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

Question 1:
Mr. Anand is an auditor and he has ventured newly into this area. He is having the following issues in his mind. You are requested to guide him in resolving his issues, stating relevant sections and laws.

a) He wishes to undertake audit work as well as work as employee with Firm ABC, an auditing firm.
b) He wishes to join Firm ABC as a partner, what would be his ceiling limit.
c) He wants to compute and understand which of the following companies shall be/ not be taken into consideration for calculating specified number of audits.
  i) Audit of a Private Company
  ii) Guarantee Companies not having Share Capital
  iii) Audit of a Non-Profit Company
  iv) Special Audits
  v) Audit of foreign companies
  vi) Branch Audits
  vii) Company Audit where he is appointed as a Joint Auditor.
d) He wants to know, that as a member of ICAI, is there any other restrictions on him as a matter of self regulation in matter of inclusion/exclusion of audit of Private Companies for calculating the specified number of assignments.
e) Would the rules be different from case (d) above had he joined a CA Firm.
f) He also wishes to accept an offer to become the first auditor of Xee Ltd. What are the procedures that the Board of Directors and Mr. Anand need to undertake.

[1+2+3+1+4+4]

Answer:

(a) Restriction on Appointment [Sec.224(IB)]: No Company or its Board of Directors shall appoint or re-appoint any person or Firm as its Auditors if -,

(a) Such person is in full time employment elsewhere, or
(b) Such person or Firm holds the office of Auditor of the specified number of Companies or more than the specified number of Companies.

In the case of a Firm of Auditors, 'Specified Number of Companies' means the number of Companies specified for every Partner of the Firm who is not in full time employment elsewhere.

Hence, Mr. Anand cannot undertake the work of audit and be employed with Firm ABC at the same time.

(b) Ceiling Limit: The ceiling limit is 20 Company Audits per person. Of this 20, not more than 10 shall be in respect of Companies having Paid-Up Capital of ₹ 25 Lakhs or more. Further, in addition to this, Mr. Anand has to keep the following points in mind –

Situation	Ceiling Limit
(i) If he works for Firm ABC, and Firm ABC is a Partnership Firm	Ceiling Limit shall be 20 Company Audits per Partner who is not in full-time employment elsewhere.
(ii) When he is a Partner in a number of Firms including Firm ABC	Ceiling Limit shall be 20 Company Audits on his account in all the Firms together in which he is Partner or Proprietor.
(iii) Where he is a Partner of Firm ABC and also holds office in his individual capacity	Ceiling Limit shall not exceed 20 Company Audits in his individual capacity and all Firms taken together.

(c) Computation of Ceiling Limit:

Included Audits	Excluded Audits
i) Part Audit: When an Auditor is appointed to audit even a part of a Company's accounts, the part will be considered as a unit of audit for the purpose of calculation of the ceiling. **ii) Joint Audit**: When two or more Auditors are appointed as Auditors, each of the Joint Auditors is considered a Part Auditor for the purpose. Hence, any joint audit held by an Auditor will be included as one audit unit. **iii) Sec.25 Companies:** Audit of Non-Profit Companies would be included for the purpose of ceiling.	**i) Branch Audit:** Audit of a Branch of Company is not included in the computation of the ceiling. **ii) Audit of Corporations**, which are not Companies, shall not be included for ceiling purpose. **iii) Audit of Foreign Companies** shall not be included. **iv) Guarantee Companies:** Company Limited by Guarantee and not having Share Capital will not be included in the ceiling. **v) Private Companies:** Audit of Private Limited Companies will not be included for ceiling u/s 224(1B). **vi) Special Audit** u/s 233A or Investigation of Companies will not be included for ceiling purposes.

Hence the following would not be included in computing the ceiling limit.

i) Audit of a Private Company
ii) Guarantee Companies not having Share Capital
iii) Special Audits
iv) Audit of foreign companies
v) Branch Audits

(d) Restrictions as per ICAI Notification 53/ 2001: As per the ICAI Notification, a CA in practice will be guilty of professional misconduct, if he holds at any time, the appointment of more than 30 audit assignments, including audit of Private Companies. This restriction is intended to uphold the principles of fairness and to provide equitable opportunities to all practicing members. [Note: This provision is an additional restriction under the CA Act and does not override the Companies Act.]

(e) In case of a CA Firm:

1. In case of CA Firm, the ceiling limit is 30 Audits per Partner, including audit of Private Companies.
2. Where a member is a Partner in more than one CA Firm, all the Firms in which he is a Partner will be together entitled to 30 Company audits in his account.
3. Where a Partner of a Firm also accepts audits in his individual capacity / Proprietary Firm, the total number of Company audits should not exceed 30 in his individual capacity /

Proprietary Firm and all Partnership Firms taken together.

4. As specified in Sec. 224(1B), out of the above 30, the audits of Public Companies having paid up capital of ₹ 25 Lakhs or more, shall not exceed 10.
5. For this purpose, Joint Audits held will be construed as one audit unit for each of the Joint Auditors.
6. Audit of Head Office and Branches or one or more Branches of the same Company will be construed as one audit only.
7. The number of Partners of a firm on the date of acceptance of audit assignment shall be taken into account for computing the ceiling for the Firm.
8. A CA in full time employment elsewhere shall not be taken into account while computing the ceiling for the Firm.

(f) Becoming the First auditor of Xee ltd:

In case Mr. Anand wants to be the first auditor of Xee Ltd. the following points needs to be complied with.

1. **Appointment by Board:** Sec. 224(5) specifies that the Board of Directors can appoint the First Auditor(s) of a Company.
2. **Time of Appointment:** The appointment shall be made by the Directors, within 1 month from the date of incorporation of the Company.
3. **Tenure of Office:** The First Auditor(s) shall hold office till the conclusion of the first AGM.
4. **Failure:** If the Board fails to appoint the First Auditor(s) within 1 month of registration, the Company in General Meeting is empowered to make the appointment.
5. **Members' Power of Removal:** The Company may, at a general meeting, remove such an Auditor or all or any of them and appoint another or others in his or their place, on a nomination being made by any member of the Company. For this purpose, notice should be given to the members of the Company, not less than 14 days before the date of the meeting.
6. **Provision in Articles:** An Auditor cannot be appointed as First Auditor(s) simply because his name has been stated in the Articles of Association.
7. **Intimation:** The Company need not send any statutory intimation to the First Auditor(s), of their appointment within 7 days. Notice of appointment can be sent in the ordinary course of business within reasonable time.
8. **Acceptance:** The First Auditor(s) are themselves not required to inform the ROC about their acceptance or refusal of such an appointment.

Question 2:

(a) Wee Ltd. has suffered a Net Loss for the year. The Directors however declared and paid an Interim Dividend at 30% based on the half-yearly performance. Comment.

(b) Board of Directors of M/s. ABee Ltd, in its meeting held on 29th May 2013, declared an interim dividend payable on paid up Equity Share Capital of the Company. In the Board Meeting Scheduled for 10th June 2013, 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) ROC has received a complaint from a group of Creditors of a Company. The complaint alleges that the Directors of the Company, in order to prevent the unearthing of their embezzlement of Company's funds, are engaged in falsification and destruction of original accounting books and records. The Complainants urged the ROC to seize the accounting books and records of the Company so that the Directors may not be able to tamper the same. You are required to state the powers, if any, of the ROC and inspector in this respect.

(d) Can Central Government investigate into the affairs of a company?

[4+4+6+1]

Answer:

(a) In declaration of interim dividend, in case there is a net loss the following points needs to be considered.

i) **Factors:** In declaration and payment of Interim Dividend, the Management has to consider whether - (a) there is a favorable trend of profits in the current year as that in the past years, and (b) there is a reasonable anticipation that the year would close with a surplus at least as that in the previous year.

ii) **Effect of Interim Dividend:** The fact that the Company has suffered a Net Loss at the end of the year indicates that the Directors have miscalculated the performance of the Company about the second half of the year. Hence, the following possibilities arise in this case -

Dividend out of Past Accumulated Profits – where sufficient balance is available in the P&L A/c.	• The amount of profits should be sufficient enough to cover - (a) Transfer to Reserves as per Rules, and (b) Payment of Interim Dividend of 30%. • The Auditor has to verify compliance with the Transfer to Reserve Rules and procedure for payment of Interim Dividend.
Dividend out of Reserves – where sufficient balance is not available in the P&L A/c.	• The balance in P&L Account could be sufficient to declare dividend but not for Transfer of Profits to Reserves. • In such case, Dividend can be declared out of Reserves, subject to a maximum of 10% only. • Hence, the Auditor has to report non-compliance with the Rules in this case, as the actual rate of dividend is 30%.
Dividend out of Capital - where there is no balance in the P&L A/c and Reserves	• Where there is no balance in the P & L A/c and there are no reserves available, the Interim Dividend constitutes a payment out of Capital. • The Auditor should qualify his report mentioning the fact that the Interim Dividend has been paid out of Capital.

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

Principle: 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 [Sec. 205(1A)].

Conclusion: As per Sec.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 2013, 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 2013. Therefore, revocation of Interim Dividend in the Board Meeting held on 10th June is not possible.

(c)

Particulars	Seizure by ROC u/s 234A	Seizure by Inspector u/s 240A

1. Belief	ROC / Inspector can inspect, if it has reasonable ground to believe that books and papers of, or relating to, any Company or other Body Corporate, Managing Director or Manager of such Company or other Body Corporate, may be - (a) destroyed, (b) mutilated, (c) altered, (d) falsified, or (e) secreted.	
2.Basis of belief	Upon information in ROC's possession or otherwise.	In the course of investigation u/s 235/237/239/247.
3. Application to Magistrate	ROC / Inspector may make an application to the First Class Magistrate or Presidency Magistrate having jurisdiction, for an order for the seizure of such books and papers.	
4. Order by Magistrate	After considering the application and hearing the ROC/Inspector", if necessary, the Magistrate may, by order, authorize the ROC / Inspector - (a) to enter, with such assistance as may be required the place or places where such books and papers are kept, (b) to search that place of those places in the manner specified in the order, and (c) to seize such books and papers as ROC/Inspector considers necessary.	
5. Period of retention of books & papers	ROC shall return the books and papers within 30 days of such seizure, and inform the Magistrate of such return.	Inspector shall retain the books and papers for such period not later than the conclusion of investigation, as he considers necessary. Thereafter, he shall return the same, and inform the Magistrate of such return.
6.Taking Copies, & other powers	Before returning books & papers, ROC may - (a) take copies of, or extracts from them, or (b) place identification marks on them or any part thereof, or (c) deal with the same in such other manner as he considers necessary.	Before returning books & papers, Inspector may place identification marks on them or any part thereof.

Note: Other provisions of Code of Criminal Procedure, 1898 relating to searches or seizures shall also apply.

(d) The Central Government delegates its powers u/s 240(l)(a), u/s 240(1A), u/s 240(2)(b) and u/s 240(3) of the Companies Act, 1956, to the Director, Serious Fraud Investigation Office only in respect of those cases wherein the Central Government appoints officers of SFIO as Inspectors, to investigate into the affairs of a company u/s 235 or u/s 237.

Question 3:

a) M/s Bee Ltd. a company registered in the State of West Bengal desires to shift its registered office. State the laws and the provisions to be followed if the change occurs under the following conditions:
   - **i) Change from one place to another within the same city.**
   - **ii) Change from one city to another within the same state.**
   - **iii) Change of jurisdiction of ROC.**
   - **iv) Change of state.**

b) The Articles of Association of a Limited Company provided that 'X' shall be the Law Officer of the company and he shall not be removed except on the ground of proved misconduct. The company removed him even though he was not guilty of misconduct. Decide, whether company's action is valid.

c) Article of a Public company clearly stated that Mr. L will be the life time solicitor of the company. Company in its General Meeting of shareholders resolved unanimously to appoint Mr. M in place of Mr. L as the solicitor of company by altering its AOA. State with reasons, whether the company can do so? If L files a case against the company for removal as solicitor, will he succeed?

d) The Secretary of a Company issued a share certificate to 'A under the Company's seal with his own signature and the signature of a Director forged by him. 'A' Borrowed money from 'B' on the strength of this certificate. 'B' wanted to realize the security and requested the company to register him as a holder of the shares. Explain whether 'B' will succeed in getting the share registered in his name. [9+1+3+2]

Answer:

a)

ALTERATION OF REGISTERED OFFICE CLAUSE [Section 17]	
(i) Change within the same city, town or village [Section 146]	1. A resolution of the Board of Directors is required to be passed.
	2. Notice of new location must be given to the Registrar within 30 days of the Change under form 18.
(ii) Change from one City, town or village to another within the same ROC and same State [Section 146]	1. Special resolution is required to be passed at a general meeting of the shareholders.
	2. Filing of Copy of Special Resolution with ROC within 30 days
	3. Notice of New Location Notice of the new location must be given to the Registrar within 30 days of change under form 18.
	4. A resolution of the Board of Directors is required to be passed.
(iii) Change from the jurisdiction of one ROC to the jurisdiction of another ROC within the same State. [Section 146 &17A]	1. Special resolution is required to be passed at a general meeting of the shareholders.
	2. Confirmation of Regional Director to be obtained. The Regional Director must convey his confirmation within 4 weeks from the date of receipt of application for such change.
	3. Filing of Copy of Special Resolution with ROC within 30 days
	4. Certified copy of the confirmation by Regional director together with a printed copy of the altered memorandum of association to be filled with ROC within 2 months of the date of confirmation.
	5. Notice of the new location must be given to the Registrar within 30 days of change under form 18.
	6. A resolution of the Board of Directors is required to be passed.
(iv) Change from one state to another	1. A special resolution is required to be passed by the company at its general meeting. Copy thereof shall be filled with ROC within 30 days.
	2. Such alteration must be confirmed by the Company Law Board
	3. Copy of the order of the CLB must be filed by the company with the ROC of both the States. Thereafter, the Registrar of each State shall registered proposed alteration.
	4. The Registrar of the State where the office was originally situated shall send Registrar of the other State all records and documents relating to company
	5. When the registered office of the company is shifted to its new location, the notice of same must be given to the Registrar of Companies within 30 days of the shifting office under form 18.

	6. A resolution of the Board of Directors is required to be passed

b) According to the provisions of Section 36, 'X' cannot enforce the right conferred on him by the articles against the company. Hence the action taken by the company (i.e. removal of 'X' even though he was not guilty of misconduct) is valid.

c) According to Section 36 of Company Act 1956, upon registration, the Memorandum and Articles of Association bind the company and its members to the same extent as if they had been signed by the company and each member respectively. -Consequences of this shall be as follow:-

i) Members bound to the Company-This view was also held in the case of **Boreland's Trustee v Steel Brothers and Co. Ltd.**

ii) Company bound to the members- Company is also bound to its members in same manner as members are bound to it

iii) Company not liable to outsider-Section 36, only create a contract between a company and members, thus company may alter its AOA for any term as concerned with a contract along with an outsider

In given case Article of the Public company clearly stated that Mr. L will be the life time solicitor of company. Company in its General Meeting of shareholders resolved unanimously to appoint Mr. M in place of Mr. L as the solicitor of company by altering its AOA.

Conclusion: Based upon the provisions of Sec 36, we can conclude that the Company is entitled to remove Mr. L and he cannot succeed in bringing a suit against the company

This view was also taken in leading case of [**Eley v Positive Government Life Assurance Co. Ltd**]

d) Share certificate is not binding on company as it contained forged signatures. Thus no title could be transferred to A even if he is a bona fide purchaser since as per the general rule forgery is nullity (It means if any signatures are forged, it shall be taken as if no signatures are there, thus no tile can be transfer to transferee). This view was also held in the case of **Rubben v Great Fingal Consolidated**. Hence B would not succeed in having the shares in his name.

Question 4:

a) Rajesh, who is a resident of New Delhi, sent a transfer deed, for registration of transfer of shares to the company at the address of its Registered Office in Mumbai on 13.05.2013. He did not receive the shares certificates till14.09.2013. He lodged a criminal complaint in the Court at New Delhi. Decide, under the provisions of the Companies Act, 1956, whether the Court at New Delhi is competent to take action in the said matter.

b) 'A' commits forgery and thereby obtains a certificate of transfer of shares from a company and transfers the shares to 'B' for value acting in good faith. Company refuses to transfer the shares to 'B'. Whether the company can refuse? Decide the liability of 'A' and of the company towards 'B'. In the light of the above state the meaning and consequences of a forged transfer.

c) ABC Company refuses to register transfer of shares made by Mr. A to Mr. B. The company does not even send a notice of refusal within the prescribed time. Has the aggrieved party any rights against the company for such refusal. Advice.

d) The Board of Directors of a company decided to pay 5% of issue price as underwriting commission to the underwriters. On the other hand the Articles of Association of the company permit only 3% commission. The Board of Directors further decides to pay the commission out of the proceeds of share capital. Are the decisions taken by the Board of Directors valid under the Companies Act, 1956?

e) When can a Public Company offer the new shares (further issue of shares) to persons other than the existing shareholders of the Company? Can these shares be offered to Preference Shareholders? [3+4+4+2+2]

Answer:

a) According to section 113(1) every company shall within two months after the application for the registration of transfer of any such shares, deliver the certificates to its shareholders.
In the case of a listed company under the listing agreement this period has been reduced to 30 days. Hence legal steps can be taken by Rajesh.
In the case of **H.V. Jaya Ram v ICICI Ltd**. It was held that cause of action for failure to deliver share certificate arises where the registered office of the company is situated and not in the jurisdiction of the Court located in the place where the complaint resides. Accordingly in the present case also, the Court in New Delhi cannot entertain the complaint against a company having its registered office in Mumbai.

b) Any forged transfer does not give the transferee concerned any title to the shares.
Although the innocent purchaser acting in good faith could validly and reasonably assume that the person named in the certificate is the owner of the shares. Still the illegality cannot be converted into legality.
Therefore, in this case company is right to refuse to do the transfer of the shares in the name of the transferee B.

Forged Transfer
Meaning:

- Forged Transfer means, transfer of shares made on the basis of forged transfer deed.
- The instrument of transfer is said to be forged when transferor's signatures bearing on it are forged.

Consequences of Forged Transfer:

1. **Restoration of name of:** True owner can compel the company to restore his name to the register.
2. **Claim to Dividend:** True owner can also claim any dividend which may not have been paid to him during the intervening period.
3. **Right of Bona fide Purchaser:**
   - If the company had issued a share certificate to the transferee on a forged transfer and he further sold them to another buyer who has acted in good faith, then the purchaser will have no right to be registered as shareholder.
   - However, he can claim damages from the company on the ground since he has acted on the faith of the share certificate issued by the company.
   - Company in turn can claim damages from the person who has submitted said forged transfer deed to it.

c) Remedies available to aggrieved party against refusal to register the transfer of shares by ABC Company:

1. In case ABC is a private company [Section 111]
Transferor or the transferee may prefer an appeal to Company Law Board. The appeal should be in writing and should be filed within the prescribed time.

Meaning of Prescribe Time:

i) **Where the company gives a notice of refusal:** Appeal should be filed within 2 months of the receipt of such notice, and

ii) **Where the company does not give any notice of refusal:** Appeal should be filed within 4 months from the date on which the instrument of transfer was delivered to the company.

2. In case ABC is a public company [Section 111A]:
In case a public company without any sufficient cause, refuses to register a transfer of shares within 2 months from the date on which, the instrument of transfer was delivered to the company, the transferee may make an application to the Company Law Board to register such transfer.

3. Right to Appeal where the transfer of security effected in contravention of certain law: Where any transfer has been affected in contravention of provisions contained under SEBI Act, 1992 or SICA or any other law for the time being in force. The Company, participants, investor or SEBI may make an appeal to Company Law Board within a reasonable time to rectify the register or records of the company or depository within.

4. Power of Company Law Board:
- Company Law Board may direct the company or the depository to rectify the register or the Records of ownership.
- Company Law Board may also suspend the voting rights in respect of the securities subject to enquiry in case enquiry has not yet completed.

d) According to the provisions of Section 76 of the Companies Act, 1956:
i) The payment of commission should be authorized by the articles.
ii) The amount of commission should not exceed, in case of shares, 5% of the price at which the shares have been issued or the amount or rate authorized by the articles whichever is less, and in case of debentures, it should not exceed 2½%

Based upon the provisions of the above section, we can conclude that the Board of Director's decision to pay 5% is not valid, since the payment cannot exceed 3% as provided in the Articles of the company.
Secondly, decision of the Board to pay the commission out of capital is valid since underwriting commission can be paid both out of capital as well as out of profits. **[Madan Lal Fakir Chand Vs Shree Changdeo Sugar Mills Ltd]**

e) From the wordings of Section 81, of Companies Act, 1956 it is quite clear that the further issue of shares can be issued only to equity shareholders, unless a certain specific procedure as stated in law has been adopted for issue of these shares to outsiders. This specific procedure would essentially include passing a special resolution in the general meeting and obtaining more votes for the agenda than against the agenda. Therefore, in general issue of these shares cannot be offered to preference shareholders.

Question 5:

a) K Ltd was in process of incorporation. Promoters of the company signed an agreement for purchase of certain furniture for company and payment was to be made to the supplier of the furniture after incorporation of the company. The company was incorporated and the furniture was received and used by it. Shortly after incorporation, company went into liquidation and debt could not be paid. As a result supplier sued the promoters. Examine whether the promoters can be held liable under following situations:-
i) Where company has adopted the contract after incorporation
ii) Where company entered into a fresh contract after incorporation

b) A company was incorporated on 6th October, 2013. The certificate of incorporation of the company was issued by the Registrar on 15th October, 2013. The company on 10th October,

2013 entered into a contract which created its contractual liability. The company denies from the said liability on the ground that company is not bound by the contract entered into prior to issuing of certificate of incorporation. Decide, under the provisions of the Companies Act, 1956, whether the company can be exempted from the said contractual liability.

c) The Memorandum of Association of a company was presented to the Registrar of Companies for registration and the Registrar issued the certificate of incorporation. After complying with all the legal formalities the company started a business according to the object clause, which was clearly an illegal business. The company contends that the nature of the business cannot be gone into as the certificate of incorporation is conclusive. Answer the question whether company's contention is correct or not.

d) The Central Government, without referring the matter to the Supreme Court of India for inquiry, removed a member of the Competition Commission of India, on the ground that he has become physically or mentally incapable of acting as a member. Decide under the provisions of Competition Act, 2002 whether the removal of the member is valid.

[7+3+3+2]

Answer:

a) According to Company Act 1956, any contract which is entered into by the promoters for and on behalf of the proposed company before its incorporation shall be regarded as Pre-incorporation contract.

Provisions regarding these contracts can be discussed as follow:-

1. **The Company is not bound by the Preliminary Contract:** In case of [**Re English and Colonial Produce Ltd**], it was held that Company cannot be held liable for the preliminary contracts, A company is not bound by the preliminary contracts even if the company has taken the benefit of the work on its behalf under the contract.
2. **The Company cannot Enforce Preliminary Contracts:** In the case of [**Natal Land Co. v Pauline Colliery Syndicate**], it was held that other party is also not liable to company through pre-incorporation contract, here in this stated case
   - The owner of a piece of land agreed to lease it to a company to be formed by promoters.
   - The promoters later on formed a company.
   - Subsequently 'owner' refused to grant the lease to the company.
   - It was held that the company cannot sue 'owner' and cannot claim specific performance as it was not even in existence when the lease was signed.

   Thus, preliminary contracts cannot be enforced by or against the company.
3. **Personal Liability of Promoters:** In the case of (**Kelner v Baxter**), it was held that promoters shall be personally liable with any such contract. This is because one cannot enter into any contract on behalf of any person who is not in existence. Therefore, for any such contract; promoters shall be personally liable for the performance.

   However, liability of promoter shall come to an end where after incorporation company adopt the contract according to Sec 15 and Sec 19 of Specific Relief Act 1963.

   Based upon above provision, we can conclude as follow:-

   i) Since in the given case company has adopted the contract after incorporation, thus company shall be liable for the contract so entered.

   ii) Situation where company enter into a fresh contract-

   Where a company enter into a fresh contract after incorporation, then liability of promoters shall come to an end and company shall become liable with this contract.

   This view was also taken in case of [**Howard v Patent Ivory Manufacturing Co.**]

b) Section 35 provides that a certificate of incorporation issued by the Registrar is conclusive as to all administrative acts relating to the incorporation and as to the date of incorporation.
Case of **[Jubilee Cotton Mills v Lewis]**

Thus based upon the above, we can conclude that even though Certificate of incorporation was issued on 15th Oct, however it contained a date as 6th Oct. Therefore company shall be considered as registered on 6th only and consequently contract so entered was a valid contract

c) Though a certificate of incorporation is a conclusive evidence of its registration, but, it does not mean that all its objects are legal.
In **Bowman v Secular Society Ltd**., the court held that the statute does not provide that all or any of the objects specified in the memorandum, if otherwise illegal, would be rendered legal by the certificate.
Therefore, the contention of the company that the nature of business cannot be gone into after the certificate of incorporation has been obtained is not tenable.

d) The order of removal made by Central Government is valid and lawful on the following grounds:
i) Since CG has ordered removal under the ground, that he has become physically or mentally incapable of acting as a member.
ii) Since removal under such ground does not require CG to refer the matter to the Supreme Court for inquiry.

Question 6:

a) Useful Ltd. had taken a loan of ₹ 2 crore from ABC Bank secured by some 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 1000 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 hardships 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 the 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.

b) Young Bank is a newly formed bank. The constitution of its Board of Directors is mostly graduates and under-graduates. Is the constitution as per The Banking Regulations Act, 1949? Discuss. Also the Bank wants to reconstitute its board and retire some of its directors. What are the provisions as per law?

c) Mr. A was a member of the Competition Commission of India. On the basis of information that he had acquired such financial interest as was likely to affect prejudicially his functions as a member of the Commission, the Central Government appointed an officer to hold an inquiry. On the basis of report of the said officer the Central Government issued an order of removal of Mr. A. Decide whether the action of the Central Government is in order under the provisions of the Competition Act, 2002?

d) Ajay Ltd. is being wound up by the court. All the assets of the company have been charged to the company's bankers to whom the company y owes 1 crore. The company owes the following amounts to others:
i) Dues to workers – ₹25 lakhs
ii) Taxes payable to Government – ₹5 lakh
iii) Unsecured creditors - ₹10 lakhs
You are required to compute with reference to the provisions of the Companies Act, 1956 the amount each kind of creditors is likely to get if the amount realized by the official

liquidators from the secured assets and available for distribution among the creditors is only ₹ 80 lakhs. [3+6+3+3]

Answer:

a) The company is unable to pay its debts, and it has defaulted in payment of the installments of its Bank loan.

The court may not order winding-up in this case as:

- The power of the court to order winding up is discretionary.
- Since the court shall consider the interest of 1000 employees, temporary cash crisis, loss of taxes to the Government, loss of production, loss of business, probable hardships on other creditors, and public policy.
- If the court decides that it is not in the interest of justice to wind up the company. **[Tata Iron and Steel Co. V Micro Forge (India) Ltd.]**

b) BOARD OF DIRECTORS TO INCLUDE PERSONS WITH PROFESSIONAL OR OTHER EXPERIENCE (Sec. 10A), as per Banking Regulation Act, 1949:

51% or more directors to be specialized in certain specified areas [Sec. 10A (2)] i.e.

- Not less than 51% of the total number of members of the Board of Directors of a banking company shall consist of persons, who shall have special knowledge or practical experience
- in respect of one or more of the following matters, namely:
  - agriculture and rural economy,
  - co-operation,
  - small-scale industry,
  - accountancy,
  - banking,
  - economics,
  - finance,
  - law,
  - any other matter the special knowledge of, and practical experience, which would, in the opinion of RBI, be useful to the banking company.

Minimum 2 directors to be specialised in certain specified areas [Proviso to Sec. 10A (2)]

- It shall also be ensured that out of the aforesaid number of Directors, not less than 2 shall be persons having special knowledge or practical experience in respect of agriculture and rural economy, co-operation or small-scale industry.

Reconstitution of Board if requirements not fulfilled [Sec. 10A (3)]

- If, in respect of any banking company, the requirements, as laid down in sub-section (2), are not fulfilled at any time, the Board of Directors of such banking company shall re-constitute such Board so as to ensure that the said requirements are fulfilled.

Retirement of directors by lots to ensure reconstitution [Sec. 10A (4)]

- If, for the purpose of re-constituting the Board under sub-section (3), it is necessary to retire any Director or Directors, the Board may, by lots drawn in such manner as may be prescribed, decides which Director or Directors shall cease to hold office and such decision shall be binding on every Director of the Board.

c) CG has the power to remove Mr. A:

Since Sec. 11 empowers CG to remove the Chairperson or any member of the Commission on various grounds specified u/s 11 including the ground "where the Chairperson or the member

has acquired such financial or other interest as is likely to affect prejudicially his functions as a Member or Chairperson."

Procedure for removal of Mr. A:

i) CG shall make a reference to the Supreme Court.
ii) The Supreme Court shall order holding of an enquiry. The enquiry shall be held in accordance with the procedure prescribed by the Supreme Court.
iii) The Supreme Court may make an order for removal of Mr. A.

d)

(i) The amount overriding preferential payments (₹1 crore due to secured creditors and ₹25 lakhs due to workers), hence a total of ₹1.25 crore

(ii) Since the amount realized is ₹80 lakhs and it is not sufficient to pay the overriding preferential payments in full, the workmen's dues and dues payable to secured creditors shall abate in equal proportions, i.e., the payments to workmen and secured creditors should be in the proportion of amount owed by the company to them (i.e. 100:25). Therefore, workers shall be paid ₹16 lakhs and secrured creditos should be paid ₹64 lakhs.

(iii) No payments shall be made to the Government authorities towards taxes payable or to unsecured creditors.

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

Question 7:

a) Discuss the difficulties faced in Governance by state owned businesses.
b) Analyze CSR as a Corporate Brand
c) State the reason for failure of construction industry to embrace Whole Life Cycle Costing
d) Describe the core elements to be covered under CSR Policy
e) Write a short note on Memorandum of Understanding and Public Sector Enterprises.
f) Discuss the relevance of OECD Guidelines for Corporate Governance of State-owned enterprises.

[5×5]

Answer:

a) Difficulties Encountered in Governance in state owned businesses

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 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 components 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.

b) CSR as a Corporate Brand:

In an economy where corporates strive for a unique selling proposition to differentiate themselves from their competitors, CSR initiatives enable corporates to build a stronger brand that resonates with key external stake-holders – customers, general public and the government.

Businesses are recognising that adopting an effective approach to CSR can open up new opportunities, and increasingly contribute to the corporates' ability to attract passionate and committed workforces.

Corporate in India are also realising that their reputation is intrinsically connected with how well they consider the effects of their activities on those with whom they interact. Wherever the corporates fail to involve parties, affected by their activities, it may put at risk their ability to create wealth for themselves and society.

Therefore, in terms of business, CSR is essentially a strategic approach for firms to anticipate and address issues associated with their interactions with others and, through those interactions, to succeed in their business endeavors. The idea that CSR is important to profitability and can prevent the loss of customers, shareholders, and even employees is gaining increasing acceptance.

Further, CSR can help to boost the employee morale in the organisation and create a positive brand-centric corporate culture in the organisation. By developing and implementing CSR initiatives, corporates feel contented and proud, and this pride trickles down to their employees. The sense of fulfilling the social responsibility leaves them with a feeling of elation. Moreover it serves as a soothing diversion from the mundane workplace routine and gives one a feeling of satisfaction and a meaning to their lives.

c) Reason for failure of construction industry to embrace WLCC

Currently, the application of Whole Life Cycle Costing (WLCC) in the construction industry is still hindered significantly by the lack of standard method and the excuse of lack of sound data upon which to arrive at accurate decisions. As a result, the output from WLCC models is looked on as unreliable. A Government report issued by the Building Research Establishment on Whole Life Costing identified several factors that presently act as barriers to applying WLCC:

- The lack of universal methods and standard formats for calculating whole life costs
- The difficulty in integration of operating and maintenance strategies at the design phase
- The scale of the data collection exercise, data inconsistency
- The requirement for an independently maintained database on performance and cost of building components.

These barriers might be directly related to the absence of adequate knowledge of WLCC processes and mechanisms. There may also be a lack of willingness from stakeholders to set up appropriate mechanisms to solve these problems. If, for example, all building occupiers were required to submit annual running cost profiles, the risk associated with WLCC techniques could be significantly reduced (Bird 1987). In fact, White (1991) argues the case for 'performance profiles' and in particular, highlights again the requirements for a universal construction data

information system. One could argue that a plethora of WLCC models does exist but the common denominator in practical application and development is lack of appropriate information or know-how to use and develop models with existing information.
It seems to be worth noting how both the academic and practical 'schools of thought' in the industry need to get their own houses in order if significant steps are to be taken in the wider applications of WLCC. Newton (1991) in his work in cost modelling procedures highlights the need for a methodological and organised framework for such research activities. The sheer complexity of many models lends little to practical application and in many cases, if not the majority, the lack of available good quality data prohibits further development. In terms of the practitioners, they need to be willing to encourage clients and building occupiers into adopting a more holistic approach to running cost control so that procedures can be put in place to aid all those requiring WLCC cost profiles.

d) The core elements to be covered under CSR Policy

The core elements to be covered under CSR Policy is as follows:
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 non-discriminatory 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.

e) Memorandum of Understanding and Public Sector Enterprises:

After Independence, Public Sector Enterprises (PSEs) were set up in India with an objective to promote rapid economic development through the creation and expansion of infrastructure by the government. With different phases of development, the role of PSEs has changed and their operations have extended to a wide range of activities in manufacturing, engineering, steel, heavy machinery, machine tools, fertilizers, drugs, textiles, pharmaceuticals, petro-chemicals, extraction and refining of crude oil and services such as telecommunication, trading, tourism, warehousing, etc. as well as a range of consultancy services. While there have been many PSEs that have performed very well in competition with private sector enterprises, there are also many PSEs that have performed very poorly. In an economic environment that has changed considerably in the last two decades, the role of PSEs has changed and they have been increasingly guided to reduce their dependence on the Government. They have been listed on the stock exchange and few of them have been privatized. The Government has provided PSEs the necessary flexibility and autonomy to operate effectively in a competitive environment. However, there are a few issues with the operation and management of PSEs which still persist and need to be attended to. There is a need to develop a mechanism on how government can get an efficient Indian presence in the sectors where the private sector investments are not forthcoming especially in strategic areas where developing capabilities is essential if India has to play its rightful role among the among the nations of the world.

f) The relevance of OECD Guidelines for Corporate Governance of State-owned enterprises:

Many of the developing countries still continue to have a dominant presence of state-owned enterprises. Hence, OECD thought it appropriate to evolve a set of governance guidelines for the state-owned enterprises as it did for the private enterprises in member countries. 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. If properly implemented, these and other recommended reforms would go a long way to ensure that state ownership is exercised in a professional and accountable manner, and that the state plays a positive role in improving corporate governance across all sectors of our economies. The result would be healthier, more competitive, and transparent enterprises'.

<u>The major recommendations in OECD guidelines are as discussed below:</u>

- 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.
- State-owned Enterprises should not be exempt from the application of general laws and regulations. Stakeholders including competitors should have access to efficient redress and an even-handed ruling when they believe that their rights have been violated.
- State-owned Enterprises 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.