Paper-13: CORPORATE LAWS AND COMPLIANCE

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Full Marks: 100 **Time Allowed: 3 Hours**

Answer Question No. 1 which is compulsory carries 20 marks and answer any 5 Question from Q. No 2 to Q. No. 8

Question 1: Answer any 4 from the below **[4×5 = 20]**

(a) The Board of Directors of Nimbahera Chemicals Limited proposes to transfer more than 10% of the profits of the company to the reserves for the current year. Advise the Board of Directors of the said company mentioning the relevant provisions of the Companies Act, 2013.

Answer:

The first Proviso to 123(1) of the Companies Act, 2013 provides that a company may, before the declaration of any dividend in any financial year, transfer such percentage of its profits for that financial year as it may consider appropriate to the reserves of the company. Therefore, under the Companies Act, 2013 the amount transferred to reserves out of profits for a financial year has been left at the discretion of the company acting vide its Board of Directors. Therefore the company is free to transfer any part of its profits to reserves as it deems fit.

(b) An audit firm, comprising of two partners, holds office as auditor of 40 private companies out of which paid-up capital of 20 companies exceeds ₹50 lakhs. Such audit firm wants to be appointed as an auditor in XYZ Pvt. Ltd. Decide whether this is in consonance with the applicable law.

Answer:

As per Section 141(3)(g) of the Companies Act, 2013 private companies shall also be included in the provisions with respect to ceiling on number of audits with the restriction that the private companies having paid up share capital less than 100 crore rupees shall not be included for calculation of specified number of audits. As per the provision, a person shall not be eligible for appointment as an auditor of a company if such person or partner is at the date of such appointment or reappointment holding appointment as an auditor of more than twenty companies. Therefore, such firm cannot be appointed as an auditor of XYZ Pvt. Ltd as it will exceed the ceiling prescribed for number of audits. There is no relevance of paid up share capital of 20 companies in the above case.

(c) The Board of Directors of MNP Limited appointed Ms. Neha as a Women Director in the Board Meeting held on 10th September, 2014. The said appointment was made to fill the vacancy of the Woman Director, which had occurred as a result of resignation of Ms. Sheela on 30th June, 2014. Examine the validity of the following appointment with reference to the provisions of the Companies Act, 2013.
Will your answer differ if the Board Meeting of the company was held on 8th November, 2014?

Answer:

Woman Director: At least one woman director shall be on the Board of such class or classes of companies as may be prescribed (Second Proviso to Sec. 149(1) of the Companies Act, 2013).

Further, any intermittent vacancy of a woman director shall be filled up by the Board at the earliest but not later than immediate next Board meeting or three months from the date of such vacancy, whichever is later.

As per the above provisions, the appointment of Ms. Neha is valid. The vacancy of a woman director of MNP Limited which arose on 30th June 2014, due to the resignation of Ms. Sheela, should be filled up latest by 29th September 2014 or the day of the next Board Meeting, whichever is later. Since Ms. Neha was appointed in the next Board Meeting after the vacancy arose, i.e. on 10th September 2014, her appointment is valid.

The answer will remain the same, even if MNP Ltd. appoints Ms. Neha in the Board Meeting held on 8th November 2014, provided the said meeting is the first meeting of the Board after 30th June 2014 i.e. after the resignation of Ms. Sheela.

(d) What is the procedure to be followed, when a board meeting is adjourned for want of quorum?

Answer:

Section 174(4) of the Companies Act, 2013 provides that, 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 in the next week, at the same time and place, or if that day is a national holiday, till the next succeeding day which is not a national holiday, at the same time and place.

It may be noted that on adjournment of a meeting, the meeting having started and not ended will not constitute a contravention of Section 173(1) under which a company is required to hold four board meetings in a year and not more than 120 days shall elapse between two board meetings. In case of adjournment of the meeting, it shall be deemed to have been held on the date on which it was started and not on the date when the adjourned meeting was held.

(e) Explain briefly the purpose of establishing SEBI.

Answer:

The purpose of the SEBI Act is to provide for the establishment of a Board called Securities and Exchange Board of India (SEBI). The Preamble to the Act provides for the establishment of a Board to:

(i) Protect the interests of investors in securities.
(ii) Promote the development of the securities market.
(iii) To regulate the securities market, and
(iv) For matters connected therewith or incidental thereto.

The SEBI was set up to achieve the following objectives:

(i) To promote fair dealings by the issuers of securities and ensure a market place where they can raise funds at a relatively low cost.
(ii) To provide a degree of protection to the investors and safeguard their rights and interests so that there is a steady flow of savings into the market.
(iii) To regulate and develop a code of conduct and fair practices by intermediaries like brokers, merchant bankers, etc., with a view to making them competitive and professional.

Question 2:

(a) The Board of Directors of AJD Limited appointed Mr. N as an alternate director for a period of two months against a director who has proceeded abroad on leave for period of six months. Articles of Association of the company is silent.
Referring to the provisions of the Companies Act, 2013, examine the validity of the above. 5

Answer:

According to Sec. 161(2) of the Companies Act, 2013, the Board of Directors of a company may, if so authorized by its articles or by a resolution passed by the company in general meeting, appoint a person to act as an alternate director for a director (original director) during his absence for a period of not less than three months from India.

In the present case, the Board of Directors of AJD Limited appointed Mr. N as an alternate director for a period of two months against a director who has proceeded abroad on leave for a period of six months and Articles of Association of the company are silent. The said appointment is not valid because the power to appoint alternate director is not authorized by its articles or by a resolution passed by the company in general meeting.

(b) Explain the concept of KMP (Key Managerial Personnel) as introduced by the Companies Act, 2013. Explain the classes of companies which are required to appoint whole time Key Managerial Person under the provisions of the said Act. 6

Answer:

As per the provisions of Section 203(1) of the Companies Act, 2013, every company belonging to such class or classes of companies as may be prescribed, shall have the following whole time Key Managerial Personnel.

(i) Managing Director or Chief Executive Officer or Manager and in their absence, a Whole – Time Director;
(ii) Company Secretary; and
(iii) Chief Financial Officer.

According to Rule 8 of the Companies (appointment and Remuneration of Managerial Personnel) Rules, 2014, every listed company and every other public company having a paid up share capital of ₹ 10 crore or more shall have a whole time Key Managerial Personnel.

Further, as per the Companies (Appointment and Remuneration of Managerial Personnel) Amendment Rules, 2014, a company other than a company covered under Rule 8 above, which has a paid up share capital of ₹ 5 crore or more than shall have a whole time Company Secretary.

With the insertion of Rule 8A to the above rules, it is now mandatory for every other company to have a whole-time company secretary, if its paid up share capital is ₹ 5 Crore or more.

(c) Mr. X is a director of ABC Ltd. He has approached Housing Finance Co. Ltd. for the purpose of obtaining a loan of ₹ 50 lacs to be used for construction of building his residential house. The loan was sanctioned subject to the condition that ABC Ltd. should provide the guarantee for repayment of loan instalments by Mr. X. Advise Mr. X. 5

Answer:

According to Section 185 of the Companies Act, 2013, no company shall, directly or indirectly, advance any loan, including any loan represented by a book debt, to any of its directors or to any other person in whom the director is interested or give any guarantee or provide any security in connection with any loan taken by him or such other person.

Thus, Mr. X is not allowed for loan of ₹ 50 lacs against guarantee by the company ABC Ltd.

Question 3:

(a) Referring to the provisions of the Companies Act, 2013 which companies are required to constitute a 'Nomination and Remuneration Committee'? 6

Answer:

As per the provisions of Section 178 of the Companies Act, 2013 a Nomination and Remuneration Committee shall be constituted by the Board of Directors of:

(a) Every listed company and
(b) Such other class or classes of companies as may be provided.

The Companies (Meetings of Board and its powers) Rules, 2014 has prescribed the following classes of companies that shall constitute Nomination and Remuneration Committee of the Board:

(a) All public companies with a paid up capital of 10 crore rupees or more;
(b) All public companies having a turnover of one hundred crore rupees or more;
(c) All public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

Explanation:
The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into account for the purposes of this rule.

Provided further that public companies covered under this rule shall constitute their Nomination and Remuneration Committee within one year from the commencement of these rules or appointment or independent directors by them, whichever is earlier.

(b) A scheme provides for Amalgamation of PQL International Limited, a foreign company, with DHP Limited, an Indian company registered under the Companies Act, 1956. Referring to the provisions of the above Act, decide whether the scheme providing amalgamation of a foreign company as a transferor company can be sanctioned by the Court (NCLT). 5

Answer:

A scheme of compromise or arrangement may provide for amalgamation of companies under Section 394 of the Companies Act, 1956. Section 394(4)(b) defines the "transferee" and "transferor" companies. While the 'transferee company' does not include any company other than a company within the meaning of the Companies Act, 1956 the 'transferor company' includes anybody corporate whether a company within the meaning of the Companies Act or not. Hence, the scheme of amalgamation may provide for transfer of foreign companies (as transferor) to Indian Companies.

Hence, the Court (NCLT) can sanction the scheme providing for amalgamation of PQL International Limited with DHP Limited.

(c) ABC Private Limited is a company in which there are eight shareholders. Can a member holding less than one-tenth of the share capital of the company apply to the Company Law Board for relief against oppression and mismanagement? Give your answer according to the provisions of the Companies Act, 1956. 5

Answer:

Under Section 399(1)(a) of the Companies Act, 1956, in the case of a company having share capital, the following member(s) have the right to apply to the Company Law Board under Section 397 or 398.

(i) Not less than 100 members of the company or not less than one-tenth of the total number of members, whichever is less; or

(ii) Any member or members holding not less than one-tenth of the issued share capital of the company provided the applicant(s) have paid all the calls and other sums due on the shares.

In the given case, since there are eight shareholders. As per the condition (a) above, 10% of 8 i.e. 1 satisfies the condition. Therefore a single member can present a petition to the Company Law Board (CLB), regardless of the fact that he holds less than one-tenth of the company's share capital.

Question 4:

(a) Explain the provisions under the Companies Act, 1956 for amendment of Articles of Association of a producer company. 5

Answer:

Amendment of articles (Section 581 - I of the Companies Act, 1956):

(i) Any amendment of the articles shall be proposed by not less than two third of the elected directors or by not less than one third of the members of the producer company, and adopted by the members by a special resolution.

(ii) A copy of the amended articles together with the copy of the special resolution, both duly certified by two directors, should be filed with the Registrar within thirty days from the date of its adoption.

(b) X Inc is a company registered in UK and carrying on Trading Activity, with Principal Place of Business in Chennai. Since the company did not obtain registration or make arrangement to file Return, the State VAT Officer having jurisdiction, intends to serve show cause notice on the Foreign Company. As Standing Counsel for the department, advise the VAT Officer on valid service of notice. 5

Answer:

Service of notice on foreign company (Section 383 of the Companies Act, 2013):

According to Section 383 of the Companies Act, 2013, any process, notice, or other document required to be served on a foreign company shall be deemed to be sufficiently served, if addressed to any person whose name and address have been delivered to the Registrar under Section 380 of the Companies Act, 2013, and left at, or sent by post to, the address which has been so delivered to the Registrar or by electronic mode. Hence, the VAT Officer may serve the show cause notice by following the above provisions.

It is assumed that X Inc is a foreign company within the meaning of Section 379 of the Companies Act, 2013.

(c) What are the scanned documents required to be attached with e form DIR-3? 6

Answer:

(i) High resolution photograph of the applicant.
(ii) PAN is mandatory now. So copy of pan is mandatory for identity, name, father's name and date of birth. Proof of father's name is not required in the case of foreign nationals.
(iii) Copy of passport is mandatory as an id proof in the case of foreign nationals.
(iv) Present Address proof which should not be older than 2 months.
(v) Verification as perform DIR – 4 as per the format given on the website.

Question 5:

(a) What are the agreements prohibited under Section 3(1) of the Competition Act, 2002? 6

Answer:

Agreements at different stage in different market are prohibited under Section 3(1) of the Competition Act, 2002. Any agreement amongst enterprises or persons at different stage of the production chain in different markets, in respect of production, supply, distribution, storage, sales etc. shall be a void agreement if it causes or is likely to cause an appreciable adverse effect on Competition in India including:

(a) Tie-in agreement: Tie in agreement includes any agreement requiring a purchaser of goods, as a condition of such purchase to purchase some other good;
(b) Exclusive supply agreement: Exclusive supply agreement includes any agreement restricting in any manner the purchaser in the course of his trade from acquiring or otherwise dealing in any goods other than those of the seller or any other person;

(c) Exclusive distribution agreement: Exclusive distribution agreement includes any agreement to limit, restrict or withhold the output or supply of goods or allocate any area or market for the disposal or sale of the goods;

(d) Refusal to deal: Refusal to deal includes any agreement, which restrict, 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: Resale price maintenance includes any agreement to sell goods on condition that the price 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.

(b) Rampur Stock Exchange wants to get itself recognized. Explain who enjoys the power to recognize stock exchange? 5

Answer:

Power to recognize Stock Exchange vests with Central Government. However, Central Government has delegated the powers to SEBI vide its notification No. F.No.1/57/SE/93 dated 13-9-94. [Section 3 of the Securities Contracts (Regulation) Act, 1956].

(c) L, a famous playback singer of India wants to perform a musical night in Paris for Indians residing there. Foreign exchange to the extent of USD 20,000 is required for this purpose. State the kind of approval required for the said transactions under the Foreign Exchange Management Act, 1999. 5

Answer:

Foreign exchange drawals for cultural tours require prior permission/approval of the Government of India irrespective of amount of foreign exchange required. Therefore, in the given case L, the singer is required to seek permission of the Government of India.

Question 6:

(a) The Board of Directors of a newly incorporated Banking Company is required to file the accounts and Balance Sheet. Advise the Board of Directors about the law relating to preparation, signing and filing of accounts and Balance Sheet under the provisions of the Banking Regulation Act, 1949. 8

Answer:

Preparation of Accounts and Balance Sheet:

According to Section 29 of the Banking Regulation Act, 1949, every Banking Company incorporated in India, in respect of all business transacted by it and through its branches in India, shall prepare a balance sheet and profit & loss account as on the last working

day of the Accounting Year (which is April to March i.e. 31st March) in the Form "A" and "B" given in the third schedule of the Act.

Signing of Accounts and Balance Sheet:

The amalgamated Balance Sheet and Profit and Loss Account should be signed by the CMD (Chairman and Managing Director) and at least three Directors where there are more than three directors or where there are not more than three directors, by all the directors.

In case of banking companies incorporated outside India by the principal officer of the company in India.

Filling/submission Balance Sheet & Profit and Loss Account:

Sections 31 and 32 of the Banking Regulation Act, 1949 lay down the procedure for the filling of the accounts and balance sheet. The accounts and balance sheet along with auditor's report shall be published in prescribed manner and three copies thereof shall be furnished as returns to Reserve Bank of India (RBI) within three months from the end of the period to which they refer. The RBI may extend the period by a further period of not exceeding three months.

These three copies of accounts and balance sheet along with auditor's report shall be sent by the banking company to the Registrar of Companies, at the same time while sending the same to RBI.

(b) Enumerate the obligations of banking companies under the Prevention of Money Laundering Act, 2002. 8

Answer:

Section 12 provides for the obligation of Banking Companies, Financial Institutions and Intermediaries or a person carrying on a designated business or profession. According to Sub-section (1), every banking company, financial institution and intermediary or a person carrying on a designated business or profession shall-

(a) maintain a record of all transactions, including information relating to transactions covered under clause (b), in such manner as to enable it to reconstruct individual transactions;

(b) furnish to the Director within such time as may be prescribed, information relating to such transactions, whether attempted or executed, the nature and value of which may be prescribed;

(c) verify the identity of its clients in such manner and subject to such conditions, as may be prescribed;

(d) identify the beneficial owner, if any, of such of its clients, as may be prescribed;

(e) maintain record of documents evidencing identity of its clients and beneficial owners as well as account files and business correspondence relating to its clients.

Every information maintained, furnished or verified, save as otherwise provided under any law for the time being in force shall be kept confidential.

The records referred to in clause (a) of sub-section (1) shall be maintained for a period of five years from the date of transaction between a client and the reporting entity.

The records referred to in clause (e) of sub-section (1) shall be maintained for a period of five years after the business relationship between a client and the reporting entity has ended or the account has been closed, whichever is later.

The Central Government may, by notification, exempt any reporting entity or class of reporting entities from any obligation under this chapter.

Question 7:

(a) What is meant by the corporate governance as per renowned exponents in this field? How far do you agree with their views (agree/strongly agree/disagree etc.)? 8

Answer:

Corporate governance is...

- The process of supervision and control intended to ensure that the company's management acts in accordance with the interests of shareholders (Parkinson, 1994). -Strongly agree
- The governance role is not concerned with the running of the business of the company per se, but with giving overall direction to the enterprise, with overseeing and controlling the executive actions of management and with satisfying legitimate expectations of accountability and regulation by interests beyond the corporate boundaries (Tricker, 1984).-Agree
- The governance of an enterprise is the sum of those activities that make up the internal regulation of the business in compliance with the obligations placed on the firm by legislation, ownership trusteeship of assets, their management and their deployment (cannon, 1994). – Agree
- The relationship between shareholders and their companies and the way in which shareholders act to encourage best practice (e.g., by voting at AMs and by regular meetings with companies' senior management). Increasingly, this includes shareholder activism' which involves a campaign by a shareholder or a group of shareholders to achieve change in companies (the Corporate Governance Handbook, 1996). -Some agreement
- The structures, process, cultures and systems that engender the successful operation of the Organization (Keasey and Wright, 1993). -Some agreement
- The system by which companies are directed and controlled (The Cadbury Report, 1992) - slight agreement

(b) As per the revised corporate governance code published in Japan in 2001, discuss the mission and role of (i) Board of Directors and (ii) Committees established within the board. 8

Answer:

Mission and role of the board of directors:
This first chapter contained five principles relating to: the position and purpose of the board of directors; the function and powers of the board of directors; the organization of the board of directors; outside directors and their independence; the role of the leader of the board of directors.

The board should be comprised of outside directors (someone who has never been a full-time director, executive, or employee of the company)- preferably a majority- and inside directors (executives or employees of the company). Independent directors are outside directors who can make their decisions independently. The board of directors' role is seen as one of management supervision including approving important strategic decisions, nominating candidates for director positions, appointment and removal of the CEO, and general oversight of accounting and auditing, the board of directors may also be required to approve certain decisions made by the CEO.

Mission and role of the committees established within the board of directors:
The board is recommended to establish various committees including an audit committee, compensation committee, and nominating committee. Each committee established should comprise at least three directors, and an outside director appointed as chair of each committee. The majority of directors on the audit committee should be independent directors, whilst the majority of directors on the audit committee should be independent directors, whilst the majority of directors on the other two committees should be outside directors, of whom at least one should be an independent director. The roles of the various committees are broadly defined and cover the usual areas that one would expect for each of these committees.

Question 8:

(a) "The development of Corporate Governance in the UK was initially the findings of a Trilogy of Codes". Explain the same in brief. 10

Answer:

As in other countries, the development of Corporate Governance in the UK was initially the findings of a trilogy of codes: the Cadbury Report (1992), the Greenbury Report (1995), and the Hampel Report (1998). These are explained as under:

Cadbury Report (1992)

Following various financial scandals and collapses (Coloroll and Polly Peck, to name but two) and a perceived general lack of confidence in the financial reporting of many UK companies, the Financial Reporting Council, the London Stock Exchange, and the accountancy profession established the Committee on the Financial Aspects of Corporate Governance in May 1991.

After the Committee was set up, the scandals at BCCI and Maxwell happened, and as a result, the committee interpreted its remit more widely and looked beyond the financial aspects to Corporate Governance as a whole. The Committee was chaired by Sir Adrian Cadbury and, when the Committee reported in December 1992, the report became widely known as 'the Cadbury Report'. The recommendations covered: the operation of the main board; the establishment, composition, and operation of key board committees; the importance of, and contribution that can be made by, non-executive directors; the reporting and control mechanisms of a business. The Cadbury Report recommended a code of Best Practice with which the boards of all listed companies registered in the UK should comply, and utilized a 'comply or explain' mechanism. This mechanism means that a company should comply with the code but, if it cannot comply with any particular aspect of it, then it should explain why it is unable to do so. This disclosure gives investors detailed information about any instances of non-compliance and enables them to decide whether the company's non-compliance is justified.

Greenbury Report (1995)

The Greenbury committee was set up in response to concern at both the size of directors' remuneration packages and their inconsistent and incomplete disclosure in companies' annual reports. It made, in 1995, comprehensive recommendations regarding disclosure of directors' remuneration packages. There has been much discussion about how much disclosure there should be of directors' remuneration and how useful detailed disclosures might be. Whilst the work of the Greenbury Committee focused on the directors of public limited companies, it hoped that both smaller listed companies and unlisted companies would find its recommendations useful.

Central to the Greenbury report recommendations were strengthening accountability and enhancing the performance of directors. These two aims were to be achieved by (i) the presence of a remuneration committee comprised of independent non-executive directors who would report fully to the shareholders each year about the company's executive remuneration policy, including full disclosure of the elements in the remuneration of individual directors; and (ii) the adoption of performance measures linking rewards to the performance of both the company and individual directors, so that the interests of directors and shareholders were more closely aligned. Since that time (1995), disclosure of directors' remuneration has become quite prolific in UK company accounts.

Hampel Report (1998)

The Hampel Committee was set up in 1995 to review the implementation of the Cadbury and Greenbury Committee recommendations. The Hampel Committee reported in 1998. The Hampel Report said: 'We endorse the overwhelming majority of the findings of the two earlier committees'. There has been much discussion about the extent to which a company should consider the interests of various stakeholders, such as employees, customers, suppliers, providers of credit, the local community, etc., as well as the interests of its shareholders. The Hampel report stated that the directors as a board are responsible for relations with stakeholders; but they are accountable to the shareholders'. However, the report does also state that directors can meet their legal duties to shareholders, and can pursue the objective of long-term shareholder value successfully, only by developing and sustaining these stakeholder relationships'.

The Hampel Report, like its precursors, also emphasized the important role that institutional investors have to play in the companies in which they invest (investee companies). It is highly desirable that companies and institutional investors engage in dialogue and that institutional investors make considered use of their shares, in other words, institutional investors should consider carefully the resolutions on which they have a right to vote and reach a decision based on careful thought, rather than engage in 'box ticking'. The combined code due together the recommendations of the Cadbury, Greenbury and Hampel reports. It has two sections, one aimed at companies and another aimed at Institutional Investors.

(b) What do you mean by Hedging and Pledging? Explain the factors in determining vote recommendations for the election of directors. 6

Answer:

Hedging and Pledging Current ISS policy provides for the recommendation of a negative vote for directors, whether individually or as part of a committee or the entire board, due to material failures of risk oversight at the company. The 2013 updates expand the examples of a failure of "risk oversight" to include, among other things, the hedging of company stock and the significant pledging of company stock as collateral for a loan. These practices are seen as severing the alignment of interests between the officers and directors and the shareholders. Hedging of company stock at any level and in any form poses enough of a problem to warrant a negative vote recommendation. For companies in which officers or directors have pledged company stock as collateral, ISS considers the following factors in determining vote recommendations for the election of directors:

- Presence in the company's proxy statement of an anti-pledging policy that prohibits future pledging activity;
- Magnitude of aggregate pledged shares in terms of total common shares outstanding or market value or trading volume;
- Disclosure of progress or lack thereof in reducing the magnitude of aggregate pledged shares over time;

- Disclosure in the proxy statement that shares subject to stock ownership and holding requirements do not include pledged company stock; and
- Any other relevant factors.