PAPER 13 – Corporate Laws and Compliance

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

The figures in the margin on the right side indicate full marks.

SECTION A

[Answer to Q.No.1 is compulsory and attempt any 4 from the rest]

1. (a) 'X' was appointed as managing director for life by the articles of association of a private company incorporated on 1st June, 1970. The articles also empowered 'X' to appoint a successor. 'X' appointed, by will, 'S' to succeed him after his death. Can 'S' succeed 'X' as managing director after the death of 'X'? [3]

(b) The issues, subscribed and paid-up share capital of XYZ Ltd. Is Rs. 10 lakhs consisting of 90,000 equity shares of Rs. 10 each fully paid up and 10,000 preference shares of Rs. 10 each fully paid up. Out of members of company, 400 members holding one preference share each and 50 members holding 500 equity shares applied for relief under sections 397 and 398 of the Companies Act, 1956. As on the date of petition, the company had 600 equity shareholders and 5,000 preference shareholders.

Examine whether the above petition under sections 397 and 398 is maintainable. Will your answer be different, if preference shareholders have subsequently withdrawn their consent ? [6]

(c) The subscribed share capital of ABC Company Ltd at the end of the financial year ending 31.3.2012 was Rs. 25 crores, out of which 2 Public Financial Institutions were holding share capital amounting to Rs. 4 crores. During the financial year 2012-13 the company through public issue of shares raised its subscribed capital by additional Rs. 70 crores. Out of Rs. 70 crores, the 2 Public Financial Institutions were further allotted shares amounting to Rs. 22 crores, raising the total contribution of these two institutions to Rs. 26 crores before the date of the company's closure of books for AGM scheduled for 15.9.2013, where Auditors were to be appointed.

The company as usual, by getting an ordinary resolution passed appointed the Auditors. A group of shareholders of the company allege that the appointment of Auditors is violative of certain provisions of the Companies Act, 1956. They, however, did not raise any objection to the appointment of auditors at the previous AGM held on 10.9.2012.

(i) Whether the contention of the shareholders is tenable?

(ii) If the contention of shareholders be tenable, what action should the company take for the appointment of Auditors at the AGM scheduled for 15.9.2013 ? [6]

Answer 1 (a) :

No director shall assign his office to any other person. If he does, the assignment shall be void (**Section 312**).

The articles of a company empowered its managing director to appoint a successor. The managing director appointed, by his will, Mr. S to succeed him as a managing director after his death. The Court observed that a director is prohibited from assigning his office. The word 'his' used in section 312 indicates that the prohibition applies only when an office held by a director is assigned to any other person. Where a director dies, the office held by him becomes vacant and therefore such office cannot be assigned to any other person. Therefore, appointment of a new person in such office does not amount to an assignment within the meaning of section 312.

[**Oriental Metal Pressing Pvt. Ltd. v B.K. Thakoor (1961) 31 Comp Cas 143**]. The facts of the given case are identical to the facts discussed in the above case. Accordingly, it can be said that appointment of 'S' is valid and it does not amount to an assignment of office by 'X'.

Answer 1 (b):

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 :

(i) 100 members ; or
(ii) 1/10 th of the total number of members; or
(iii) Members holding not less than 1/10 th of the issued share capital of the company

It must be noted that the term member includes an equity shareholder as well as preference shareholder.

The consent to be given by shareholder is reckoned at the beginning of the proceedings. The withdrawal of consent by shareholder during the course of proceedings does not affect the maintainability of the application [**Rajahmundri electric Supply Corporation v Nageshwara Rao AIR 1956 SC 213].**

In the present case, the shareholding pattern of the company is as follows :

(i) Rs. 9,00,000 equity share capital held by 600 members
(ii) Rs. 1,00,000 preference share capital held by 5,000 members
(iii) Rs. 10,00,000 total share capital held by 5,600 members

The application alleging oppression and mismanagement has been made by the members as follows :

Number of members making the application:

Preference shareholders	400
Equity shareholders	50
Total members	450

Amount of share capital held by the members making the application :

Preference share capital	4,000	(400 preference shares of RS. 10 each)
Equity share capital	5,000	(500 equity shares of Rs. 10 each)
Total capital	9,000	

The application shall be valid if it has been made by the lowest of the following :

(i) 100 members
(ii) 560 members (being 1/10th of 5,600)
(iii) Members holding Rs. 1,00,000 share capital (being 1/10th of Rs. 10,00,000)

As is evident, the application made by 450 members meets the eligibility criteria specified under section 399, and therefore the application is maintainable.

Such application shall remain valid despite the fact that some of the applicants have subsequently withdrawn their consents **[Rajahmundri electric Supply Corporation v Nageshwara Rao AIR 1956 SC 213].**

It has been assumed that the members making the application have paid all the calls due on their shares.

Answer 1 (c):

Section 224A of the Act, provides that in the case of a company in which twenty-five present or more of the subscribed share capital is held, whether singly or in any combination, by :

(a) A public financial institution or a Government Company or Central Government or any State Government, or
(b) Any financial or other institution established by any provincial or State Act in which a State Government holds not less than fifty-one percent of the subscribed share capital, or
(c) A nationalized bank or an insurance company carrying on general insurance business.

The appointment of an auditor or auditors shall be in the annual general meeting by a special resolution only.
If the company fails to pass a special resolution, it shall be deemed that no auditor or auditors had been appointed by the company at its annual general meeting and the Central Government will be empowered to make the appointment.

(i) For AGM held on 10.9.2012 :
The holding of Public Financial Institution was Rs. 4 crores ÷ Rs. 25 crores = 16%.
Hence, Sec 224A is not attracted. Hence, appointment of Auditor(s) by an Ordinary Resolution is valid.

For AGM held on 15.9.2013 :
The holding of Public Financial Institution will be Rs. 26 crores ÷ Rs. 95 crores = 27.37%.
Hence, special resolution is required to be passed for appointment of Auditor(s), in terms of Sec 224A. Appointment by way of Ordinary Resolution is not valid. Hence, the Shareholder's contention is tenable.

(ii) Where a company is required to appoint an Auditor at an AGM by passing a special resolution, but omits or fails to pass such resolution due to any reason, it shall be deemed that no Auditor has been appointed by the company at its AGM and the provisions of Section 224 (3) of the Act will be attracted. **[Section 224A (2)]**
Section **224(3)** of the Act provides that where at an annual general meeting no auditor or auditors are appointed or re-appointed, the Central Government may appoint a person to fill the vacancy. For this purpose, the company is charged with the responsibility of intimating the above fact to the Central Government within seven days from the date of such meeting. The company and every officer of the company who is in default in this respect are punishable with fine which may extend to Rupees five thousand.

2. (a) The liability of members may become unlimited and several, even in the case of a limited liability company – explain. [4]

(b) In relation to winding up of a Company incorporated under the Companies' Act 1956, explain clearly the meaning of the term 'Overriding Preferential Payments'. Examine and decide whether the following debts of a Company under the winding up shall be 'Preferential Payments' and shall be paid in priority to the claim of Unsecured Creditors –

- **Wages amounting to ₹30,000 only of an Employee for services rendered for a period of 8 Months within the preceding 12 Months next before the relevant date.**
- **₹1 Lakh due to an employee from Provident Fund and ₹50,000 towards Gratuity.**
- **₹20,000 payable by the Company on account of expenses incurred in respect of investigation held u/s 235. [6]**

(c) The board meeting of MNO Ltd. was held on 10th May, 2008 at Chennai at 11 a.m. At the time of starting the board meeting the number of directors present were 7. The total number of directors were 10. The board transacted ten items in the board meeting. At 12 noon after the completion of

four items in the agenda 4 directors left the meeting. Examine the validity of these transactions explaining the relevant provisions of the Companies Act, 1956. [5]

Answer 2 (a) :
The liability of members may become unlimited and several, even in the case of a limited liability company. If, at any time, the number of members of a company is reduced below the statutory minimum (seven in the case of a public company and two in the case of a private company), and the company carries on business for more than six months while the number is so reduced, every person who is a member of the company at the time the company so carries on business after those six months and is aware of that fact shall be severally (individually) liable for the payment of company's debts, contracted during that time. Thus, in this case, the privilege of limited liability of shareholders is lost.

However, it may be noted that the personal liability of the members will arise only after the expiry of six months from the date of reduction of membership below the statutory minimum. **[Section 45].**

Answer 2 (b):
Preferential Payments u/s 530

1) **Wages and Salaries of Employees:** All wages or Salary (whether by way of time or piece work, or whether wholly or partly by way of commission) of any employee, in respect of services rendered to the Company. The following conditions / restrictions apply in this regard –
   (i) The amount should be due for a period not exceeding 4 months within the 12 months before the relevant date.
   (ii) The amount should not exceed ₹20,000 in the case of any one claimant. [GSR 30(E) dated 17-02-1997]

Note: Any remuneration in respect of a period of holiday or of absence from work through sickness or other good cause shall be deemed to be wages in respect of services rendered to the Company during that period.

2) **Dues from Employee Welfare Funds:** All sums due to any Employee from a Provident Fund, Pension Fund, Gratuity Fund or any other Fund for the welfare of the employees, maintained by the company.

3) **Investigation Expenses:** Expenses of any investigation held in pursuance of Sec. 235 or 237, so far as they are payable by the Company.

In the given case,

- Salary / Wage shall be restricted to least of the following –

  (i) 4 Months Wages = ₹15,000 (i.e., ₹30,000 x 4/8 = ₹15,000)
  (ii) Notified Amount = ₹20,000. Hence ₹15,000 is preferential.

- Entire amount due under PF and Gratuity is Preferential.

- Entire Investigation expenses u/s 235 is preferential.

Answer 2 (c):

As per section 287(2), the quorum for a Board meeting shall be higher of-

(a) 1/3rd of total strength (any fraction contained in that one-third shall be rounded off as one); or

(b) 2 directors.

Total strength' means the total strength of the Board of directors of a company, as reduced by the number of directors whose places are vacant at that time.

Quorum has to be present at the time of transacting each and every business. It is not enough that a quorum was present at the commencement of the meeting. Therefore, where quorum is present at the beginning of the meeting, but some of the directors leave the meeting, so that remaining directors do not constitute quorum, any subsequent resolutions will be invalid.

In the given case, total strength is 10. Quorum for the Board meeting held on 10th May, 2008 shall be 1/3rd of 10 directors, i.e. 3.33, taken as 4 directors. Since 7 directors were present at the time of commencement of the Board meeting, the Board meeting has been validly held.

However, after transacting 4 items on agenda, 4 directors left, because of which the number of directors present has fallen below the quorum required. Since, quorum is required at the time of transacting each and every business, the remaining 6 agenda items cannot be validly discussed and voted upon. Therefore, resolutions passed in respect of these 6 agenda items are void, and have no legal effect.

3. (a) A French manufacturing company desirous of setting up its branch office at Pune, seeks your advice on the object for which the company may be allowed to set up the desired branch office. Advise the company about the procedure as required under the Foreign Exchange Management Act, 1999 to be followed in this regard. [7]

(b) Mr. MKS was a member of the Competition Commission of India. He ceased to be such member on 31st May, 2013. Thereafter, he was offered the post of Executive Director with appropriate remuneration and perquisites in the following organizations to join his duties on and from 1st September, 2013:

- **(i) HIL Ltd, a private sector public limited company, whose case was disposed off by the Competition Commission under the provisions of the Competition Act, 2002 in the month of March, 2013.**
- **(ii) Life Insurance Corporation of India. [3]**

(c) The Balance Sheet of M/s. Quick Bucks Ltd. As at 31.3.2013 disclosed the following details :
(i) Share Capital Rs. 200 Crores
(ii) Reserves and Surplus Rs. 800 Crores
The company has issued in the year 2008, fully convertible debentures of Rs. 150 Crores, which are due for conversion in the year 2013. The company proposes to issue bonus shares in the ratio of 1:1. Explain briefly the SEBI guidelines to be followed by the company. [5]

Answer 3 (a):

As per section 6, the Reserve Bank may, by regulations, prohibit, restrict, or regulate establishment in India of a branch, office or other place of business by a person resident outside India, for carrying on any activity relating to such branch, office or other place of business. In exercise of such power, the Reserve Bank of India has framed Foreign Exchange Management (Establishment in India of Branch or Office or other Place of Business) Regulations, 2000.

The provisions of Foreign Exchange Management (Establishment in India of Branch or Office or other Place of Business) Regulations, 2000 are explained below:

1. RBI may permit a company engaged in manufacturing and trading activities abroad to set up Branch Office in India with the following objectives:
   (a) To represent the parent company or other foreign companies in various matters in India, e.g., acting as buying or selling agents in India.
   (b) To conduct research work in the area in which the parent company is engaged.
   (c) To undertake export and import trading activities.
   (d) To promote possible technical and financial collaborations between the Indian companies and overseas companies.
   (e) Rendering professional or consultancy services.
   (f) Rendering services in information technology and development of software in India.
   (g) Rendering technical support to the products supplied by the partner or group companies.
2. Approval of the RBI is required for establishment in India of branch or office or other place of business by a person resident outside India.
3. A person resident outside India desiring to establish a branch or liaison office in India shall apply to the RBI in Form No. FNC 1.
4. A foreign company may open Branch Office in India if all the following conditions are satisfied:
   (a) The office can act as a channel of communication between the Head Office abroad and parties in India. It is not allowed to undertake any business activity in India and cannot earn any income in India.
   (b) Expenses of the Branch Office are to be met entirely through inward remittances of foreign exchange from the Head Office abroad.
   (c) Permission to set up Branch Office is initially granted for a period of 3 years and this period may be extended from time to time by the Regional Office in whose jurisdiction the Branch Office is set up.
   (d) The Branch Office shall file with the concerned Regional Office an Annual Activity Certificate issued by a Chartered Accountant.

1. No approval of the RBI is necessary for a banking company if such company has obtained necessary approvals under the provisions of the Banking Regulation Act, 1949.
2. No approval of the RBI is necessary for establishment of a branch or unit in Special Economic Zones to undertake manufacturing and service activities, if the following conditions are satisfied:
   (a) Such units are functioning in those sectors in which 100% Foreign Direct Investment (FDI) is permitted.
   (b) Such units comply with Part IX of the Companies Act, 1956 (Sections 592 to 602).
   (c) Such units function on a stand-alone basis, i.e., such unit will be isolated and restricted to the Special Economic Zone alone and no business activity or transaction will be allowed outside the Special Economic Zones in India.
   (d) In the event of winding up of business and for remittance of winding up proceeds, the branch shall approach an authorised dealer.

Answer 3 (b):

As per Section 12, the Chairperson and other members shall not, for a period of two years, accept any employment connected with the management or administration of any enterprise which has been a party to any proceeding before the Commission under this Act. However, the said restriction shall not apply where the Chairperson or any member is offered an employment in a corporation established by or under any Central, State or Provincial Act.

In the present case, HIL Ltd. Is an enterprise which has been a party to any proceeding before the Commission. Therefore, Mr. MKS cannot join HIL Ltd. Upto 31st May, 2015 (i.e., upto 2 years of cessation of his office of member). However, LIC is a corporation established by a Central Act,

and so the restriction on employment of Chaiman or a member shall not apply where appointment is made in LIC. Therefore, Mr. MKS can join LIC.

Answer 3 (c):

Chapter IX consisting of Regulations 92 to 95 of Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements)Regulations, 2009 contains the Regulations for issue of bonus shares.

Applying the provisions contained in these Regulations to the given problem, M/s. Quick Bucks Ltd. can make a bonus issue in the ratio of 1:1 as follows :

(i) The articles of M/s. Quick Bucks Ltd. must authorize it to issue the bonus shares, if there is no provision in the articles authorizing the company to issue bonus shares, firstly, the articles shall be amended by passing a special resolution.

(ii) Steps for determining whether any increase in Authorised share capital is required.

(a) Paid up share capital as on 31st March, 2013 — 200 Crores

(b) Paid up capital (after conversion of Rs. 150 crores fully convertible debentures, assuming that these debentures shall be converted into share capital of Rs. 100 crores) — 350 Crores

(c) Proposed bonus issue – 1 share for every share held

(d) Post bonus issue capital — 700 Crores

Assumed that authorized share capital of M/s. Quick Bucks Ltd. is Rs. 700 crores, or more, no increase in authorized share capital is required.

(iii) Sources of issue of bonus shares

Reserve and surplus (since free reserves built out of the genuine profits can be used for issue of bonus issue) — 800 Crores

Since the sources for issue of bonus shares (Rs. 800 crores) is sufficient to issue bonus shares (Rs. 350 crores), the proposed issue can be made.

(iv) Other legal requirements for issue of bonus shares are as under

(a) A resolution shall be passed by the Board in a duly convened Board meeting

(b) The bonus shall be issued within 6 months of passing the board resolution

(c) After the issue of bonus shares, the company shall file with SEBI a compliance certificate duly signed by the statutory auditor of the company or a secretary in whole time practice.

(v) The bonus issue can be made if there is o default in

(a) Payment of interest or principal in respect of fixed deposits and interest on existing debentures or principal on redemption thereof; and

(b) Payment of statutory dues of the employees such as contribution to provident fund, gratuity, bonus etc.

4. (a) Three persons X, Y and Z formed a scheme of developing barren land. Under the scheme, X and Y were to incorporate a company and Z, a professional, was to provide loan equivalent to the capital brought in by X and Y. The loan part was essential for giving shape to the scheme. Can Z be regarded as one of the promoters of the company ? [4]

(b) A Public Company has been declaring dividend at the rate of 20% on equity shares during the last 5 years. The company has not made adequate profits during the year ended 31, 2013, but it has got adequate reserves which can be utilized for maintaining the rate of dividend at 20%. Advise the company as to how it should go about if it wants to declare dividend at the rate of 20% for the year 2012-13. Would your answer be different if the company utilized only the profits made in the previous years and retained in the profit and loss account for the purpose of payment of dividend at the rate of 20% for the year 2012-13? [7]

(c) The Directors of Khalsa Electronics Ltd. allotted to themselves certain Rights Shares for which no application was made by certain shareholders as required u/s 81. Discuss the validity of their action specially in view of the fact that market price of shares of his company is 40% above par. [4]

Answer 4 (a):

The expression 'promoter' has not been defined under the Companies Act. Section 62(6) (a) defines the expression 'promoter' to mean a promoter who was a party to the preparation of the prospectus or of a portion thereof containing the untrue statement, but does not include any person by reason of his acting in a profession capacity in procuring the formation of the company.

To be a promoter one need not necessarily be associated with the initial formation of the company, one who subsequently helps to arrange floating of its capital will equally be regarded as a promoter. A person who does not take a prominent part may also have so acted in the formation of a company as to bring himself under the term promoter.

However, the person assisting the promoters by acting in a professional capacity do not thereby become promoters themselves. Thus, a solicitor who drafts the articles or the accountant who values assets of a business to be purchased are merely giving professional assistance to the promoter. However, where he goes further than this, for example, by introducing his clients to a person who may be interested in purchasing shares in the proposed company, he would be regarded as promoter.

In the given case, the scheme is such that it cannot be completed without the loan being provided by Z to the company and Z has already agreed to provide loan to the company on incorporation. Therefore, Z has necessarily participated in the formation of the company even though not being in professional capacity. Hence, Z can be regarded as a Promoter of the company.

Answer 4 (b):

The fundamental principle with respect to payment of dividend is that dividend is to be paid only out of profits. In other words, the dividend can be paid only out of the following sources :

(i) Profits of current financial year
(ii) Undistributed profits of previous financial years, i.e., accumulated profits of previous years
(iii) Moneys provided by the Central Government or State Government in pursuance of a guarantee given by it.

Payment of dividend out of reserves :

Dividend can be declared out of the profits transferred to the reserves only if

(i) Previous approval of the Central Government is obtained; or
(ii) Such payment is made in accordance with such rules as may be prescribed by the Central Government this behalf, i.e., The Companies (Declaration of Dividend out of Reserves) Rules, 1975, which are detailed hereunder :

In the event of inadequacy of absence of profits in any year, a company may declare dividend out of the accumulated profits earned by it is previous years and transferred by it to the reserves, subject to the following conditions :

(i) The rate of dividend must not exceed the lower of –
  (a) Average of the rates of dividend declared by the company in immediately preceding 5 financial years; or
  (b) 10%
(ii) The amount to be withdrawn from reserves must not exceed 1/10 th of aggregate of paid up capital and free reserves. Further, the amount so withdrawn shall be first utilized to set off the losses incurred in the financial year, and the balance amount can only be utilized for the declaration of dividend.

(iii) The balance of reserves after such withdrawal, shall not fall below 15% of paid up share capital.

In the present case, the company intends to distribute dividend at the rate of 20%. But as per the provisions discussed in point (i) above, the rate of dividend declared cannot exceed 10%, i.e., the rate of dividend declared out of reserves can be a maximum of 10%. Thus, the company cannot declare dividend @ 20% out of reserves.

Payment of dividend by utilizing credit balance of Profit and Loss Account

Carried forward profits which have not been transferred to the reserves (i.e., credit balance in the Profit and Loss Account) can be utilized for payment of dividend without any restriction. Such utilization would not amount to withdrawal of profits from reserves.

Thus, the company can declare dividend @ 20% for the year 2012-13 out of accumulated profits retained in the Profit and Loss Account without any restriction.

Answer 4 (c):

"Right" refers to the entitlement of the existing shareholders to receive invitation of offer or subscription to the shares of a company in case of further issue of capital by the company, before being offered to others. This is called as the 'Right of pre-emption'.

If the shareholder does not inform the company of his decision within the stipulated time, he shall be deemed to have declined the offer. If the shareholder declines or is deemed to have declined or if the person in whose favour the renunciation is made declines to buy the shares, the company's directors may dispose of those shares in such manner as they may think fit.

If a member did not respond to offers made by company, it has to be necessarily held that he was not inclined to subscribe to additional shares, thereby impliedly consenting for allotment of shares to others **[R. Khemka v. Deccan Enterprises (P) Ltd. 1998 16 SCL 1 (AP)]**

In the given case the Directors of Khalsa Electronics Ltd. allotted to themselves certain Rights Shares for which no application was made by certain shareholders as required u/s 81. With the reference to the above discussion it can be said that the allotment would be valid unless it is proved that the shares were allotted to Directors on terms unfavourable to the company.

5. (a) Can an auditor be disqualified for indebtedness in the following cases?

(i) Where he is recovering his fees on a progressive basis even though the job is not complete.

(ii) Where the auditor's firm has purchased goods from the auditee company and not paid for them for over six months. [4]

(b) A company wants to provide financial assistance to its employees to enable them to subscribe for fully paid shares of the company. Does it amount to purchase of its own share? If, the instant case, the company itself purchases to redeem its Preference Shares, does it amount to acquisition of its own shares ? [4]

(c) Indian citizens incorporated a company in London for the purpose of carrying on business there. Examine with reference to the relevant provisions of the Companies Act, 1956 whether it is a "Foreign Company". What would be your answer in case the London company was incorporated by a company registered in India ? [4]

(d) on 1st January 2013 the Board of Directors of Amir Co Ltd. Appointed Mr. J as sole selling agent of the accompany for a period of 4 years. On 8th March 2013, Amir Co Ltd. In its general meeting disapproved the appointment of Mr. J as sole selling agent of the company.

(i) What are the circumstances when compensation for loss of office is prohibited to a sole selling agent ?

(ii) Is Mr. J entitled to payment of compensation for loss of office ? [3]

Answer 5 (a):

As per section 226(3), a person who is indebted to the company for an amount exceeding ₹1,000 shall be disqualified for appointment as an auditor.

The answer to the given problem is as under:

(i) An auditor can receive the audit fees on a progressive basis in accordance with a resolution passed by the general meeting even though the audit is not complete. In such a case, he cannot be said to indebted to the company and thus he does not vacate his office.

(ii) Where an auditor purchases goods from the company on credit he will be said to be indebted to the company in respect of such credit purchases, notwithstanding the fact that such credit period is normally allowed to all the customers by the company [ICAI, Guidance Note on Independent Auditors]. Where the firm is indebted to the company, each and every partner of the firm is deemed to have been indebted. Thus, if the amount outstanding exceeds ₹1,000 the auditor shall vacate his office.

Answer 5 (b):

Sub section (2) of Section 77 disallows a public company and a private subsidiary of a public company to give loan or provide financial assistance (directly or indirectly) to any person to enable him to purchase or subscribe company's own shares or shares of its holding company. Thus, whereas companies have now been allowed to purchase their own shares, they are still not permitted to finance the purchase of their shares, directly or indirectly.

However, the aforesaid provisions regarding the prohibition to buy its own shares or give loans or provide financial assistance shall not affect the making by a company of loans to persons (other than directors or managers) bona fide in the employment of the company or its holding company to be held by themselves by way of beneficial ownership.

However, the loan made to any employee for this purpose shall not exceed his salary or wages at that time for a period of six months [Sec 77 (3)].

In the given case, providing financial assistance to its employees to enable them to subscribe for fully paid shares of the company will not amount to purchase of own shares.

Section 77 applies both for Preference and Equity Shares. However, redemption of Preference Shares is not in violation of Section 77.

Answer 5 (c):

As per Section 591, a company shall be a foreign company if –

(i) It is incorporated outside India; and

(ii) It has established a place of business in India

Thus, for deciding as to whether a company is a foreign company or not, the criterion is to see as to whether the company has established a place of business in India or not, and not the persons who have incorporated the company.

In this case, Indian citizens have formed a company outside India. Since, the company has not established any place of business in India, the company cannot be said to be a foreign company. The fact that Indian citizens have formed a company in a foreign country is immaterial in deciding whether the company is a foreign company or not.

The answer have remained same even if the London company had been incorporated by a company registered in India for the same reason as stated above.

Answer 5 (d):

As per section 294A, a sole selling agent shall not be entitled to any compensation for premature termination of the agency brought about in any of the following circumstances :

(i) Where the appointment of sole selling agent is not approved in the first general meeting held after his appointment.
(ii) Where the sole selling agent resigns because of the reconstruction or amalgamation of the company and is appointed as the sole selling agent of the reconstructed or amalgamated company.
(iii) Where the sole selling agent resign voluntarily.
(iv) Where the sole selling agent is guilty of fraud or breach of trust or gross negligence in the conduct of his duties.
(v) Where the sole selling agent has instigated or is directly or indirectly responsible for the termination of the sole selling agency.

6. (a) After serious disagreement and difference of opinion among the shareholders of the company in the last annual general meeting, some of the directors took the steps as noted below. Discuss the validity and effect of the following:

(i) Mr. John, the managing director sends his notice of resignation.
(ii) Mr. Paul, an ordinary director verbally resigns and not in writing.
(iii) Mr. David, another ordinary director, had sent his resignation, but withdrew it before the Board meeting was held for accepting his resignation. [6]

(b) M/s ABC Ltd. had power under its memorandum to sell its undertaking to another company having similar objects. The Articles of the company contained a provision by which directors were empowered to sell or otherwise deal with the property of the company. The Shareholders passed an ordinary resolution for the sale of its assets on certain terms and required the directors to carry out the sale. The Directors refused to comply with the wishes of the shareholders where upon it was contended on behalf of the shareholders that they were the principal and directors being their agents were bound to give effect to their decision. Based on the above facts, decide the following issues, having regard to the provisions of the Companies Act, 1956 and case laws.

(i) Whether the contention of shareholders against the non-compliance of their wishes by the directors is tenable.
(ii) Can shareholders usurp the powers which by the articles are vested in the directors by passing a resolution in the general meeting? [6]

(c) All statements in a prospectus issued by ABC Co Ltd. were literally true, but it failed to disclose that the dividends stated in it as paid were not paid out of trading profits, but out of realized capital profits. An allottee of shares wanted to avoid the contract on the ground that the prospectus did not disclose this fact which, in his opinion, was very material. Would he succeed? [3]

Answer 6 (a):

The resignation takes effect immediately without any need for its acceptance where the articles do not contain any provision relating to resignation of directors or where the articles allow the director to resign at any time. However, a managing director cannot resign by merely sending a resignation. His resignation becomes effective only when the company accepts the resignation and relieves him from the office. This is because he occupies two positions, viz., one that of a director and other that of an employee of the company. An employee cannot resign at his pleasure by giving notice. Instead, his resignation is required to be approved and accepted by

the company to relieve him from his duties and responsibilities **[Achutha Pai v ROC(1966) 36 Comp Cas 598].**

Any form of resignation, whether oral or written, is sufficient, provided the intention to resign is clear. However, it is advisable that the resignation is in writing and states the time from which it is to take effect. A verbal resignation shall be effective, if it is made in the general meeting and is accepted at the general meeting **[Latchford Premier Cinema Ltd. v Ennion (1931) 2 Ch 409]**. A resignation once made cannot be withdrawn except with the consent of the shareholders or the Board of directors even if such withdrawal is sought before the general meeting or the Board considers the resignation **[Glossop v Glossop (1907) 2 Ch 370].**

Thus, in the given problem –

(i) The managing director, Mr. John, cannot resign merely by giving a notice. He shall continue as managing director until his resignation is accepted.

(ii) Mr. Paul is an ordinary director and so a verbal notice of resignation is sufficient in his case. The resignation shall be effective from the date of notice of resignation.

(iii) Mr. David cannot withdraw his resignation without the consent of the company even though such withdrawal was sought before the Board considered his resignation.

Answer 6 (b):

The Board has the absolute power to do all things other than those that are expressly required to be done by the company in general meeting **(Section 291).**

As per section 293, without the prior consent of the shareholders in general meeting, Board shall not sell, lease or otherwise dispose of the whole, or substantially the whole, of one or more undertakings of the company. The section has been framed negatively; it states that Board shall not exercise such power without the concurrence of the shareholders in general meeting. It does not imply that a consent or even a direction by the shareholders would make it obligatory on the Board to exercise such power.

The power to sell the assets of the company is vested in the Board of directors. If in the opinion of the Board, it is not in the best interest of the company to sell its assets, the Board is not bound to do so, notwithstanding the fact that the company in general meeting has resolved that the assets should be sold **[Pothen v Hindustan Trading Corpn. (P) Ltd. (1967) 37 Comp Cas 6 (Ker)].**

The given problem is answered as follows:

(i) The Board is the supreme body having the management of the company. The Board has the absolute power to do all things except those that are expressly required to be done by the company in general meeting. The shareholders cannot interfere in the day to day management of the company. The shareholders cannot supersede or usurp the Board's powers, or instruct it as to how it shall exercise its powers.

Also, as per Sec. 293, the power to sell, lease or otherwise dispose of any undertaking of the company is vested with the Board, though the Board can exercise such power only with the consent of the shareholders in general meeting. Thus, it is evident that a direction by the shareholders does not make it obligatory for the Board to exercise such power.

If in the opinion of the Board, it is not in the best interest of the company to sell its assets, the Board is not bound to do so, notwithstanding the fact that the company in general meeting has resolved that the assets should be sold **[Pothen v Hindustan Trading Corpn. (P) Ltd.].**

Thus, the contention of the shareholders is not tenable.

(ii) The powers of management are vested in the Board of directors; the Board alone can exercise such powers. Even a unanimous resolution of the shareholders will not enable the shareholders to exercise the powers of the Board. The shareholders cannot interfere in the day to day management of the company. Thus, the shareholders cannot usurp the powers vested in directors.

Answer 6 (c):
According to section 65(1) of the Companies Act, 1956 where the omission from a prospectus of any matter is calculated to mislead the prospectus shall be deemed in respect of such omission, to be a prospectus in which an untrue statement is included.
The given problem is based on the facts of **Rex v Kylsant [1932] 1 K.B. 42** where all the statements included in the prospectus issued by the company were literally true. One of the statements disclosed the rates of dividends paid for a number of years. But, dividends had been paid not out of trading profits but out of realized capital profits. This material fact was not disclosed. Held, that the prospectus was false in material particulars and Lord Kylsant, the managing director and chairman, who knew that it was false, was held guilty of fraud.
So, in the given case, the allottee can avoid the contract on the same ground.

SECTION B

[Answer any five questions from Q.No.7 (a) to (f)]

7. (a) Describe the role of stock exchange in Corporate Governance ? [5]

(b) What is the relationship between CSR and sustainability ? [5]

(c) Why Corporate Governance is required in Banks ? [5]

(d) What are the difficulties encountered in governance in state owned business ? [5]

(e) Corporate Social Responsibility is not charity – explain. [5]

(f) Write short note on Corporate Citizenship. [5]

Answer 7 (a):
Stock exchanges have established themselves as promoters of corporate governance recommendations for listed companies. Demutualisation and the subsequent self-listing of exchanges have spurred debate on the role of exchanges. The conversion of exchanges to listed companies is thought to have intensified competition. And, the sharper competition has forced the question of whether there is a risk of a regulatory "race to the bottom".

Also exchanges are uneasy about the prospect of having to continue performing their traditional regulatory and other corporate governance enhancing functions amid a shrinking revenue base. Therefore extension of role and wider responsibility are always welcome.

Following points show relevance of role of Stock Exchanges' in the Corporate Governance:
1.Stock exchanges in the region developing rapidly; new exchanges being established
2. Stock exchanges remain government owned entities
3. CG codes proliferating, some no longer voluntary
4. Regulatory or enforcement powers of exchanges limited
5. Room for strengthening of listing rules
6. Disclosure of listed companies requires further attention
7. No evidence of race to the bottom, need to align with industry peers

THE TRADITIONAL ROLE OF EXCHANGES IN CORPORATE GOVERNANCE

Historically, the main direct contribution of exchanges to corporate governance has been listing and disclosure standards and monitoring compliance. The regulatory function of stock exchanges was in the past mostly limited to issuing rules and clarifying aspects of existing frameworks. The standard-setting role of stock exchanges was essentially exercised through the issuance of listing, ongoing disclosure, maintenance and de-listing requirements. On the enforcement side, stock exchanges have shared their regulatory function with capital market supervisory agencies. In addition to overseeing their own rules, stock exchanges were assigned the role of monitoring the compliance with legislation and subsidiary securities regulation. Since the promulgation of the SEBI, stock exchanges have often enlarged their regulatory role to embrace a wider palette of corporate governance concerns. They have contributed to the development of corporate governance recommendations and encouraged their application to listed companies. The objective of the following part of the article is to summarize these key channels for exchanges' contributions to good corporate governance in listed companies.

THE EVOLVING ROLE OF EXCHANGES IN RESPECT OF CORPORATE GOVERNANCE

1. Exchanges act as a source of corporate governance related regulation

Exchanges provide complementary rationales for establishing themselves as a source of corporate governance-related regulations. In essence, by raising transparency and discouraging illegal or irregular practices, exchanges are act as regulatory authorities. The regulatory function of exchanges is exercised in the context of an existing legal framework. Exchanges' ability to introduce and enforce regulations is obviously circumscribed by the authority of the relevant market regulators. To the extent that the relevant laws or securities regulation already address corporate governance of listed companies, the role of exchange regulation can therefore only be complementary. For instance, rules on prospectus issuance follow largely from SEBI Prospectus Directive which may have further limited the scope of standards setting by exchanges. Even in jurisdictions where exchanges are empowered to issue regulations, they may be subject to an approval by another regulatory authority, e.g., in the India, proposed changes to exchange rules must be filed with the SEBI.

2. Exchanges played a central role in the effective implementation of national corporate governance codes

"Corporate Governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society." One of the first among such endeavors was the CII Code for Desirable Corporate Governance developed by a committee chaired by Rahul Bajaj. The committee was formed in 1996 and submitted its code in April 1998. Later SEBI constituted two committees to look into the issue of corporate governance – the first chaired by Kumar Mangalam Birla that submitted its report in early 2000 and the second by Narayana Murthy three

years later. The SEBI committee recommendations have had the maximum impact on changing the corporate governance situation in India. The Narayana Murthy committee worked on further refining the rules. The Exchange has brought about unparalleled transparency, speed & efficiency, safety and market integrity. It has set up facilities that serve as a model for the securities industry in terms of systems, practices and procedures.

3. Compliance requirements

Listed companies have to comply with rules and regulations of concerned stock exchange and work under the vigilance (i.e. supervision) of stock exchange authorities. Clause 49 of the listing agreement with stock exchanges provides the code of corporate governance prescribed by SEBI for listed Indian companies. With the introduction of clause 49, compliance with its requirements is mandatory for such companies. Exchanges have played a pioneering role in the development of the Indian securities market.

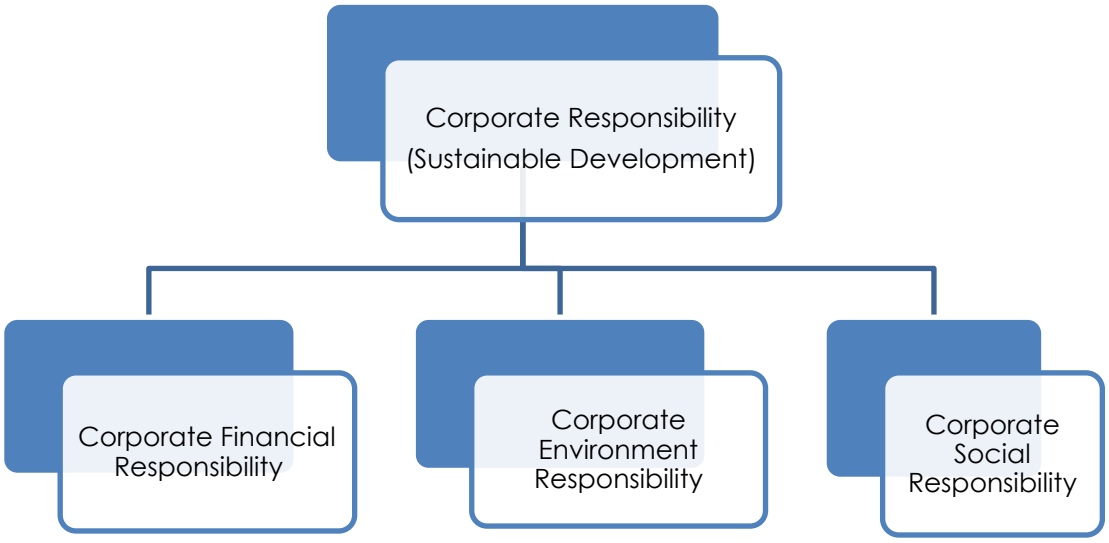
4. Awareness raising efforts have also played a role

Some exchanges have been actively involved in increasing the awareness around the value of good corporate governance. For instance, The National Stock Exchange (NSE) a leading stock exchange covering various cities and towns across the country has established & organized training sessions and other educational projects in order to increase the awareness of securities market & good governance practices and the Code of Best Practice for Listed Companies. Such programmes not only serve the general public but also require corporates to maintain good governance in light of investor awareness. In the same way an equally important accomplishment of BSE Limited is its nationwide investor awareness campaign - "Safe Investing in the Stock Market" under which awareness campaigns and dissemination of information through print and electronic medium is undertaken across the country. BSE Limited also actively promotes the securities market awareness campaign of the Securities and Exchange Board of India.

Answer 7 (b):

Relation between CSR & Sustainable Development

CSR is an integral part of sustainable development. Exactly where it fits in is vigorously debated, mainly because the concept of sustainable development also has many different interpretations. This diagram, illuminates CSR's relationship with sustainable development.



The basic idea to incorporate the sustainability aspect into business management should be grounded in the ethical belief of give and take to maintain a successful company in the long-term. As the company is embedded in a complex system of interdependences in- and outside the firm, this maintaining character should be fulfilled due to the company's commitment in protecting the environment or reducing its ecological footprint and due to the general acceptance of its corporate behaviour by society in- and outside of the firm.

It is recommended that CSR is to be used as social strand of the SD-concept which is mainly built on a sound stakeholder approach. CSR focus especially on the corporate engagement realizing its responsibilities as a member of society and meeting the expectations of all stakeholders.

The concept of SD on a corporate level is stated as Corporate Sustainability which is based on the three pillars economic, ecological and social issues, therefore, the social dimension is named CSR. The corporate orientation on sustainability is specially affected by external influences due to the specific sustainability orientation on a macro-level:
Legal/Institutional: laws, human rights, etc.
Technological: new technologies
Market: suppliers, competitors, customers, trends
Societal: NGO's, society
Cultural: attitudes, behavior
Environmental: nature, availability of resources

Answer 7 (c):
If we examine the need for improving corporate governance in banks, two reasons stand out: (i) Banks exist because they are willing to take on and manage risks. Besides, with the rapid pace of financial innovation and globalisation, the face of banking business is undergoing a sea-change. Banking business is becoming more complex and diversified. Risk taking and management in a less regulated competitive market will have to be done in such a way that investors' confidence is not eroded, (ii) Even in a regulated set-up, as it was in India prior to 1991, some big banks in the public sector and a few in the private sector had incurred substantial losses. This, along with the massive failures of non-banking financial Companies (NBFCs), had adversely impacted investors' confidence.

Moreover, protecting the interests of depositors becomes a matter of paramount importance to banks. In other corporates, this is not and need not be so for two reasons: (i) The depositors collectively entrust a very large sum of their hard-earned money to the care of banks. It is found that in India, the depositor's contribution was well over 15.5 times the shareholders' stake in banks as early as in March 2001. This is bound to be much more now. (ii) The depositors are very large in number and are scattered and have little say in the administration of banks. In other corporates, big lenders do exercise the right to direct the management. In any case, the lenders' stake in them might not exceed 2 or 3 times the owners' stake.

Banks deal in people's funds and should, therefore, act as trustees of the depositors. Regulators the world over have recognised the vulnerability of depositors to the whims of managerial misadventures in banks and, therefore, have been regulating banks more tightly than other corporates.

To sum up, the objective of governance in banks should first be protection of depositors' interests and then be to "optimise" the sharehodlers' interests. All other considerations would fall in place once these two are achieved.

As part of its ongoing efforts to address supervisory issues, the Basel Committee on Banking Supervision (BCBS) has been active in drawing from the collective supervisory experience of its members and other supervisors in issuing supervisory guidance to foster safe and sound banking practices. The committee was set up to reinforce the importance for banks of the OECD principles, to draw attention to corporate governance issues addressed by previous committees, and to present some new topics related to corporate governance for banks and their supervisors to consider.

Banking supervision cannot function effectively if sound corporate governance is not in place and, consequently, banking supervisors have a strong interest in ensuring that there is effective corporate governance at every banking organisation. Supervisory experience underscores the necessity of having the appropriate levels of accountability and checks and balances within each bank. Put plainly, sound corporate governance makes the work of supervisors infinitely easier. Sound corporate governance can contribute to a collaborative working relationship between bank management and bank supervisors.

Answer 7 (d):

While routine governance regulations become applicable for public sector companies formed under the Companies Act, 1956 and come under the purview of SEBI regulations the moment they mobilize funds from the public, the typical organizational structure of PSUs makes it difficult for the implementation of corporate governance practices as applicable to other publicly-listed private enterprises. The typical difficulties faced are:

- The board of directors will comprise essentially of bureaucrats drawn from various ministries which are interested in the PSU In addition, there may be nominee directors from banks or financial institutions who have loan or equity exposures to the unit. The effect will be to have a board much beyond the required size, rendering decision-making a difficult process.
- The chief executive or managing director (or chairman and managing director) and other functional directors are likely to be bureaucrats and not necessarily professionals with the required expertise. This can affect the efficient running of the enterprise.
- Difficult to attract expert professionals as independent directors. The laws and regulations may necessitate a percentage of independent component on the board; but many professionals may not be enthused as there are serious limitations on the impact they can make.
- Due to their very nature, there are difficulties in implementing better governance practices. Many public sector corporations are managed and governed according to the whims and fancies of politicians and bureaucrats. Many of them view PSUs as a means to their ends. A lot of them have turned sick due to overdoses of political interference, even when their areas of operations offered enormous opportunities for advancement and growth. And when the economy was opened up, many of them lacked the competitiveness to fight it out with their counterparts from the private sector.

Answer 7 (e):

The originally defined concept of CSR needs to be interpreted and dimensionalised in the broader conceptual framework of how the corporate embed their corporate values as a new strategic asset, to build a basis for trust and cooperation within the wider stakeholder community.

Though there have been evidences that record a paradigm shift from charity to a long-term strategy, yet the concept still is believed to be strongly linked to philanthropy. There is a need to bring about an attitudinal change in people about the concept.

By having more coherent and ethically driven discourses on CSR, it has to be understood that CSR is about how corporates place their business ethics and behaviors to balance business growth and commercial success with a positive change in the stakeholder community.

Several corporates today have specific departments to operationalise CSR. There are either foundations or trusts or a separate department within an organisation that looks into implementation of practices.

Being treated as a separate entity, there is always a flexibility and independence to carry out the tasks.

But often these entities work in isolation without creating a synergy with the other departments of the corporate. There is a need to understand that CSR is not only a pure management directive but it is something that is central to the company and has to be embedded in the core values and principles of the corporate.

Whatever corporates do within the purview of CSR has to be related to core business. It has to utilise things at which corporates are good; it has to be something that takes advantage of the core skills and competencies of the companies. It has to be a mandate of the entire organisation and its scope does not simply begin and end with one department in the organisation.

While conceptualisation and implementation seem firmly underway, evaluation is still taking a back seat. There is a need to incorporate an evaluation plan, which along with presenting a scope of improvement in terms of fund utilisation and methodology adopted for the project, measures the short and long term impact of the practices.

While there have been success stories of short term interventions, their impact has been limited and have faded over a period of time. It is essential for corporates to adopt a long term approach rather than sticking to short term interventions, involving the companies and employees in the long-term process of positive social transition.

A clearly defined mission and a vision statement combined with a sound implementation strategy and a plan of action firmly rooted in ground realities and developed in close collaboration with implementation partners, is what it takes for a successful execution of CSR.

An area that can be looked upon is the sharing of best practices by corporates. A plausible framework for this could be bench-marking. While benchmarking will help corporates evaluate their initiatives and rank them, it will also provide an impetus to others to develop similar kind of practices. Credibility Alliance, a consortium of voluntary organisations follows a mechanism of accreditation for voluntary sector. Efforts have to be directed towards building a similar kind of mechanism for CSR as well.

Sustainable development, like building a successful business, requires taking the long-term view. The KPMG International Survey of Corporate Responsibility Reporting 2005 showed that voluntary reporting on sustainability is on the increase across all the countries. Sustainability Reporting is emerging as a key vehicle to implement CSR and measure its progress in organisations.

As we move forward, increasing numbers of companies are expected to issue Sustainability Reports, with the scope of issues broadening from purely environmental reporting to a more comprehensive coverage of the environmental, social and economic dimensions.

There is a strong corporate initiative on joining the Global Compact Society in India, as well, with 43 Indian companies having already joined Global Compact as of January 2008.

Answer 7 (f):

A new terminology that has been gaining grounds in the business community today is Corporate Citizenship. So what is corporate citizenship and is this fundamentally different from corporate social responsibility? Corporate citizenship is defined by the Boston College Centre for Corporate Citizenship, as the business strategy that shapes the values underpinning a company's mission and the choices made each day by its executives, managers and employees as they engage with society.

According to this definition, the four key principles that define the essence of corporate citizenship are: (i) Minimise harm (ii) Maximise benefit (iii) Be accountable and responsive to key stakeholders (iv) Support strong financial results.

Thus, corporate citizenship, similar to its CSR concept, is focusing on the membership of the corporation in the political, social and cultural community, with a focus on enhancing social capital. Notwithstanding the different terminologies and nomenclature used, the focus for companies today should be to focus on delivering to the basic essence and promise of the message that embodies these key concepts – CSR and Corporate Citizenship.