

In the present case, the notice of the proposed director has been received after sending the notice of the annual general meeting. The notice given by the proposed director shall be valid if it has been given 14 days before the meeting and complies with other requirements of section 257. The company shall inform it members about the candidature of the proposed director by serving individual notices or by advertising in accordance with the provisions of section 257.

Answer 18(b):

The legal position

- A company shall not appoint any person having a substantial interest in the company as a sole selling agent, unless such appointment has been previously approved by the Central Government [Section 294AA].
- Where at the time of appointment, the sole selling agent has no substantial interest in the company but thereafter he acquires substantial interest in the company, the approval of the Central Government is not acquired [Dpartment Circular No. 1/78, dated 7.3.1978].
- Substantial interest means beneficial interest in the shares of the company exceeding ₹5 lakhs or 5% of paid up share capital of the company, whichever is less. In case of a body corporate, beneficial interest may be held by such body corporate together with one or more of its directors and any of the relatives of directors [Explanation to Section 294AA].
- All the provisions of the Companies Act relating to sole selling agents apply to private companies as they apply to public companies.

The given case:

Viraj and Co. holds 10% of the paid-up capital of Raj and Co. Thus, Viraj and Co. can be appointed as a sole selling agent only with the prior approval of the Central Government. Since no prior approval of the Central Government has been obtained, the appointment is void.

In case the shares were acquired on 1st December 2010, the provisions of section 294AA would not be attracted to the appointment of Viraj and Co. In that case, Viraj and Co. Pvt. Ltd. can continue as a sole selling agent for a period of 5 years, i.e., upto 31st December, 2014.

Answer 18(c):

Section 314 regulates the holding of office or place of profit under the company by a director and other persons specified under the section. Accordingly, a special resolution is required for appointment of a relative of a director at an office or place of profit carrying a monthly remuneration of ₹50,000 or more. Where the monthly remuneration exceeds ₹2,50,000, prior approval of the Central Government is also required in addition to the special resolution. However, as per section 314(4), section 314 does not apply where a person is appointed at an office or place of profit under an order of the Central Government passed under section 408. This is because, appointment under section 408 is made by the Central Government to protect the interest of the members or the company. It does not defeat the object of section 314.

In the given case, Pureesh is appointed by the Central Government under section 408. Pureesh is a member of HUF in which Mr. Paresh is also a member. As per section 6, Mr. Pureesh is a relative of Mr. Paresh. Thus, the appointment of Mr. Pureesh as a director means the appointment of relative of a director.

However, appointment of Mr. Pureesh is outside the scope of section 314 in view of exemption given to the directors appointed under section 408. Further, the appointment of a person as a director does not in itself amounts to an appointment at an office or place of profit since he does not draw anything above the remuneration to which he is entitled as a director [Department Clarification No. 4/76(8/12/314(1B)/75-CL-V), dated 11.2.1976].

Therefore, the appointment of Mr. Pureesh is not in contravention of section 314 and so he is not liable to vacate his office or refund to the company the remuneration received by him.

Comment:

The appointment of directors under section 408 can be made only for a maximum period of 3 years. Therefore, appointment of Mr. Pureesh for 4 years is ultra-vires section 408 and is therefore not valid. However, the question has been answered as if the appointment of Mr. Pureesh has been validly made under section 408.

Q.19.(a) ABC Private Limited is a company in which there are eight shareholders. Can a member holding less than 1/10th of the share capital of the company apply to the Company Law Board for the relief against oppression and mismanagement? It is alleged by the said member that the directors of the company have misused their position in making certain inter-corporate deposits which are against the interests of the company. Will the Company Law Board entertain application containing such allegation in the case of private company?

(b) M/S. LAN Limited has been running in losses and has defaulted payment to its creditors. On 1.8.2012, the company mortgaged its plant and machinery to Mr. Pal, a close friend of the managing director of the company, against payment of his dues of ₹10 lakhs payable by the company. The other creditors were left in lurch. In the meantime, Mr. Raman (who was not paid by the company for supply of raw material of the value of ₹50,000) presented a petition for winding up the company before the High Court on 31.12.2012. The company was ordered to be wound up by the court on 30.4.2013. The Official Liquidator wants to declare the transaction of mortgage with Mr. Pal as invalid. Will he succeed?

(c) The Board of Directors of Mahi Limited propose to donate ₹3,00,000 to a school established exclusively for the benefit of children of employees and also donate ₹50,000 to a political party during the Financial year ending 31st March, 2012. The average net profits determined in accordance with the provisions of Sections 349 and 350 of the Companies Act, 1956 during the three immediately preceding financial years is ₹40,00,000.

Examine with reference to the provisions of the Companies Act, 1956 whether the proposed donations are within the powers of the Board of Directors of the Company.

Answer 19(a):

As per section 399, in the case of a company having a share capital, members eligible to apply for oppression and mismanagement shall be lowest of the following:

(a) 100 members; or
(b) 1/10th of the total number of members; or
(c) Members holding not less than 1/10th of the issued share capital of the company.

In the given case, there are eight shareholders. Thus, 1/10th of 8 comes to 1 member. Therefore a single member can present a petition to the Company Law Board, regardless of the fact that he holds less than 1/10th of the share capital of the company, provided he must have paid all the calls and other sums due on his shares.

As regards the propriety rights in inter-corporate loans by a private limited company, they are not closely regulated by the Company Law Board as in the case of public companies. Although the Board of directors is the best to judge and to take a commercial decision in this regard yet the matter should be looked into if the Board has acted mala fide. Therefore, the Company Law Board may look into the allegation lodged by the member.

Answer 19(b):

In case of a winding up by the Court, the winding up shall be deemed to have commenced at the time presentation of the petition for the winding up. Thus, where a petition is made to the Court and the Court orders the winding up, the order relates back to the date of the presentation of the petition.

As per section 531, a transaction shall be deemed to be a fraudulent preference and consequently invalid if all the following conditions are satisfied:

(a) The transaction relates to transfer of property, delivery of goods, payment of money or other act relating to the property of the company.
(b) It took place within 6 months before the commencement of the winding up of the company.
(c) It was an entirely voluntary act and not made under any pressure.
(d) The dominant motive was to give a creditor a preference over other creditors.

In the given case, the winding up of M/s LAN Limited commenced on 31.12.2012, viz., the date of presentation of petition of winding up. M/s LAN Limited mortgaged its plant and machinery in favour of Mr. Pal on 1.8.2012, i.e., within 6 months before the commencement of winding up. The mortgage was made voluntarily by the company, without any consideration, and not under any pressure. Thus, the dominant motive behind the transaction was to give Mr. Pal some preference over the other creditors. Since all the requirements of section 531 are satisfied in the given case, the mortgage of plant and machinery made in favour of Mr. Pal amounts to fraudulent preference, and is therefore void. Therefore, the decision of the official liquidator to declare the mortgage in favour of Mr. Pal as void, is correct.

Answer 19(c):

As per section 293(1)(e), without the prior consent of the shareholders in general meeting, the Board shall not contribute to charitable and other funds not directly relating to the business of the company or the welfare of its employees, if the amounts contributed in a financial year will exceed:

(a) ₹50,000; or
(b) 5% of average net profits (as determined under sections 349 and 350) during 3 immediately preceding financial years, whichever is greater.

In the given case, donation of ₹3,00,000 to a school run exclusively for the benefit of children of employees amounts to welfare expenses for the employees by which the employees are likely to receive benefits, and there will be an inducement on the part of the employees to increase the effort. As such, the donation of ₹3,00,000 is outside the purview of charitable donations. Therefore, donations of ₹3,00,000 to the school established exclusively for the benefit of children of employees is within the powers of the Board, and so the approval of members in general meeting is not required.

As per section 293A, a company shall not make a political contribution unless all the following conditions are satisfied.

(a) The company is not a Government company.
(b) The company has been in existence for 3 or more financial years.
(c) The aggregate amount of political contribution in a financial year shall not exceed 5% of average net profits (as determined under sections 349 and 350) during 3 immediately preceding financial years.
(d) The Board shall make a political contribution only by passing a resolution at a Board meeting.
(e) The company shall disclose in its profit and loss account the amount of political contribution and the name of the political party or the person to whom such amount has been contributed.

In the given case, the company fulfills all the conditions prescribed under section 293A. Accordingly, it can make political donations upto ₹2,00,000 (being 5% of ₹40,00,000). As in the given case, the Board has donated only ₹50,000, the donation is well within the limits and is in accordance with section 293A. The Board shall make such political contribution only by passing a resolution at a Board meeting. Further, adequate disclosure shall be made in the profit and loss account.

Q.20. Consider the following cases:

(a). M/s. Take It Easy Holding Ltd. has filed the annual accounts for the year ended 31.3.2012 with the Registrar Of Companies, Kolkata. The registrar, after examination of the accounts issued a show cause notice to the company and its directors why prosecution proceedings should not be launched for not disclosing true and fair view of the state of affairs of the company. After careful examination you find that the registrar is justified in issuing the show cause notice. Advise as to how the company and its directors can save themselves from the prosecution proceedings under the provisions if the Companies Act.

(b). M/s X Ltd. and its two directors have received a show cause notice from the Registrar of Companies, Mumbai as to why prosecution proceedings should not be launched against them for violation of the provisions of Section 297 of the Companies Act, 1956 in not obtaining the previous approval of the Central Government in respect of a contract entered into by the company with a firm in which one of the directors of the company is interested as a partner. The company seeks your help. Advise the company the steps that should be taken to avoid prosecution proceedings, assuming that they have committed the offence.

Answer 20:

As per section 621A, following offences can be compounded:

(a) Offences punishable with fine.
(b) Offence punishable with fine or imprisonment or both.

Offences punishable with fine not exceeding ₹50,000 can be compounded by the Regional Director. Application for compounding of an offence can be made even before the institution of any prosecution. Where an offence is compounded, then no prosecution shall be launched in relation to that offence.

Case (a). In the given case the offence relates to non-disclosure of true and fair view of the state of affairs as required under section 211(1) of the Act. The offence is punishable with fine not exceeding ₹10,000 or imprisonment upto 6 months or both. Therefore such offence can be compounded by the Regional Director. The Regional Director has the power to give directions to the company to make good the default.

Case (b). In the given case the offence relates to contravention of the provisions of section 297. However, no specific penalty has been provided either in section 297 or in any other section of the Act contravention of section 297. Accordingly, the penalty for contravention of section 297 shall be levied per the residuary penalty provision, i.e. section 629A, which is fine upto ₹5,000 plus a fine upto ₹500 per day where the offence is of continuing nature. Since the offence is punishable with fine only, it can be compounded.

The contravention of section 297 cannot be said to be of continuing nature. Accordingly, the maximum amount of fine shall be ₹5,000. Therefore, such offence can be compounded by the Regional Director.

Thus, to avoid prosecution, the company or any of the directors, who are officer in default, may make an application to the Registrar for compounding of offence, in accordance with the provisions of section 621A. The Registrar shall forward the application to the Regional Director. It is the discretion of the Regional Director whether or not to compound the offence. If the Regional Director makes an order for compounding, the company and every officer in default shall pay such amount as may be specified by the Regional Director. Where an offence is compounded, no prosecution shall be launched in relation to that offence.

Q.21.(a) XLR Bank Limited is not managing its affairs properly. Employees as well as depositors of the bank have complained to the Central Government from time to time about such mismanagement and requested the Central Government to acquire the undertaking of the Banking Company. Explain the powers of the Central Government in this regard under the Banking Regulation Act, 1949.

(b) Is the Central Government empowered to supersede the Authority under Insurance Regulatory & Development Authority Act, 1999? Explain.

(c) Your company's Articles of Association do not contain any provision for nomination of directors by a financial institution. The company has borrowed long-term funds from the IDBI and ICICI Ltd. A & B are nominated by said lenders respectively on the Board of your company. Advise whether the company can accept the nominations.

(d) M, a Director of MJV Ltd., was appointed on 1st April, 2011. One of the terms of appointment was that in the absence of adequacy of profits or if the company had no profits in a particular year, he will be paid remuneration in accordance with Schedule XIII. For the financial year ended 31st March, 2012, the company suffered heavy losses company was not in a position to pay any remuneration but he was paid ₹50 lacs for the year, as paid to other directors.

The effective capital of the company is ₹150 crores. Referring to the provisions of Companies Act, 1956, as contained in Schedule XIII, examine the validity of the above payment of remuneration to M.

Answer 21(a):

Section 36AE empowers the Reserve Bank to acquire the undertakings of banking companies, as explained below:

1. Conditions for acquisition of any undertaking of a banking company [Section 36AE(1)]

If, upon receipt of a report from the Reserve Bank, the Central Government is satisfied that a banking company -

(a) has, on more than one occasion, failed to comply with the directions given to it, in so far as such directions relate to banking policy, or

(b) is being managed in a manner detrimental to the interests of its depositors, and that –

- (i) in the interests of the depositors of such banking company, or
- (ii) in the interest of banking policy, or
- (iii) for the better provision of credit generally or of credit to any particular section of the community or in any particular area,

it is necessary to acquire the undertaking of such banking company, the Central Government may, after such consultation with the Reserve Bank as it thinks fit, by notified order, acquire the undertaking of such company (hereinafter referred to as the acquired bank) with effect from such date as may be specified in this behalf by the Central Government (hereinafter referred to as the appointed day).

2. No acquisition unless opportunity to show cause given [Proviso to Section 36AE(1)]

No undertaking of any banking company shall be acquired unless such banking company given a reasonable opportunity of showing cause against the proposed action.

3. Vesting of undertaking in the Central Government from the appointed day [Section 36AE(2)]

Subject to the other provisions contained in this Part, on the appointed day, the undertaking of the acquired bank and all the assets and liabilities of the acquired bank shall stand transferred to, and vest in, the Central Government.

4. Continuation of suits and other proceedings [Section 36AE(7)]

If, on the appointed day, any suit, appeal or other proceeding of whatever nature is pending by or against the acquired bank, the same shall not abate, be discontinued or be, in any way, prejudicially affected by reason of the transfer of the undertaking of the acquired bank or of anything contained in this Part, but the suit, appeal or other proceeding may be continued, prosecuted and enforced by or against the Central Government.

Answer 21(b):

Section 19 empowers the Central Government to supersede the Authority. These provisions may be explained as follows:

1. Reasons for supersession [Section 19(1)]

The Central Government may supersede the Authority if it is of the opinion:

(a) that, on account of circumstances beyond the control of the Authority, it is unable to discharge the functions or perform the duties imposed on it by or under the provisions of this Act; or

(b) that the Authority has persistently defaulted in complying with any direction given by the Central Government under this Act or in the discharge of the functions or performance of the duties imposed on it by or under the provisions of this Act and as a result of such default the financial position of the Authority or the administration of the Authority has suffered; or

(c) that circumstances exist which render it necessary in the public interest to supersede the Authority.

2. Conditions for making an order of supersession [Section 19(1) and Proviso to Section 19(1)]

(a) The Central Government shall be required to issue a notification stating therein the reasons for supersession and the period of supersession, which shall not exceed 6 months.

(b) Before issuing any such notification, the Central Government shall give a reasonable opportunity to the Authority to make representations against the proposed supersession and shall consider the representations, if any, of the Authority.

(c) The Central Government shall appoint a person to be the Controller of Insurance under section 2B of the Insurance Act, 1938, if not already done.

3. Effects of supersession [Section 19(2)]

Upon the publication of notification under sub-section (1) superseding the Authority, -

(a) the Chairperson and other members shall, as from the date of supersession, vacate their offices as such;

(b) all the powers, functions and duties which may, by or under the provisions of this Act, be exercised or discharged by or on behalf of the Authority shall, until the Authority is reconstituted under subsection (3), be exercised and discharged by the controller of Insurance; and

(c) all properties owned or controlled by the Authority shall, until the Authority is reconstituted under sub-section (3), vest in the Central Government.

4. Reconstitution of Authority [Section 19(3)]

On or before the expiration of the period of supersession specified in the notification issued under subsection (1), the Central Government shall reconstitute the Authority by a fresh appointment of its Chairperson and other members and in such case any person who had vacated his office under clause (a) of sub-section (2) shall not be deemed to be disqualified for reappointment.

5. Laying of documents before the Parliament [Section 19(4)]

The Central Government shall cause a copy of the notification issued under sub-section (1) and a full report of any action taken under this section and the circumstances leading to such action to be laid before each House of Parliament at the earliest.

Answer 21(c):

A company may appoint a nominee director only if the articles of the company authorise it to appoint a nominee director. Further, a nominee director shall be appointed only out of 1/3rd of total number of directors so as to comply with the requirements of sections 255 and 256.

However, in case of some financial institutions (e.g., UTT, LIC and IDBI), the relevant Acts by which they are constituted, empower them to appoint a nominee director at the Board of an assisted company. These special provisions giving right of nomination to the financial institution override the provisions of the Companies Act relating to the appointment, retirement of directors, holding of qualification shares, determination of directors liable to retire by rotation, etc.

IDBI is a financial institution created by a special Act of Parliament, i.e., IDBI Act, 1964. The IDBI Act contains provisions relating to appointment of nominee directors by the IDBI, even if the articles of the company do not contain such a provision in this regard. Therefore, nominee A can be appointed by the company even if no such power is contained in the articles of the company.

However, ICICI Ltd. is a company formed and registered under the Companies Act, 1956. Therefore, a nominee of ICICI Ltd. can be appointed only if a provision in the articles of the company authorise the company to appoint a nominee director. Further, the appointment of nominee director must be made in conformity with the provisions of sections 255 and 256 of Companies Act, 1956, i.e., such a nominee director shall be included in total number of directors, and if he is appointed as a non-rotational director, he must fall within 1/3rd of total number of directors. Also, his appointment should be within the maximum number of directors as specified in the articles of the company. Since, the articles of the company do not contain any provision for nomination of a director by a financial institution, the articles need to be amended first, and only after such amendment, the nominee of ICICI Ltd. can be appointed.

Answer 21(d):

Where a company does not make any profits or its profits are inadequate, it may pay remuneration to its managing director or whole time director in accordance with Section II of Part II of Schedule XIII. The payment of remuneration may be by way of salary, dearness allowances, perquisites and other allowances.

The payment of remuneration as per Schedule XIII is possible only if the company has not made any default in repayment of any of its debts (including public deposits) or debentures or interest payable thereon for a continuous period of 30 days in the preceding financial year.

Remuneration payable to the two whole-time directors shall be approved by the Remuneration Committee. 'Remuneration Committee' means:

(i) in respect of a listed company, a committee which consists of at least 3 non-executive independent directors including nominee director or nominee directors, if any, and
(ii) in respect of any other company, a remuneration committee of directors.

In the present case, the effective capital of the company is ₹150 crores. As per amended Schedule XIII, a company having effective capital more than ₹100 crores may pay to its managerial person maximum remuneration of ₹2,00,000 per month. Thus, Mr. M can be paid a remuneration of ₹24,00,000 for the financial year 2011-12.

Further, the company may pay upto ₹4,00,000 per month instead of ₹2,00,000 per month if a special resolution is passed in this respect. However, the special resolution shall remain in force for a period of 3 years only. Thus, Mr. M can be paid a remuneration of ₹48,00,000 for the financial year 2011-12, provided a special resolution is passed in this respect.

Also, the payment of remuneration exceeding ₹4,00,000 per month is possible if the company passes a special resolution and also obtains the approval of the Central Government, if the company is a listed company or a subsidiary of a listed company.

Thus, the payment of remuneration of ₹50,00,000 to Mr. M is valid only if the company passes a special resolution. The approval of the Central Government shall also be required if the company is a listed company or a subsidiary of a listed company.

Q.22.(a) RST Ltd. is a securitization and reconstruction company under SRFAESI Act, 2002. The certificate of registration granted to it was cancelled. State the authority which can cancel the registration and the right of RST Ltd. against such cancellation.

(b) What is a Nidhi company? Explain the procedure to incorporate a Nidhi company.

(c) Advise the Board of directors of a public company about their powers in respect of the following proposals explaining the relevant provisions of the Companies Act, 1956:

Delegating to the managing director of the company the power to invest surplus funds of the company in the shares of some companies.

(d) The Board of directors of M/s. Infratech Consultants Limited, registered in Kolkata, proposes to hold the next Board meeting in the month of May, 2012. They seek your advise in respect of the following matters:

(i) Can the Board meeting be held in Chennai, when all the directors of the company reside at Kolkata?
(ii) Whether the Board meeting can be called on a public holiday and that too after business hours as the majority of the directors of the company have gone to Chennai on vacation.
(iii) Is it necessary that the notice of the Board meeting should specify the nature of business to be transacted? Advise with reference to the relevant provisions of the Companies Act.

Answer 22(a):

The provisions relating to cancellation of certificate of registration of a securitisation or reconstruction company are explained below:

1. Circumstances in which certificate may be cancelled [Section 4(1)]

The Reserve Bank may cancel a certificate of registration granted to a securitisation company or a reconstruction company, if such company:

(a) ceases to carry on the business of securitisation or asset reconstruction; or
(b) ceases to receive or hold any investment from a qualified institutional buyer; or
(c) has failed to comply with any conditions subject to which the certificate of registration has been granted to it; or
(d) at any time fails to fulfill any of the conditions referred to in clauses (a) to (g) of sub-section (3) of section 3; or
(e) fails to:
  (i) comply with any direction issued by the Reserve Bank under the provisions of this Act; or
  (ii) maintain accounts in accordance with the requirements of any law or any direction or order issued by the Reserve Bank under the provisions of this Act; or
  (iii) submit or offer for inspection its books of account or other relevant documents when so demanded by the Reserve Bank; or
  (iv) obtain prior approval of the Reserve Bank required under sub-section (6) of section 3.

Opportunity of being heard before cancellation in certain cases [Proviso to Section 4(1)]. Provided that before cancelling a certificate of registration on the ground that the securitisation company or reconstruction company has failed to comply with the provisions of clause (c) or has failed to fulfill any of the conditions referred to in clause (d) or sub-clause (iv) of clause (e), the Reserve Bank, unless it is of the opinion that the delay in cancelling the certificate of registration granted under sub-section (4) of section 3 shall be prejudicial to the public interest or the interest of the investors or the securitisation company or the reconstruction company, shall give an opportunity to such company on such terms as the Reserve Bank may specify for taking necessary steps to comply with such provisions or fulfillment of such conditions.

2. Appeal against order of cancellation [Section 4(2)]

A securitisation company or reconstruction company aggrieved by the order of cancellation of certificate of registration may prefer an appeal, within a period of 30 days from the date on which such order of cancellation is communicated to it, to the Central Government.

Opportunity of being heard before rejection of appeal [Proviso to Section 4(2)].

Before rejecting an appeal such company shall be given a reasonable opportunity of being heard.

3. Consequences of rejection or cancellation of certificate of registration where the company is already holding investments |Section 4(3)]

A securitisation company or reconstruction company, which is holding investments of qualified institutional buyers and whose application for grant of certificate of registration has been rejected or certificate of registration has been cancelled shall, notwithstanding such rejection or cancellation, be deemed to be a securitisation company or reconstruction company until it repays the entire investments held by it (together with interest, if any) within such period as the Reserve Bank may direct.

Answer 22(b):

Nidhi company according to Section 620A of Companies Act 1956 means a company which the Central Government may, by notification in the Official Gazette, declare to be a Nidhi.

Nidhi Companies are Companies notified by the Central Government as such under Section 620A of the Companies Act, 1956. These Companies mainly engage in the business of collecting deposits in the form of Savings Deposit, Recurring Deposit etc. And also lend the same to the members of the Company. One of the important feature of a Nidhi Company is that it deals only with members (share holders). Thus if you want to deposit any amount in a Nidhi Company or want to avail a loan from a Nidhi Company, first you have to become a member by subscribing to shares of the Company.

The present procedure to incorporate a Nidhi company is as follows:

- **Name of the Company:** To get approval of the name by which the company will be known. The promoters propose three names to ROC. After verification the ROC is able to either identify one name or else calls for a panel of fresh names. Following this exercise a name is finally allotted by ROC to the promoters which will be used as the name of the company. But the word 'Nidhi' cannot be used as a part of the name at this stage.
- **Submission of MOA & AOA:** The promoters submit the Memorandum and Articles of Association to ROC who after examination registers the company and issues a Certificate of Incorporation.
- **Submission of other documents:** The company submits to the ROC documents such as a Statement in lieu of Prospectus, declaration by the promoters etc., specified under Section 149 of the Companies Act. ROC registers these documents after corrections if any and issues a Certificate of Commencement of Business.

At this stage there is no stipulation as to the membership strength of the company nor any restriction regarding capital for doing business. The company can receive deposits and lend without any restriction on rates of interest and for any period of time. Consequently, the functioning of such companies is not restricted or supervised by the authorities.

Answer 22(c):

As per section 291, the Board is entitled to exercise all such powers as the company is authorised to exercise. Similarly, the Board is authorised to do all such acts and things as the company is authorised to do. However, the provisions of section 291 are subject to the provisions of sections 292, 293, 293A and certain other provisions of the Companies Act, 1956. The given proposals are examined as follows:

As per section 292, the powers relating to investment of funds of the company shall be exercised by the Board at a Board meeting only. However, such power may be delegated by the Board, subject to the following 3 conditions:

(a) The powers may be delegated to a committee of directors, managing director, manager, a principal officer of the company or a principal officer of the branch office.
(b) The delegation of power is made by passing a resolution at a Board meeting.
(c) The resolution passed at the Board meeting shall specify:

- the total amount upto which the funds may be invested; and
- the nature of investments that may be made.

However, section 372A requires that the power relating to investment of funds of the company shall be exercised by the Board by passing a unanimous resolution at a Board meeting only. Therefore, such power cannot be delegated by the Board to any other person.

In the present case, the power to invest surplus funds of the company in the shares of some companies is proposed to be delegated to the managing director of the company. Such delegation is not permissible at law in view of provisions of section 372A.

Answer 22(d):

Unlike section 166, there is no provision which requires that a Board meeting shall be held:

(a) only on a day that is not a public holiday;
(b) only at the registered office of the company or at any other place within the city, town or village in which the registered office of the company is situated;
(c) only during business hours.

The answer to the given problem is as under:

(i) Section 301 requires that the register of contracts shall be placed in each Board meeting. However, the Department of Company Affairs (now Ministry of Corporate Affairs) has allowed the companies to remove the register of contracts to any place provided adequate notice to shareholders is given indicating the precise periods during which they can inspect the register of contracts. Thus, in the instant case the Board meeting can be held in Chennai, even though all the directors of the company reside in Kolkata and the registered office is also situated at Kolkata provided adequate notice to shareholders is given and the inspection of register of contracts is allowed to the shareholders.

(ii) As per section 288, if a Board meeting could not be held for want of quorum, then, unless the articles otherwise provide, the meeting shall automatically stand adjourned to the same day, time and place in the next week, or if that day is a public holiday, then to next succeeding day, which is not a public holiday. It means that an adjourned Board meeting can be held only on a day which is not a public holiday. However, there is nothing in the Act which prohibits the holding of an original Board meeting on a public holiday. Similarly, the Act does not require that a Board meeting shall be held only during business hours. However, the articles of the company may provide otherwise.

In the instant case, the directors intend to hold a Board meeting on a public holiday and after business hours. Unless the articles of the company provide otherwise, holding a Board meeting on a public holiday and after business hours is permissible.

(iii) No form or contents of notice has been specified by the Act. Agenda of a Board meeting is not required to be sent along with the notice of a Board meeting unless the Act requires a specific notice to move a resolution at a Board meeting.

Therefore, the notice of Board meeting need not specify the nature of business to be transacted, unless the articles otherwise require. However, the notice shall state the nature of business to be transacted in the following cases:

(a) Appointment of a person as a managing director if he is already a managing director or manager in any other company (Section 316).
(b) Appointment of a person as a manager if he is already a managing director or manager in any other company (Section 386).

SECTION B

Q. 23. (a) "In a highly competitive and surcharged environment, family-owned concerns are changing for the better."
In view of the above statement, discuss some of the factors responsible for such a change.

(b) Why risk assessment is required in whole life costing?

Answer 23(a):

1. **Market forces and competition force professionalisation:** Family concerns will turn professional in order to face successfully competition and market forces. This does not imply that family-owned business will come to an end, but the demarcation between ownership and control, on the one hand, and management on the other, will be much more evident.

2. **Independent directors will have a say:** Members of the board will be persons with technical and managerial capabilities "Who can guide and oversee operating management in the discharge of their functions". The boards will have a number of (upto 50 per cent) independent external directors who can advise, admonish and control operating management, without fear or favour, on issues of policy and performance.

3. **The topmen will not wear two hats:** The practice of one person combining in himself both the positions of chairman and CEO will sooner rather than later, come to an end.

4. **Emergence of board committees:** Boards delegating specific tasks such as audit, remuneration and appointments to committees with members having professional expertise will be a normal phenomenon.

5. **Transparency in reporting and full financial disclosures:** Transparency in reporting and full

disclosures will be norms. The board has to ensure adoption of appropriate accounting standards in the preparation of company's accounts and material changes during the financial year are fully discussed and justified.

6. **Independent and competent auditors will do their jobs:** Guidelines on corporate governance all over the world insist on independence of audit, and this will be observed by boards in India too. Boards will have to ensure unattached and professionally competent auditors to audit the company's accounts.

7. **Long term stakeholder interests will be ensured:** The highest priority of the boards would be to ensure long-term maximisation of shareholder value and wealth. Better corporate performance through legitimate and transparent policies will enrich shareholders. Accountability to shareholders does not mean, however, that other stakeholders such as customers and employees would have to be excluded, as the respective objectives are not naturally exclusive.

8. **Boards members' commitment ensured through adequate compensation:** Since boards will have to shoulder greater responsibility, bear risk and manage uncertainty with a great deal of pressure on them to perform, both from internal and external sources, their members would have to be compensated adequately and appropriately.

9. **Boards will be committed to corporate social responsibility:** Corporate social responsibility would become part and parcel of the duties of boards of directors. They who draw so much from the society in terms of resources, trained manpower, law and order, public health, infrastructure and well-developed markets to do their business and make profits, have a moral and social responsibility to share with the society at least a part of what they earn and gain, by their ethical practices and catering to the basic needs of communities they operate-in, supplementing wherever possible, the efforts of public authorities. "Corporates would have to provide demonstratable evidence of their concern for the issues that confront those constituancies.

10. **Whistle blower policy will be in place:** Companies would in due course put in place an appropriate whistle blower policy enabling both the board and senior management takes corrective measures to stem the rot, if any, in good time. Through SEBI under listing agreement (LA) with stock exchanges made whistle blower policy in the revised clause 49 non-mandatory, corporate governance advocates point out that sooner than later the Indian regulator would be prompted to make mandatory the whistle blower policy through which a company might establish a mechanism for employees to report to the management concerns about unethical behavior, actual or suspended fraud, or violation of the company's code of conduct or ethics policies.

Answer 23(b):

Whole life-cycle costing is a relatively new concept to the construction industry, albeit based upon the foundations of analytical techniques that have been in existence for some time. It is in essence an evolution of lifecycle costing (LCC) techniques that are now commonly used in many areas of procurement. Like LCC, the primary purpose of WLCC is to aid capital investment decision making by providing forecasts of the long-term costs of construction and ownership of a building or structure. However, unlike LCC it is also a dynamic approach, and can provide up-to-date forecasts on cost and performance throughout the life of the building.

Combined with WLCC, risk assessment should form a major element in the strategic decision making process during project procurement and also in value analysis, especially in today's highly uncertain business environment. WLCC decisions are complex (the complexity level is usually determined by the scale, funding and financial environment surrounding the scheme, amongst other factors), and usually comprise an array of significant factors affecting the ultimate cost decisions. WLCC decisions generally have multiple objectives and alternatives, long-term impacts, multiple constituencies in the procurement of construction projects, generally involve multiple disciplines and numerous decision makers, and always involve various degrees of risk and uncertainty. Project cost, design and operational decision parameters are often established very early in the life of a given building project. Often, these parameters are chosen based on owner's and project team's personal experiences or on an ad hoc static economic analysis of the anticipated project costs. While these approaches are common, they do not provide a robust framework for dealing with the risks and decisions that are taken in the evaluation process. Nor do they allow for a systematic evaluation of all the parameters that are considered important in the examination of the WLCC aspects of a project. The existing methods also do not adequately quantify the true economic impacts of many quantitative and qualitative parameters.

Capital costs and future costs must be quantified, analysed and presented as part of the strategic decision making process in today's business environment. Cost analysis and value analysis techniques are used to quantify and assess the economic implications of investment in building facilities in general. These techniques have typically concentrated on utilising life-cycle and comparative cost procedures to determine either the lowest initial cost alternative or the highest investment return alternative. While these techniques do provide a basis for making project cost decisions, they most often do not account for many of the parameters which may affect the actual project value or cost. The existing methods also do not use formal decision making processes and risk assessment methods in performing cost benefit analysis.

It is not surprising that the BRE report (Clift & Bourke 1998) found that clients have a lack of interest and trust in the value of whole cost exercises. This might be due to the fact that WLCC analysis that is not supplemented with risk assessment of all aspects of decision making involved in this process has little value to any decision maker. Risk assessment should be an integral part of the WLCC process. A significant effort is being invested in developing a framework for data collection but data collection on its own, without the correct methods and tools to identify important decisions in the WLCC process and associated risks, is of little value to clients or other interested parties. Clients did not know what to do with information when received and practitioners did not understand the process or the benefits of WLCC.

Q.24. Discuss the OECD Guidelines for Corporate Governance of State-owned Enterprises.

Answer 24:

According to OECD, a major challenge is to find a balance between the state's responsibility for actively exercising its ownership functions, such as, the nomination and election of the board, while at the same time refraining from imposing undue political interference in the management of the company. Another important challenge is to ensure that there is a level playing field in markets where private sector companies can compete with the state-owned enterprises, and that governments do not distort competition in the way they use their regulatory or supervisory powers.'

According to OECD, the guidelines suggest that the state should exercise its ownership functions through a centralized ownership entity, or effectively co-ordinated entities, which should act independently and in accordance with a publicly disclosed ownership policy. The guidelines also suggest the strict separation of the state's ownership and regulatory functions.

The major recommendations in OECD guidelines are as discussed below:

Ensuring an effective legal and regulatory framework for state-owned enterprises

- There should be a clear separation between the state's ownership function and other state functions that may influence the conditions for state-owned enterprises, particularly with regard to market regulation.
- SOEs should not be exempt from the application of general laws and regulations. Stakeholders including competitors, should have access to efficient redress.
- SOEs should face competitive conditions regarding access to finance. Their relations with state-owned banks, state-owned financial institutions, and other state-owned companies, should be based on purely commercial grounds.

State acting as an owner

The state should act as an informed and active owner, and establish a clear and consistent ownership policy, ensuring that governance of state-owned enterprises is carried out in a transparent and accountable manner with the necessary degree of professionalism and effectiveness.

- The government should develop and issue an ownership policy that defines the overall objectives of state ownership, the state's role in corporate governance of SOEs, and how it will implement its ownership policy.
- The government should not be involved in the day-to-day management of SOEs and allow them full operational autonomy to achieve their defined objectives.
- The state should let SOE boards exercise their responsibilities and respect their independence.
- The state should exercise its ownership rights according to the legal structure of each company. Keeping this in mind, it should ensure that remuneration schemes for SOE board members foster the long-term interest of the company, and can attract and motivate qualified professionals.

Equitable treatment of shareholders

The SOEs should recognize the rights of all shareholders and in accordance with the OECD principles of corporate governance, ensure their equitable treatment and equal access to corporate information.

- SOEs should observe a high degree of transparency towards all shareholders.
- The co-ordinating or ownership entity and SOEs should ensure that all shareholders are treated equally.
- The participation of minority shareholders in shareholder meetings should be facilitated in order to allow them to take part in fundamental corporate decisions, such as board election.

Relations with stakeholders

The state ownership policy should fully recognize the state-owned enterprises' responsibilities towards stakeholders and report their relations with them.

- Listed on large SOEs, as well as SOEs pursuing important public policy objectives, should report on stakeholder relations.

Transparency and disclosure

State-owned enterprises should observe high standards of transparency in accordance with the OECD Principles of Corporate Governance.

- SOEs should develop efficient internal audit procedures and establish an internal audit function that is monitored by and reports directly to the board and to the audit committee or the equivalent company organ.
- SOEs, especially large ones, should be subject to an annual independent external audit based on international standards. The existence of specific state control procedures dots not substitute for an independent external audit.

Responsibilities of the boards of state-owned enterprises

The boards of state-owned enterprises should have the necessary authority, competencies, and objectivity to carry out their function of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.

- The boards of SOEs should be assigned a clear mandate and ultimate responsibility for the company's performance. The board should be fully accountable to the owners, act in the best interest of the company, and treat all shareholders equally.
- SOE boards should carry out their functions of monitoring of management and strategic guidance, subject to the objectives set by the government and the ownership entity. They should have the power to appoint and remove the CEO.
- The boards of SOEs should be so composed that they can exercise objective and independent judgement. Good practice calls for the chair to be separate from the CEO.
- SOE boards should carry out an annual evaluation to appraise their performance.

Q.25. Write a short note on:

(a) Memorandum of Understanding (MoU) in respect of corporate governance in state owned enterprises.

(b) Triple Bottom Line Approach of Corporate Social Responsibility (CSR).

Answer 25(a):

Notwithstanding the spectacular performance of CPSEs in several areas, there has been a sense of disillusionment with some aspects of CPSE performance such as low profitability and lack of competitiveness. The extensive regulation of CPSEs by government had stifled the initiative and growth of public sector. The concept of Memorandum of Understanding (MoU) has been designed to provide flexibility and autonomy to Central Public Sector Enterprises (CPSEs) such that it facilitates them in pursuing the objectives and purposes, for which the enterprises have been set up. Accountability has to be understood in a wider sense by associating it with answerability for the performance of the tasks and the achievement of targets negotiated mutually between the Government and the CPSE. The rationale for MoU could be derived from principal/agent theory. The principal (administrative ministry on behalf of real owners- the people) can only observe outcomes and cannot measure accurately the efforts expended by the agent (CPSE managers). Also the Principal can only, to a limited extent, distinguish the effects of influences from other factors, which affect the performance (Laffont and Tirole 1993). Therefore extensive intervention by administrators, who might not be too knowledgeable about the nature of problems confronting the enterprises, not only impacts productivity and profitability but also makes it impossible to fix accountability for non-achievement of targets.

A negotiated incentive contract (MoU), hence, is viewed as a device to reveal information and motivate managers to exert effort. Proponents argue that the contract can translate multiple objectives into targets which can be measured by specified criteria and could be given weights to reflect priorities. Moreover, targets can be set to take into account circumstances where CPSE managers have less control over their firms than their counterparts in the private sector. For example, performance might be judged against the firm's past trends, rather than against an industry standard, to take account of situations where the firm's performance is sub-standard because of government imposed constraints (such as prohibitions on layoffs, price controls, etc.).

By specifying targets and evaluating results ex post, the MoU is seen by its advocates as a way to encourage governments to reduce ex ante controls, giving managers more freedom and motivation to improve operating efficiency.

Hence, it is strongly felt that Performance Contracts will improve performance only if they elicit both the Government's and the Firms' commitment. Since Government is both a signatory and the enforcer of the contract, it is especially important that its commitment remains credible. Political determinants may preclude the design of incentive contracts and impede CPSEs in producing the sort of productivity gains being achieved by the private firms. These findings suggest that effort in designing a framework of MoU on consistent basis can produce good results.

The Memorandum of Understanding (MoU) System in India was introduced in the year 1986, after the recommendations of the Arjun Sengupta Committee Report (1984). Twenty six years after its inception, the MoU system has evolved and is being strengthened, through regular reviews, to become a management tool that helps in performance evaluation as well as performance enhancement of CPSEs in the country.

In the backdrop of the dynamic external environment, "world- wide competition" and globalization, it is critical that the MoU system is strengthened such that it facilitates the CPSEs in becoming economically viable through efficient management and control. Hence, the MoU system aims at offering autonomy to CPSEs and is designed such that it can aid in the assessment of the extent to which mutually agreed objectives (Mandal, 2012) are achieved. This section of the report traces the evolution of the MoU system through various committee reports and highlights the major observations, along with the actions taken thereafter. This would act as an indicator of the developments that have happened in the MoU system in India and, through the study of extant literature, would also highlight the areas of concern raised after each study.

The various committees formed over the years are:

1. Arjun Sengupta Committee Report (1984)
2. National Council of Applied Economic Research (2004)
3. Report of the Working Group (2008)
4. S.K. Roongta Committee Report (2011)
5. Mankad Committee and Task Force (2012)

Answer 25(b):

Within the broader concept of corporate social responsibility, the concept of Triple Bottom Line (TBL) is gaining significance and becoming popular amongst corporate. Coined in 1997 by John Ellington, noted management consultant, the concept of TBL is based on the premise that business entities have more to do than make just profits for the owners of the capital, only bottom line people understand. "People, Planet and Profit" is used to succinctly describe the TBL. "People" (Human Capital) pertains to fair and beneficial business practices toward labour and the community and region in which a corporations conducts its business. "Planet" (Natural Capital) refers to sustainable environmental practices. It is the lasting economic impact the organization has on its economic environment A TBL company endeavors to benefits the natural order as much as possible or at the least do no harm and curtails environmental impact. "Profit" is the bottom line shared by all commerce.

The people issues faced by the organization includes-

- Health
- Safety
- Diversity
- Ethnicity
- Education and literacy
- Prevention of child labour
- Differently-abled

The planet concerns include

- Climate change
- Energy
- Water
- Air pollution
- Waste management
- Ozone layer depletion, etc.

The need to apply the concept of TBL is caused due to –

(a) Increased consumer sensitivity to corporate social behavior
(b) Growing demands for transparency from shareholders/stakeholders
(c) Increase environmental regulation
(d) Legal costs of compliances and defaults
(e) Concerns over global warming
(f) Increased social awareness
(g) Awareness about and willingness for respecting human rights
(h) Media's attention to social issues
(i) Growing corporate participation in social upliftment

While profitability is a pure economic bottom line, social and environmental bottom lines are semi or non-economic in nature so far as revenue generation is concerned but it has certainly a positive impact on long term value that an enterprise commands.
But discharge of social responsibilities by corporate is a subjected matter as it cannot be measured with reasonable accuracy.

Q.26. Why should Corporate Social Responsibility (CSR) look beyond the concept of philanthropy?

Answer 26:
Corporate Social Responsibility (CSR) is a management concept where good business is not only seen as maximization of shareholder value but also of stakeholder value. It is about the management of a company's impact on its stakeholders, the environment, and the community in which it operates. It is more than just a philanthropic activity for some charitable causes. It is about the integrity with which a company governs itself, how it fulfils its mission, the values it has, what it wants to stand for, and how it engages with transparency. Here, the corporations have to move beyond the financial bottom-line to the social and environmental bottom line.

Corporate philanthropy is certainly a piece of the CSR puzzle. The thing to understand here is that it is just that: a piece. CSR and corporate philanthropy are often viewed as interchangeable terms because many of the most basic CSR efforts are philanthropic in nature. However, CSR encompasses more than corporate giving. CSR programs take a proactive approach to reduce negative impacts and increase positive impacts on the people and environment the corporation touches. For eg., a partnership with a non-profit organization can mean more than giving a hefty annual donation, joining as a corporate member, or sponsoring events. In a CSR program, a true partnership might mean encouraging employees to volunteer their time, hosting public awareness and educational events, or contributing services that are useful to the organization.

Corporate Social Responsibility looks beyond the interests of traditional stakeholders and considers impacts on employees, customers, vendors, suppliers, communities, and the natural environment. This approach to business strategy takes the minimum expected efforts, such as compliance with regulations and managing obvious risks, and goes a step further all within a thoughtfully developed and well organized program that aligns with the company's strategic plan.

CSR goes beyond philanthropy. It has to take into account integrity and accountability in the long-run process of sustainability. For a better understanding of this concept, it has been divided into four broad aspects of CSR:

- Responsibility
- Accountability
- Sustainability
- Social contact

Responsibility: William Frederick (1994) has taken the concept of CSR to a higher level by discussing about corporate responsiveness. According to him, corporate social responsiveness refers to the capacity of a corporation to respond to social pressures. Ethically accepted corporate activity and profit-making are not mutually exclusive. Sustainable growth and success demands ethicality in the process of dealing with stakeholders. Often, CSR has been challenged on the grounds of relativity, which means that what may be considered right by one may be considered wrong by another. Arriving at a consensus for CSR checklists may not be easy.

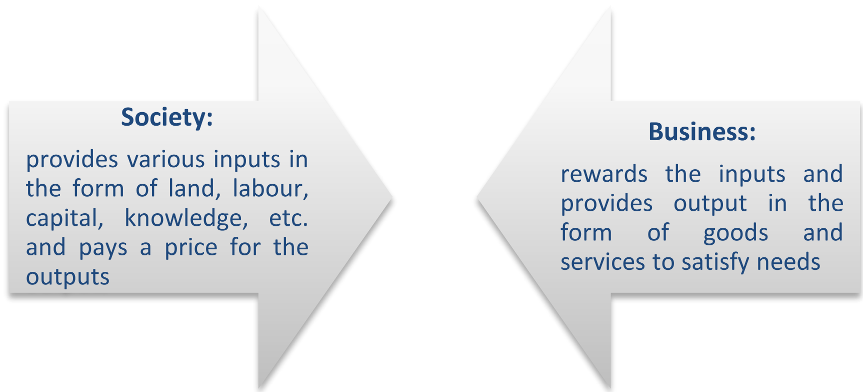
Accountability: The easiest way to understand the different levels of accountability is to adhere to the report on Social Responsibilities of Business Corporations issued by the Committee for Economic Development (CED) in 1971. The report consists of the three concentric circles: Inner Circle, Intermediate Circle and Outer Circle. CSR includes integrity and accountability because it demands knowledge that goes beyond the traditional framework of business understanding, i.e., profit-making and bottom line.

Sustainability: Sustainability places an extended set of expectations on business. Such issues as layoffs, plant closures, product quality, financial frauds, or industrial pollution demand the consideration of a diverse and complex range of systematic solutions. The reason CSR has to promote beyond philanthropy is because familiarity with unethical practices often makes society extremely tolerant and insensitive. The objectives of a company's CSR governance must be clearly defined with respect to its different stakeholders. The business environment will always be in a continuous state of flux due to the influence of socio-economic and political changes in the micro and the macro level. Therefore, CSR needs a strategy that needs to uphold the ethical standards.

Social Contract: CSR is related to the social contract between the business and the society in which it operates. At any one time in any one society, there is a set of generally accepted relationships, obligations, and duties between the major institutions and the people.

Though business has the bigger responsibility of going beyond philanthropy, one must also keep in mind that each stakeholder also has reciprocal duties with others and the consuming community also has the obligation to make the tradeoff between cost and sustainability and integrity. Different stakeholders also cannot be driven by their selfish interests alone because each stakeholder has an important role to play and one cannot be destroyed for the benefit of the other.

The reciprocal relationship between society and business is shown as under:



Q.27.(a) Enumerate the core elements that a CSR policy should normally cover.

(b) State the factors influencing Corporate Social Responsibility (CSR).

Answer 27(a):

Each business entity should formulate a CSR policy to guide its strategic planning and provide a roadmap for its CSR initiatives, which should be an integral part of overall business policy and aligned with its business goals. The policy should be framed with the participation of various level executives and should be approved by the Board.

The CSR Policy should normally cover following core elements:

1. Care for all Stakeholders

   The companies should respect the interests of, and be responsive towards all stakeholders, including shareholders, employees, customers, suppliers, project affected people, society at large etc. and create value for all of them. They should develop mechanism to actively engage with all stakeholders, inform them of inherent risks and mitigate them where they occur.

2. Ethical functioning

   Their governance systems should be underpinned by Ethics, Transparency and Accountability. They should not engage in business practices that are abusive, unfair, corrupt or anti-competitive.

3. Respect for Workers' Rights and Welfare

   Companies should provide a workplace environment that is safe, hygienic and humane and which upholds the dignity of employees. They should provide all employees with access to training and development of necessary skills for career advancement, on an equal and nondiscriminatory basis. They should uphold the freedom of association and the effective recognition of the right to collective bargaining of labour, have an effective grievance redressal system, should not employ child or forced labour and provide and maintain equality of opportunities without any discrimination on any grounds in recruitment and during employment.

4. Respect for Human Rights

   Companies should respect human rights for all and avoid complicity with human rights abuses by them or by third party.

5. Respect for Environment

   Companies should take measures to check and prevent pollution; recycle, manage and reduce waste, should manage natural resources in a sustainable manner and ensure optimal use of resources like land and water, should proactively respond to the challenges of climate change by adopting cleaner production methods, promoting efficient use of energy and environment friendly technologies.

6. Activities for Social and Inclusive Development

   Depending upon their core competency and business interest, companies should undertake activities for economic and social development of communities and geographical areas, particularly in the vicinity of their operations. These could include: education, skill building for livelihood of people, health, cultural and social welfare etc., particularly targeting at disadvantaged sections of society.

Answer 27(b):

Many factors and influences, including the following, have led to increasing attention being devoted to CSR:

- Globalization – coupled with focus on cross-border trade, multinational enterprises and global supply chains – is increasingly raising CSR concerns related to human resources management practices, environmental protection, and health and safety, among other things.
- Governments and intergovernmental bodies, such as the United Nations, The OECD and the ILO have developed compacts, declarations, guidelines, principles and other instruments that outline social norms for acceptable conduct.
- Advances in communications technology, such as the Internet, Cellular phones and personal digital assistants, are making it easier to track corporate activities and disseminate information about them. Non-governmental organization now regularly draw attention through their websites to business practices they view as problematic.
- Consumers and investors are showing increasing interest in supporting responsible business practices and a demanding more information on how companies are addressing risks and opportunities related to social and environmental issues.
- Numerous serious and high-profile breaches of corporate ethics have contributed to elevated public mistrust of corporations and highlighted the need for improved corporate governance, transparency, accountability, and ethical standards.
- Citizens in many countries are making it clear that corporations should meet standards of social and environmental care, no matter where they operate.

- There is increasing awareness of the limits of government legislative and regulatory initiatives to effectively capture all the issues that CSR addresses.
- Businesses are recognizing that adopting an effective approach to CSR can reduce risk of business disruptions, open up new opportunities, and enhance brand and company reputation.

Q.28. Highlight the role of institutional investors in promoting good Corporate Governance.

Answer 28:

Institutional investors represent an increasingly significant voice and these days hold the majority of shares in quoted companies. Institutional investors are clearly well-positioned to play an important role in improving corporate governance within the institutions in which they invest.

Most of the reports on corporate governance have emphasized the role which institutional investors play in corporate governance. The Cadbury Committee (1992) states: "Because of their collective stake, we look to the institutions in particular, with the backing of the Institutional Shareholders' Committee, to use their influence as owners to ensure that the companies in which they have invested comply with the code." At the heart of the issue about institutional investors and corporate governance is the fact that there is something called an agency problem that creeps up with professionally managed organizations. What this agency problem indicates is that managers have conflicting responsibilities to themselves and the organization and in most cases; they seek to promote their interests at the expense of the organization's interest. The point here is that managers by nature seek to maximize their benefits in relation to the profits and hence there is a need for counterbalancing this with other forces.

These forces or the countervailing balance is brought about by the institutional investors who have an interest in promoting the longer term health of the company. By actively pursuing the boards of organizations to follow effective corporate governance, institutional investors would ensure that the corporates put the longer term interests of the organization as well as ensure that organizations put shareholder interest over the interests of the managers. The point here is that institutional investors often represent large chunks of shareholders and hence they can be an effective check to the tendency of the managerial class to put their own interests first. The other aspect relates to the way in which they can monitor the health of the organization because they have the necessary expertise and knowledge in running organizations since they sit on the boards of other companies as well.

The third aspect of institutional investors is that they are more effective than minority shareholders or small shareholders. In most annual general meetings, we can see small investors raise questions related to corporate governance. In some cases, these concerns are addressed whereas in most cases, the small shareholders despite voicing objections are overruled because they do not have the numbers. This is where institutional investors come into the picture since they represent humungous numbers of shareholders and hence have the bargaining power needed to make a difference. Of course, the flipside to this is that institutional investors do not usually pursue radical changes and instead focus on maintaining the financial and operational efficiencies of the organization and promoting good corporate governance.

Finally, institutional investors can be a rock of stability in turbulent times as was evident during the recent crisis over Coal India. This case where the PSU was trying to override many objections of the shareholders was thwarted in its attempts because of the activism of the institutional investors. Further, in the case of Vedanta, institutional investors made sure that the company followed social and environmental norms and did not ride roughshod over its obligations to society and the government.

On January 04, 2013, SEBI issued a consultative paper on revising CG norms in India, with the intention of aligning the corporate governance framework in India with the OECD Principles on Corporate Governance and other global best practices. One of the key provisions in the consultative paper is to increase the role that institutional investors should play in promoting good corporate governance practices in their portfolio companies.

Increased monitoring by institutional investors and exercise of their ownership functions effectively in their portfolio companies will drive listed companies in India to enhance their corporate governance practices. Recognizing this, SEBI has proposed mandatory provisions in the consultative paper to increase institutional investor intervention in their portfolio companies.

The main provisions of the consultative paper are summarized below:

a) Institutional investors should have a clear policy on voting and disclosure of voting activity

The provision seeks to make voting mandatory for institutional shareholders on all shares held by them in portfolio companies along with public disclosure of their voting records and reasons for non-disclosures. They cannot automatically support the board in passing resolutions and if they are unsuccessful in reaching a satisfactory outcome through active dialogue with the Board, then they should register an abstention or vote against the resolution.

b) Institutional investors to have a robust policy on managing conflicts of interest

Institutional investors should formulate and regularly review a policy for managing conflicts of interest, which may include voting on matters affecting a parent company or a client.

c) Institutional investors to monitor their investee companies

Investee companies should be regularly monitored to determine when it is necessary to enter into an active dialogue with their boards. As part of these monitoring, institutional investors should:

- Seek to satisfy themselves, to the extent possible, that the investee company's board and committee structures are effective, and that independent directors provide adequate oversight, including by meeting the chairman and, where appropriate, other board members;
- Maintain a clear audit trail, for example, records of private meetings held with companies, of votes cast, and of reasons for voting against the investee company's management, for abstaining, or for voting with management in a contentious situation; and

- Attend the General Meetings of companies in which they have a major holding, where appropriate and practicable.

Institutional investors should consider carefully the explanations given for departure from the Corporate Governance Code and make reasoned judgments in each case.

d) Institutional investors to be willing to act collectively with other investors where appropriate

Institutional investors should disclose their policy on collective engagement with other investors especially during significant corporate or wider economic stress, or when the risks posed threaten the ability of the company to continue. When participating in collective engagement, institutional investors should have due regard to their policies on conflicts of interest and insider information.

e) Institutional investors to establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value

Institutional investors should set out the circumstances when they will actively intervene and regularly assess the outcomes of doing so. Intervention should be considered regardless of whether an active or passive investment policy is followed. Initial discussions should take place on a confidential basis. However, if boards do not respond constructively when institutional investors intervene, then institutional investors will consider whether to escalate their action, for example, by

- Holding additional meetings with management specifically to discuss concerns;
- Expressing concerns through the company's advisers;
- Meeting with the chairman, senior independent director, or with all independent directors;
- Intervening jointly with other institutions on particular issues;
- Making a public statement in advance of the AGM;
- Submitting resolutions at shareholders' meetings; etc.

f) Institutional investors to report periodically on their responsibilities and voting activities

Like US funds, Indian asset management funds are now required to disclose their general policies and procedures for exercising the voting rights in respect of the shares held by them on their websites as well as in the annual report distributed to the unit holders from the financial year 2010-11. However, research has shown that there is only a marginal increase in for/against votes and many funds fail to even attend meetings and have abstention as a policy. Even among funds that voted, there is little alignment between the votes and the voting policy. In view of above, existing policy needs to be examined. Fund houses should be mandated to adopt the global practice of quarterly vote reporting and fund-wise vote reporting and to adopt detailed voting policies. Further, vote reporting by fund houses should also be subject to audit.

The paper seeks deliberations from market participants on how to create incentives for institutional investors that invest in equities to become more active in the exercise of their ownership rights, without coercion, without imposing illegitimate costs on them, and given India's specific situation.

Q.29. (a) Organisation for Economic Co-operation and Development (OECD) defines corporate governance as — "a system by which business corporations are directed and controlled." In the light of this statement, enumerate the principles of corporate governance as evolved by OECD.

(b) State the advantages of Good Corporate Citizenship.

Answer 29(a):

The Organisation for Economic Co-operation and Development (OECD) was one of the earliest non-governmental organisations to work on and spell out principles and practices that should govern corporates in their goal to attain long-term shareholder value. The OECD Principles were oft-quoted and have won universal acclaim, especially of the authorities on the subject of corporate governance. Because of the ubiquitous approval, the OECD Principles are as much trendsetters as the Codes of Best Practices associated to the Cadbury Report. A useful first step in creating or reforming the corporate governance system is to look at the principles laid out by the OECD and adopted by its member governments. In summary, they include the following elements:

1. **The rights of shareholders:** The rights of shareholders include a set of rights to secure ownership of their shares, the right to full disclosure of information, voting rights, participation in decisions on sale or modification of corporate assets, mergers and new share issues. The guidelines go on to specify a host of other issues connected to the basic concern of protecting the value of the corporation.

2. **Equitable treatment of shareholders:** The OECD is concerned with protecting minority shareholders' rights by setting up systems that keep insiders, including managers and directors, from taking advantage of their roles. Insider trading, for example, is explicitly prohibited and directors should disclose any material interest regarding transactions.

3. **The role of stakeholders in corporate governance:** The OECD recognizes that there are other stakeholders in companies in addition to shareholders and workers, for example, are important stakeholders in the way in which companies perform and make decisions. The OECD guidelines lay out several general provisions for protecting stakeholder's interests.

4. **Disclosure and transparency:** The OECD lays down a number of provisions for the disclosure and communication of key facts about the company ranging from financial details to governance structures including the board of directors and their remuneration. The guidelines also specify that independent auditors in accordance with high quality standards should perform annual audits.

5. **The responsibilities of the board:** The OECD guidelines provide a great deal of details about the functions of the board in protecting the company and its shareholders. These include concerns about corporate strategy, risk, executive compensation and performance as well as accounting and reporting systems.

Answer 29(b):

Business cannot exist in isolation; business cannot be oblivious to societal development. The social responsibility of business can be integrated into the business purpose so as to build a positive synergy between the two.

1. CSR creates a favourable public image, which attracts customers. Reputation or brand equity of the products of a company which understands and demonstrates its social responsibilities is very high. Customers trust the products of such a company and are willing to pay a premium on its products. Organizations that perform well with regard to CSR can build reputation, while those that perform poorly can damage brand and company value when exposed. Brand equity is founded on values such as trust, credibility, reliability, quality and consistency.
2. CSR activities have its advantages. It builds up a positive image encouraging social involvement of employees, which in turn develops a sense of loyalty towards the organization, helping in creating a dedicated workforce proud of its company. Employees like to contribute to the cause of creating a better society. Employees become champions of a company for which they are proud to work.
3. Society gains through better neighbourhoods and employment opportunities, while the organization benefits from a better community, which is the main source of its workforce and the consumer of its products.
4. Public needs have changed leading to changed expectations from consumers. The industry/business owes its very existence to society and has to respond to needs of the society.
5. The company's social involvement discourages excessive regulation or intervention from the Government or statutory bodies, and hence gives greater freedom and flexibility in decision-making.
6. The internal activities of the organization have an impact on the external environment, since the society is an inter-dependent system.
7. A business organization has a great deal of power and money, entrusted upon it by the society and should be accompanied by an equal amount of responsibility. In other words, there should be a balance between the authority and responsibility.
8. The good public image secured by one organization by their social responsiveness encourages other organizations in the neighbourhood or in the professional group to adapt themselves to achieve their social responsiveness.
9. The atmosphere of social responsiveness encourages co-operative attitude between groups of companies. One company can advise or solve social problems that other organizations could not solve.
10. Companies can better address the grievances of its employees and create employment opportunities for the unemployed.
11. A company with its "ear to the ground" through regular stakeholder dialogue is in a better position to anticipate and respond to regulatory, economic, social and environmental change that may occur.
12. Financial institutions are increasingly incorporating social and environmental criteria into their assessment of projects. When making decisions about where to place their money, investors are looking for indicators of effective CSR management.

13. In a number of jurisdictions, governments have expedited approval processes for firms that have undertaken social and environmental activities beyond those required by regulation.

Q.30. "Good corporates are not born, but are made by the combined efforts of all stakeholders, board of directors, government and the society at large." In the light of this statement, bring out the elements of good Corporate Governance in India.

Or

"Corporate governance extends beyond corporate law. Its fundamental objective is not mere fulfillment of the requirements of law, but in ensuring commitment of the Board of directors in managing the company in a transparent manner for maximizing stakeholders' value."

In the light of this statement, discuss the various factors which add greater value through good governance.

Answer 30:

Yes, Corporate governance extends beyond corporate law. Its fundamental objective is not mere fulfillment of the requirements of law, but in ensuring commitment of the Board of directors in managing the company in a transparent manner for maximizing stakeholders' value.

In the light of the above statement, the following factors add greater value through good governance.

1. **Role and powers of Board**
   Good governance is decisively the manifestation of personal beliefs and values which configure the organizational values, beliefs and actions of its Board. The Board as a main functionary is primary responsible to ensure value creation for its stakeholders. The absence of clearly designated role and powers of Board weakens accountability mechanism and threatens the achievement of organizational goals. Therefore, the foremost requirement of good governance is the clear identification of powers, roles, responsibilities and accountability of the Board, CEO, and the Chairman of the Board. The role of the Board should be clearly documented in a Board Charter.
2. **Legislation**
   Clear and unambiguous legislation and regulations are fundamental to effective corporate governance. Legislation that requires continuing legal interpretation or is difficult to interpret on a day-to-day basis can be subject to deliberate manipulation or inadvertent misinterpretation.
3. **Management environment**
   Management environment includes setting-up of clear objectives and appropriate ethical framework, establishing due processes, providing for transparency and clear enunciation of responsibility and accountability, implementing sound business planning, encouraging business risk assessment, having right people and right skill for the jobs, establishing clear boundaries for acceptable behaviour, establishing performance evaluation measures and evaluating performance and sufficiently recognizing individual and group contribution.
4. **Board skills**

To be able to undertake its functions efficiently and effectively, the Board must possess the necessary blend of qualities, skills, knowledge and experience. Each of the directors should make quality contribution. A Board should have a mix of the following skills, knowledge and experience:

→ Operational or technical expertise, commitment to establish leadership;
→ Financial skills;
→ Legal skills; and
→ Knowledge of Government and regulatory requirement.

5. **Board appointments**

To ensure that the most competent people are appointed in the Board, the Board positions should be filled through the process of extensive search. A well-defined and open procedure must be in place for reappointments as well as for appointment of new directors. Appointment mechanism should satisfy all statutory and administrative requirements. High on the priority should be an understanding of skill requirements of the Board particularly at the time of making a choice for appointing a new director. All new directors should be provided with a letter of appointment setting out in detail their duties and responsibilities.

6. **Board induction and training**

Directors must have a broad understanding of the area of operation of the company's business, corporate strategy and challenges being faced by the Board. Attendance at continuing education and professional development programmes is essential to ensure that directors remain abreast of all developments, which are or may impact on their corporate governance and other related duties.

7. **Board independence**

Independent Board is essential for sound corporate governance. This goal may be achieved by associating sufficient number of independent directors with the Board. Independence of directors would ensure that there are no actual or perceived conflicts of interest. It also ensures that the Board is effective in supervising and, where necessary, challenging the activities of management. The Board needs to be capable of assessing the performance of managers with an objective perspective. Accordingly, the majority of Board members should be independent of both the management team and any commercial dealings with the company.

8. **Board meetings**

Directors must devote sufficient time and give due attention to meet their obligations. Attending Board meetings regularly and preparing thoroughly before entering the Boardroom increases the quality of interaction at Board meetings. Board meetings are the forums for Board decision-making. These meetings enable directors to discharge their responsibilities. The effectiveness of Board meetings is dependent on carefully planned agendas and providing relevant papers and materials to directors sufficiently prior to Board meetings.

9. **Code of conduct**

It is essential that the organization's explicitly prescribed norms of ethical practices and code of conduct are communicated to all stakeholders and are clearly understood and followed by each member of the organization. Systems should be in place to periodically measure, evaluate and if possible recognise the adherence to code of conduct.

10. **Strategy setting**

The objectives of the company must be clearly documented in a long-term corporate strategy including an annual business plan together with achievable and measurable performance targets and milestones.

11. Business and community obligations

Though basic activity of a business entity is inherently commercial yet it must also take care of community's obligations. Commercial objectives and community service obligations should be clearly documented after approval by the Board. The stakeholders must be informed about the proposed and ongoing initiatives taken to meet the community obligations.

12. Financial and operational reporting

The Board requires comprehensive, regular, reliable, timely, correct and relevant information in a form and of a quality that is appropriate to discharge its function of monitoring corporate performance. For this purpose, clearly defined performance measures - financial and non-financial should be prescribed which would add to the efficiency and effectiveness of the organisation.

The reports and information provided by the management must be comprehensive but not so extensive and detailed as to hamper comprehension of the key issues. The reports should be available to Board members well in advance to allow informed decision-making. Reporting should include status report about the state of implementation to facilitate the monitoring of the progress of all significant Board approved initiatives.

13. Monitoring the Board performance

The Board must monitor and evaluate its combined performance and also that of individual directors at periodic intervals, using key performance indicators besides peer review. The Board should establish an appropriate mechanism for reporting the results of Board's performance evaluation results.

14. Audit Committees

The Audit Committee is inter alia responsible for liaison with the management; internal and statutory auditors, reviewing the adequacy of internal control and compliance with significant policies and procedures, reporting to the Board on the key issues. The quality of Audit Committee significantly contributes to the governance of the company.

15. Risk management

Risk is an important element of corporate functioning and governance. There should be a clearly established process of identifying, analyzing and treating risks, which could prevent the company from effectively achieving its objectives. It also involves establishing a link between risk-return and resourcing priorities. Appropriate control procedures in the form of a risk management plan must be put in place to manage risk throughout the organization. The plan should cover activities as diverse as review of operating performance, effective use of information technology, contracting out and outsourcing.