Paper-13: CORPORATE LAWS AND COMPLIANCE

STUDY NOTE 1 – THE COMPANIES ACT:

Question 1:

(a) What will be the consequence in case of a private Company incorporated under the provisions of the Indian Companies Act defaults in complying with the conditions constituting a Private Company, as per Companies Act, 1956?

(b) The paid-up Share Capital of Asha Private Limited is ₹ 1 crore, consisting of 8 lacs Equity Shares of ₹ 10 each, fully paid-up and 2 lacs Cumulative Preference Shares of ₹ 10 each, fully paid-up. Disha Private Limited and Nisha Private Limited are holding 3 lacs Equity Shares and 1,50,000 Equity Shares respectively in Asha Private Limited.
Disha Private Limited and Nisha Private Limited are the subsidiaries of Pratiksha Private Limited. Examine whether Asha Private Limited is a subsidiary of Pratiksha Private Limited? Would your answer be different if Pratiksha Private Limited has 8 out of total 10 directors on the Board of Directors of Asha Private Limited? Answer as per Companies Act, 2013.

(c) Noble Meters Limited was incorporated with the equity share capital of ₹ 50 lakh. The company received the Certificate of Incorporation on 20th May, 2009. The company issued the prospectus inviting the public to subscribe for its equity shares. Meanwhile, the company intended to commence its business. Whether Noble Meters Ltd. is entitled to commence its business without obtaining the Certificate to Commencement of Business?
Advice the company stating the conditions to be fulfilled for obtaining the Certificate to Commencement of Business from the Registrar of Companies under Companies Act, 1956.

(d) The object clause of the Memorandum of Association of Rishi Limited authorizes it to publish and sell text-books for students. The company however entered into an agreement with Kashi to supply 100 laptops of worth ₹ 5 lakh for resale purposes. Subsequently, the company refused to make payment on the ground that the transaction was ultra vires the company. Examine the validity of the company's refusal for payment to Kashi under the provisions of the Companies Act, 1956.

Answer:

(a) The consequence in case of a private Company are:

Nature of default:

Sec. 43 of Companies Act, 1956 applies where a private company makes a default in complying with any of the conditions constituting a private company. In other words, in case of contravention or violation of any of the conditions specified u/s 2(68) of the Companies Act, 2013, Sec. 43 of the Companies Act, 1956 is attracted.

Consequences of default:

- The company shall cease to be entitled to the privileges and exemptions conferred on private companies.
- The Companies Act shall apply to the company as if it were not a private company, i.e. the

private company shall have to comply with such provisions of the Companies Act, 1956 and the Companies Act, 2013 as are applicable to public companies'.

Restoration of privileges:

- CLB has the power to restore the privileges {i.e. relieve the company from the consequences of default) if it is satisfied that -
  (a) failure to comply with the conditions was accidental or due to inadvertence or due to some other sufficient cause; or
  (b) on other grounds it h just and equitable to grant relief.
- CLB may exercise such powers on an application made by the company or any other interested person.
- CLB may specify in its order such terms and conditions as it may deem fit.

(b) The stated case relates to section 2(46) and Sec 2(87) of Companies Act, 2013.

Total ESC of Asha Pvt. Ltd.	- is ₹ 80,00,000.
ESC held by Disha Pvt. Ltd. in Asha Pvt. Ltd.	- is ₹ 30,00,000.
ESC held by Nisha Pvt. Ltd. in Asha Pvt. Ltd.	- is ₹ 15,00,000.
ESC held by Pratiksha Pvt. Ltd. in Asha Pvt. Ltd.	- is ₹ 45,00,000, since for the purpose of determining holding-subsidiary relationship, ESC held in Asha Ltd. by its Subsidiaries Disha Pvt. Ltd. (viz. ₹ 30,00,000) and Nisha Pvt. Ltd. (viz. ₹ 15,00,000) shall be considered.
Asha Pvt. Ltd. is a subsidiary of Pratiksha Pvt. Ltd.	- since Pratiksha Pvt. Ltd. holds more than one-half of ESC of Asha Pvt. Ltd.
The answer would remain same	- even if Pratiksha Pvt. Ltd. has 8 out of 10 directors on the Board of Directors of Asha Pvt. Ltd. since in such a case Pratiksha Pvt. Ltd. controls the composition of Board of Directors of Asha Pvt. Ltd.

(c) The stated case relates to section 149 of Companies Act, 1956.

Noble Meters Ltd. not entitled to commence business:

- Since it has not obtained certificate of commencement of business;
- Since it is a public company having share capital;
- Since a public company having share capital cannot commence its business unless it has obtained certificate of commencement of business.

Conditions to be satisfied for obtaining certificate of commencement of business:

Where a company issues a prospectus, the certificate of commencement of business shall be issued only if the following conditions, as given u/s 149(1) are satisfied:

(i) The company must apply to one or more stock exchanges for listing of its shares. If any of these stock exchanges refuse to list the shares of the company, the company shall have to refund the entire amount received from the applicants, and the company shall not be issued a certificate of commencement of business.

(ii) Where shares have been allotted to the directors and manager, the company must have received the amount due on application and allotment from every such director or manager.

(iii) The company must have received the minimum subscription. Further, the company must have made the allotment of such number of shares as are not less than the minimum

subscription.

(iv) The company shall file a declaration with the Registrar that all the requirements of Sec. 149(1) have been duly complied with.

(d) The contract to purchase laptops is an ultra vires contract, and is therefore, void ab initio.

Kashi cannot enforce the contract against Rishi Limited since the contract is ultra vires; and since no party to an ultra vires contract has a right to sue.
The Court may order Rishi Limited to deliver back the laptops to Kashi if the laptops are still in the possession of the company; and if the Court, applying the principle of equity, deems it fit considering the circumstances of the case.

Question 2:

(a) Ashi Company Limited at a general meeting of members of the company passes an ordinary resolution to buy-back 30% of its equity share capital. The articles of the company empower the company for buy-back of shares. The company further decides that the payment for buy-back be made out of the proceeds of the company's earlier issue of equity shares. Explaining the provisions of the Companies Act,1956 and stating the sources through which the buy-back of companies own shares be executed, examine:

(i) Whether company's proposal is in order?

(ii) Would your answer be still the same in case the company, instead of 30%, decides to buy-back only 20% of its equity share capital?

(b) Superb Furniture's Limited was willing to purchase teakwood estate in Chhattisgarh State. Its prospectus contained some important extracts from an expert report giving the number of teakwood trees and other relevant information in the estate in Chhattisgarh State. The report was found inaccurate. Mr. 'X' purchased the shares of Superb Furniture's Limited on the basis of the above statement in the prospectus. Will Mr. 'X' have any remedy against the company? When an expert will not be liable? State the provisions of the Companies Act, 2013 in this respect.

(c) Define the term 'Financial Statement', as per Companies Act, 2013.

(d) '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'.

Answer:

(a)

(i) The proposal of the company to buy-back its shares is not valid since the company has passed OR instead of SR, as required u/s 77A of Companies Act, 1956; and also since the company proposes to buy-back 30% of the equity share capital which exceeds the statutory ceiling of 25% of total paid up equity capital; The company also proposes to buy-back out of the proceeds of an earlier issue of same kind of shares, which is prohibited u/s 77A.

(ii) The decision to buy-back 20% of equity share capital shall not be valid since buy-back by passing OR is violative of Sec. 77A of Companies Act, 1956 and buy-back out of the proceeds of an earlier issue of same kind of shares is prohibited u/s 77A.

(b) The stated case relates to section 35 of Companies Act, 2013.

- Mr. X is entitled to repudiate the allotment:
  Since he purchased the shares relying on a mis-statement contained in the prospectus.

- An expert is not liable if:
  He proves that the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent.

(c) 'Financial statement' as per Section 2(40) of Companies Act, 2013 in relation to a company, includes -
(i) a balance sheet as at the end of the financial year;
(ii) a profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;
(iii) cash flow statement for the financial year;
(iv) a statement of changes in equity, if applicable; and
(v) any explanatory note annexed to, or forming part of, any document referred to in sub-clause (i) to sub-clause (iv).
However, in the case of a One Person Company, small company and dormant company, the financial statement may not include the cash flow statement.

(d)

Rights of the true owner:
He can compel the company to restore his name on the register of members (since a forged transfer is without any legal effect and the true owner continues to be the member of the company).

Liabilities of A:
'A is liable to compensate the loss caused to the company since he had lodged the forged transfer deed.

Rights of B:
No title could be transferred to B even if he is a bona fide purchaser since as per the general rule forgery is nullity (It means if any of the signatures are forged, it shall be taken as if no signatures are there, and thus no tile can be transfer to transferee). This view was also held in the case of [**Rubben v Great Fingal Consolidated**]

1. The company can refuse to register 'B' as a member.
2. The company is liable to 'B' since the company had issued share certificate to A, and therefore, the company shall be stopped from denying the liability accruing to it from its own default.

Question 3:

(a) Following information is available from the audited Balance Sheet as at 31st March, 2014 of Sarah Ltd.:

Capital and Liabilities	₹	Assets	₹
Share Capital:		Fixed Assets:	
Equity Share Capital	50,00,000	Goodwill	10,00,000
(5,00,000 shares of ₹ 10 each fully paid up in cash)		Land & buildings	75,00,000
		Plant & Machinery	1,50,00,000
Less: Calls in arrears	50,000	Furniture & Other Assess	2,50,000
	49,50,000		
		Investments:	
Preference Share Capital	15,00,000	Equity Shares in wholly owned	
Share Application Money	10,00,000	Subsidiary Company - Sama Ltd.	12,50,000
Reserves and Surplus:			
Securities Premium A/c	15,00,000	Equity Shares representing 90%	
Capital Redemption Reserve	12,00,000	of Share capital of Cezar Ltd.	4,50,000
Fixed Assets Revaluation Reserve	10,50,000	Debentures in Sona Ltd.	12,00,000
Sinking Fund Reserve	11,00,000	Preference Shares in Hareem Ltd.	5,00,000
General Reserve	40,00,000		
Profit & Loss A/c	22,00,000	Capital Account Balance in Partnership Firm - Bashir & Co.	8,00,000
Dividend Equalisation Reserve	6,00,000		
Secured Loans:		Current Assets:	
Cash Credit facility from Bank	1,00,00,000	Stock and Book Debts	14,00,000
Unsecured Loans:		Cash & Bank Balances	1,00,000
Fixed Deposits (from general public maturing after 31.12.2014)	20,00,000	Loans & Advances:	
		Inter-corporate Deposits	25,00,000
Current Liabilities A Provisions:		Business Advances	14,00,000
Current Liabilities	12,50,000		
Provision for Taxation	10,00,000		
	3,33,50,000		3,33,50,000

The directors of the company want to make further investments stated below by taking a decision in the meeting of Board of directors without seeking approval of the shareholders:

(i)	Loan to Sama Ltd.	25,00,000
(ii)	Loan to Cezar Ltd.	15,00,000
(iii)	Purchase of further debentures in Sona Ltd.	8,00,000
(iv)	Purchase of shares from the open market in Ocean Ltd.	15,00,000

You are required to state, with to the relevant provisions of the Companies Act, 1956, whether the directors can do so and mention the relevant calculations.

(b) A group of creditors of a company lodged a complaint with the Registrar of Companies alleging that the Directors of the company are engaged in falsification and destruction of account books and records of the company and urged the Registrar to seize the account books and records of the company. Discuss whether the Registrar can exercise such powers under the provisions of Companies Act, 1956.

Answer:

(a) Requirements for making inter-corporate loans and investments as per section 372 of Companies Act, 1956:

1. Unanimous approval of Board is required. The approval shall be obtained by passing a resolution at a Board meeting.
2. Special resolution is required if the aggregate of loans etc. (already made plus proposed) exceeds the higher of-
   - 60% of the aggregate of paid-up capital and free reserves; or
   - 100% of its free reserves.

   The notice of special resolution must state the specified particulars.
3. Approval of Public Financial Institution shall be obtained unless -
   - the limits of 60% is not exceeded: and
   - there is no default in repayment of loan installments or interest.
4. No default of section 58A (Public deposits) is subsisting.

Loan includes debentures or deposits, of money made by one company with another company.

'Free reserves' as per Section 2(43) of Companies Act, 2013 means those reserves which, as per the latest audited balance sheet, are free for distribution as dividend, provided that—

(i) any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or

(ii) any change in carrying amount of an asset or of a liability recognized in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value, shall not be treated as free reserves;

Thus it, includes the balance to the credit of securities premium account but does not include share application money. Capital redemption reserve, Fixed Assets Revaluation Reserve and sinking fund are not free for distribution as dividend and hence are not included in free reserves. Provision for taxation is a liability and is therefore not included in free reserves.

First determine whether a special resolution is required for making the proposed loans and investments. This can be determined as under:

Step 1: Determine the paid up share capital

	Amount (₹)
Equity share capital Less. Calls unpaid	50,00,000 50,000
Balance Preference share capital	49,50,000 15,00,000
Paid up share capital	64,50,000

Step 2. Determine the 'free reserves'

	Amount (₹)
Securities premium A/c General reserve Profit & loss A/c Dividend equalisation reserve	15,00,000 40,00,000 22,00,000 6,00,000
Free reserves	83,00,000

Step 3. Determine the overall limit for inter-corporate loans and investments, i.e.

	Amount (₹)
higher of'60% of (paid up capital and free reserves) or 100% of free	88,50,000

reserves 60% of (64,50,000 + 83,00,000) 100% of free reserves	83,00,000
Overall limit for loans and investments	88,50,000

Step 4. Determine inter-corporate loans and investments already made

	Amount (₹)
Equity Shares in wholly owned Subsidiary Company - Sama Ltd. Equity Shares of Cezar Ltd. Debentures in Sona Ltd. Preference Shares in Hareem Ltd. Inter-corporate Deposits	Nil 4,50,000 12,00,000 5,00,000 25,00,000
Total investments and loans already made	46,50,000

As per section 372A(8), investments made by a holding company in its wholly owned subsidiary are outside the purview of section 372A of Companies Act, 1956. Therefore, Investments made in equity shares of Sama Ltd. are excluded from the investments already made.

Step 5. Determine further inter-corporate loans and investments permissible without passing a special resolution

	Amount (₹)
Overall limit for inter-corporate loans and investments Less: investments already made	88,50,000 46,50,000
Further loans and investments permissible without special resolution	42,00,000

Step 6. Determine inter-corporate loans and investments proposed to be made

	Amount (₹)
Loan to Sama Ltd. Loan to Cezar Ltd. Debentures in Sona Ltd. Shares in Ocean Ltd.	Nil 15,00,000 8,00,000 15,00,000
Proposed loans and investments	38,00,000

As per section 372/4(8), investments made by a holding company in its wholly owned subsidiary are outside the purview of section 372A. Therefore, proposed loan of ₹ 25,00,000 to Sama Ltd. has been ignored.

Step 7. Determine whether special resolution is required
Since proposed loans and investments (₹ 38,00,000) are within the permissible limits (₹ 42,00,000), special resolution is not required.

Therefore, Sarah Ltd. can make the proposed investment as follows:
(i) A resolution shall be passed at a Board meeting with the consent of all the directors present.
(ii) The company shall enter the prescribed particulars in the register within 7 days.
(iii) The company shall ensure that no default in compliance with section 58A of Companies Act 1956 (relating to public deposits) is subsisting. Since deposits are maturing only after 31.12.2014, this condition is fulfilled.

(b) The provisions of section 234A are explained as follows:

1. <u>Application by registrar for seizure of books and papers</u>

The registrar may make an application to the Magistrate of the First Class or the Presidency Magistrate having jurisdiction for an order for the seizure of books and papers. Such an application may be made if the registrar has reasonable ground to believe that books and papers relating to the affairs of the company may be destroyed, mutilated, altered, falsified or secreted. The books and papers may relate to the company or other body corporate or managing director or manager of such company or other body corporate.

2. <u>Magistrate's power</u>

After considering the application and hearing the registrar, the Magistrate may authorise the registrar-

(a) to enter, with such assistance as may be required, the places where such books and papers are kept;
(b) to search those places in the manner specified in the order;
(c) to seize such books and papers as he considers necessary.
The search or seizure shall be carried out in accordance with the provisions of the Code of Criminal Procedure, 1898.

3. <u>Return of books and papers</u>

The registrar shall return the books and papers within 30 days to the person from whose custody or power they were seized and inform the magistrate of such return. Before returning the books and papers the registrar may take copies or extracts, place identification marks or deal with the books and papers in such other manner, as he considers necessary.

<u>Question 4:</u>

(a) Profound Housing Finance Company Limited is prepared to give housing loans to the employees of Super Chemicals Limited subject to the condition that the loans are guaranteed by Super Chemicals Limited. Super Chemicals Limited is not a listed company and the company will be exceeding the limits prescribed under the Companies Act, 1956 by providing such guarantee. The company desires to give the guarantee early as part of employees' welfare measure without waiting for the next annual general meeting, which is due only after eight months. Advise the company about the legal requirements under the Companies Act, 1956 to give effect to the above proposal. What would be your advice, if the company was required to provide security instead of guarantee?

(b) An inspector was appointed under Section 235 of the Companies Act, 1956 to investigate the affairs of a public Company. Mr. Winny, the works manager of the company, who is aware of certain misdeeds of the management, desires to know whether he is entitled to any protection against dismissal by the company, if he discloses the misdeeds during the course of examination by the inspector. Advise him explaining the relevant provisions of the Companies Act, 1956.

<u>Answer:</u>

(a) Inter-corporate loans and investments are governed by the provisions of section 372A of Companies Act, 1956.

Legal requirements for giving guarantee by Super Chemicals Limited

- Approval of the Board must be obtained by passing a unanimous resolution in a Board meeting.
- Approval of the members must be obtained by passing a special resolution in a general meeting (whether annual general meeting or extraordinary general meeting). However,

since the company desires to give guarantee without waiting for the next annual general meeting, the Board may give guarantee, without being previously authorised by special resolution, if the following three conditions are satisfied:

1. There exist exceptional circumstances which prevent the company from passing special resolution.
2. Unanimous approval of the Board is obtained in a Board meeting.
3. The resolution of the Board is confirmed by the members –
   (i) within 12 months, or
   (ii) in the ensuing annual general meeting,
   whichever is earlier.

- If the company has taken any term loan from any Public Financial Institution, the approval of such Public Financial Institution shall also be obtained,
- No default of section 58A must be subsisting, otherwise the company cannot give such guarantee.

Legal requirements for providing security by Super Chemicals Limited

If instead of giving guarantee, Super Chemicals Limited is required to provide security, the same legal requirements shall have to be complied with as in case of giving guarantee, except that, it is mandatory to pass special resolution before providing security.

(b)

(i) Non-disclosure of source of information

Section 457 of the Companies Act, 2013 seeks to protect the informant (the registrar, any officer of the Government or any other person). Thus, no Court or any other authority can compel the informant to disclose the source from where he got any information which -

1. led to the order of investigation; or
2. has been material or relevant in connection with such investigation.

(ii) Temporary protection of employees

Object of the section. Section 635B of Companies Act, 1956 seeks to protect the interest of employees who disclose information to the inspectors during the investigation proceedings.

Procedure for discharging or punishing an employee. During the pendency of the investigation, a company can discharge or punish (whether by way of dismissal, removal, reduction in rank or otherwise) any employee only after giving a previous intimation to the Company Law Board. If the Company Law Board does not make any objection within 30 days, the company may proceed to take the proposed action. If the company is dissatisfied with the objection raised by the Company Law Board, it may within 30 days prefer an appeal to the Court. The decision of the Court shall be final and binding on the company.

The Company Law Board acts unilaterally. The Company Law Board is not bound to hear representatives or evidence on behalf of the parties in arriving at its opinion. The principles of natural justice are not attracted to make such a decision. The Company Law Board has to form its opinion unilaterally and subjectively [Ashoka Marketing Ltd. v Additional Registrar of Companies, W.B. (1985) 57 Comp Cas 187 (Cal)].

Question 5:

(a) Jacqueline, having substantial interest in Sunlit Ltd, is appointed as a sole selling agent by the Board of directors of the company for a period of 5 years. The company's paid-up share capital is ₹ 49 (Forty nine) crores. The Board of directors did not place the matter in the AGM, for paucity

of time and communicated to Jacqueline about her appointment, who in turn accepted the appointment. Explaining the provisions of the Companies Act, 1956 decide:
(i) Whether the appointment of Jacqueline is in order?
(ii) What course of action would you take as the secretary of the company in case Jacqueline does not have substantial interest?

(b) The Board of directors of a company decides to revise the accounts which have already been adopted by the shareholders in annual general meeting. Advise.

Answer:

(a) The legal position:

(i) A sole selling agent may be appointed for a maximum period of 5 years.

(ii) The appointment of a sole selling agent must be made subject to the condition that his appointment shall be approved by the company in first general meeting held after her appointment. If her appointment is not so approved in the first general meeting, the appointment ceases from the date of the general meeting [Section 294(2A)]. She will not be entitled to claim any compensation for premature termination in such a case.

(iii) The appointment of a sole selling agent requires the previous approval of the Central Government if she has substantial interest in the company.

(iv) The appointment of a sole selling agent requires the approval of the Central Government and the consent of the company by way of a special resolution, if the paid up capital of the company is ₹ 50 lakhs or more. However, it shall be lawful, if the special resolution is passed in the first general meeting held after appointment of sole selling agent, and the approval of the Central Government is obtained after the appointment of sole selling agent.

The given case:

- The paid up capital of the company is ₹ 49 crores [i.e., more than ₹ 50 lakhs) and so the approval of the Central Government and a special resolution is required for the appointment of a sole selling agent.
- Jacqueline has a substantial interest in the company, and so the prior approval of the Central Government is necessary for the appointment of Jacqueline as a sole selling agent.
- As is evident, the prior approval of the Central Government has not been obtained and special resolution has not been passed by the company. Thus, the appointment of Jacqueline is not in order.

In case Jacqueline had no substantial interest in the company, her appointment requires special resolution (in first general meeting held after appointment) and approval of the Central Government (after appointment), since the paid up capital of the company is more than ₹ 50 lakhs. Accordingly, the appointment of Jacqueline shall be valid subject to the condition that special resolution approving her appointment is passed in the first general meeting held after her appointment, and the approval of the Central Government is obtained subsequent to her appointment.

(b) There is no provision in the Companies Act, 1956, expressly permitting or prohibiting revision or reopening of accounts after adoption.

Generally, reopening or rectification of accounts is not permitted if the accounts have already been adopted at the annual general meeting. The Institute of Chartered Accountants of India is also of this opinion. Accordingly, accounts once adopted by the members cannot be reopened, revised or rectified under any circumstances.
However, the Department of Company Affairs (now Ministry of Corporate Affairs) has permitted revision/rectification of accounts provided that -

- the revision is made for meeting the technical requirements of taxation laws or of any other law;
- such revision will result in true and fair view of state of affairs of the company;
- the revised annual accounts shall be adopted in the subsequent annual genera! meeting or extraordinary general meeting;
- the revised annual accounts shall be filed with the registrar as per section 220 of the Companies Act, 1956.

Question 6:

(a) M/s Contrasts Ltd. is a company controlled by two family groups. The first family group has four directors, namely, Mr. Anand, Mr. Bikash, Mr. Chandu and Mr. Deva on the Board of directors. The second family group has two representatives Mr. Zoom and Mr. Space on the Board. Because of internal family troubles, the first group, by virtue of its majority shareholding removed both Mr. Zoom and Mr. Space as the directors of the company. Aggrieved by this action the second group is planning to move an application before the Company Law Board. You have been approached for advice. Advise as to the eligibility and restrictions regarding filing the application and the chances of getting the relief from the Company Law Board, assuming that there is no other material on record in support of oppression on the minority group. You may refer to provisions of Companies Act, 1956 for this purpose.

(b) The issued, subscribed and paid-up share capital of ABC Company Limited is ₹ 10 lakhs consisting of 90,000 equity shares of ₹ 10 each fully paid up and 10,000 preference shares of ₹ 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 of Companies Act, 1956 is maintainable. Will your answer be different, if preference shareholders have subsequently withdrawn their consent?

Answer:

(a) The management of the company is based on the Majority Rule. The Courts do not usually intervene in the matters of internal management of the company. However, where the exercise of voting power by the majority results in oppression on the members or results in mismanagement or prejudice to public interest, the Company Law Board may grant the relief to the minority.

As per section 399 of Companies Act, 1956, the eligibility criterion to file an application with the Company Law Board for claiming relief from oppression or mismanagement is as follows:

(i) In the case of a company having a share capital. Members eligible to apply shall be the lowest of the following:
   (a) 100 members; or
   (b) l/10th of the total number of members; or
   (c) Members holding not less than l/10th of the issued share capital of the company.

(ii) In the case of a company having no share capital. The application shall be made by at least l/5th of total number of members.

The applicants must have paid all the calls and other sums due on their shares. The applicants must hold the requisite number of shares at the time of filing the application.

In the present case the removal of two directors cannot, ipso facto, amount to an act of mismanagement or an act prejudicial to public interest. Also, it does not amount to oppression because-

- The election and removal of directors is the prerogative of the members and such an act cannot ipso facto be treated as oppression on minority, unless the conduct of the majority is based on malafide considerations.
- The conduct can be said to be oppression only when it is burdensome, harsh and wrongful. Oppression involves an element of lack of probity and fair dealings to a member. Mere removal of two directors does not amount to oppression.
- The oppression complained of must affect a person in his capacity as a member of the company. Oppression in any other capacity, i.e., as a director of a company is outside the purview of section 397.
- The relief is available only when the acts complained of are shown to be continued acts of oppression.
- The relief is available only if it is established that oppression is so severe that there is just and equitable ground for winding up of the company.

In the given case, it has been made clear that there is no other material on record in support of oppression on the minority. Since the conditions specified in section 397 have not been fulfilled, there is no oppression on the second family group and therefore relief from Company Law Board cannot be claimed.

(b) As per section 399, of Companies Act, 1956, 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) 1/10th of the total number of members; or
   (iii) Members holding not less than l/10th 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 Corporations Nageshwara Rao AIR 1956 SC 213].

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

- ₹ 9,00,000 equity share capital held by 600 members.
- ₹ 1,00,000 preference share capital held by 5,000 members.
- ₹ 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:

(a) Number of members making the application:
- Preference shareholders 400
- Equity shareholders 50
- Total members 450

(b) Amount of share capital held by the members making the application:
- Preference share capital 4,000 (400 preference shares of ₹ 10 each)
- Equity share capital 5,000 (500 equity shares of ₹ 10 each)
- Total capital 9,000

The application shall be valid if it has been made by the lowest of the following:
(a) 100 members
(b) 560 members (being 1/10th of 5,600)
(c) Members holding ₹ 1,00,000 share capital (being 1/10th of ₹ 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].

Please note that, it has been assumed that the members making the application have paid all the calls due on their shares.

Question 7:

(a) On 1st January, 2014 the Board of directors of Xeal Co. Ltd. appointed Mr. Ankit as sole selling agent of the company for a period of five years. On 6th February, 2014 Xeal Co. Ltd. in its general meeting disapproved the appointment of Mr. Ankit as sole selling agent of the company.
Explain, as per provisions of Companies Act, 1956:
(i) Is Mr. Ankit entitled to payment of compensation for loss of office?
(ii) Are there some other circumstances when compensation for loss of office is prohibited to a sole selling agent?

(b) Penguin Limited had taken a loan of ₹ 2 crores from a bank secured by some of its assets. The company has defaulted in the matter of payment of some installments of loan as per terms of the loan agreement. The bank has filed a petition in the High Court on the ground that the company is unable to pay its debts.
The company opposes the petition for winding up on the ground that it has employed 1,000 workers, paid their salaries regularly and that it has paid all the tax dues to the Government. The company has further contended that if the company is compelled to repay the loan immediately, it will cripple the company causing hardship to employees and other persons having business dealings with the company. The company is also supported by some major creditors.
Explain the circumstances under which a company may be ordered to be wound up by the Court on the ground of inability to pay its debts and whether the bank will succeed in this case. Refer to provisions of Companies Act, 1956, for the said purpose.

(c) The promoters of Brahma Producer Company Ltd., proposed to be registered under Section 581C of the Companies "Act, 1956 desire to have the following information; what is the minimum number of directors required to be appointed?

Answer:

(a) As per section 294A of Companies Act 1956, 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 resigns 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.

In the present case, the appointment of Mr. Ankit has been disapproved by the general meeting and therefore he is not entitled to any compensation for loss of office.

(b) The Court may order the winding up of a company under any of the circumstances mentioned under section 433(a) to (f) of Companies Act, 1956. Section 433(e) provides that a company may be wound up by the Court if it is unable to pay its debts. As per section 434 of Companies Act, 1956, a company shall be deemed to be unable to pay its debts in the following circumstances:

1. When a company fails in paying its debts exceeding ₹ 500 within 3 weeks from the date of demand by its creditors.

2. When the company fails to satisfy a Court decree in favour of a creditor, whether whole or in part.

3. When it is proved that the company is unable to pay its debts.

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

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

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

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

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

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

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

(c) As per section 5810 -
- (i) Every Producer Company shall have at least 5 and not more than 15 directors.
- (ii) Where an inter-state co-operative society is incorporated as a Producer Company, such company may have more than 15 directors for a period of 1 year from the date of its incorporation as a Producer Company.

In the given case, the Producer Company is proposed to be incorporated afresh, and not to be incorporated by way of conversion of an inter-state co-operative society into a producer company. Therefore, it shall have a minimum of 5 directors.

Question 8:

(a) The High Court at Mumbai appointed the Official Liquidator as the liquidator of Privy Engineering Co. Ltd. Some of the creditors have brought to the notice of the liquidator that though the company is in liquidation for the past several years, nothing worthwhile has been done to speed up the winding up and no documents have been filed to indicate the progress of liquidation. Examine in this connection the nature and periodicity of returns required to be field by the liquidator in terms of the provisions contained in the Companies Act, 1956.

(b) Examine in the light of the provisions of the Companies Act, 2013 whether the following companies can be considered as "Foreign Companies":

(i) A company incorporated outside India having a share registration office at New Delhi;
(ii) A company incorporated outside India having shareholders who are all Indian Citizens;
(iii) A company incorporated in India but all the shares are, held by foreigners.

Also examine whether the above companies can issue Indian Depository Receipts under the provisions of the Companies Act, 1956?

Answer:

(a) The liquidator has to maintain an account of the proceedings of the winding up. As per section 462 of Companies Act, 1956, the liquidator shall comply with the following provisions:

(i) So long as the liquidator is in office, he shall present to the Court an account of his receipts and payments, at least twice a year. He shall furnish the Court with such vouchers and information as the Court may require. The Court may require the production of any books or accounts kept by the liquidator.

(ii) The Court shall cause the account to be audited in such manner as it thinks fit.

(iii) The account shall be in the prescribed form, shall be made in duplicate, and shall be verified by a declaration in the prescribed form. One copy of the account shall be kept by the Court and the other shall be filed with the registrar.

(iv) The copies filed with the Court and the registrar shall be open to the inspection of any creditor, contributory or any other interested person.

(v) A printed copy of the audited accounts shall be sent by the liquidator to every creditor and to every contributory. Instead of the complete account, a summary of the account may be sent. However, the Court may dispense with sending of account or summary thereof, e.g., where the assets of the company are not sufficient to meet all the liabilities.

(vi) In case of a Government company, the liquidator shall send a copy of the accounts to the Central Government and/or the State Government, as the case may be.

As per section 551 of Companies Act, 1956, the liquidator shall submit to the Court information relating to pending liquidation. The liquidator shall comply with the following provisions:

(i) Where the winding up proceedings continue for more than 1 year, the liquidator shall file a statement with respect to the proceedings of winding up.

(ii) The statement shall be duly audited by a person who is qualified to act as an auditor of the company.

(iii) The statement shall be filed within 2 months of the end of the first year and thereafter until the winding up is concluded, at intervals of not exceeding 1 year.

(iv) The statement is to be filed with the Court. A copy shall also be filed with the registrar.

In the given case, no documents have been filed by the liquidator. Therefore, the liquidator has made a default in compliance with the provisions of sections 462 and 551. For default of section 551, the liquidator shall be punishable with fine which may extend to ₹ 5,000 per day during which the failure continues. Since no penalty has been provided for contravention of section 462, the residuary penalty section 450 of Companies Act, 2013 gets attracted and consequently the liquidator shall be punishable with fine which may extend to ₹ 5,000 and a further fine of ₹ 5,000 per day in case of continuing contravention.

(b) As per section 2(42) of Companies Act,2013, 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.

The answer to the given problem is as follows:
(i) A share transfer office or share registration office constitutes a place of business (Section 386 of the Companies Act, 2013). Since, the company incorporated outside India has a share registration office at New Delhi, it is clear that the company has established a place of business in India and is therefore a foreign company.
(ii) A company incorporated outside India does not become a foreign company by the mere fact that all its shareholders are Indian citizens. Assuming that the company has not established any place of business in India, the company is not a foreign company.

(iii) A company incorporated in India is a 'company' within the meaning of Clause (20) of Section 2 of the Companies Act, 2013. It cannot become a foreign company by the mere fact that all the shares of the company are held by foreigners.

Section 605A of the Companies Act, 1956 authorises a company incorporated outside India (whether or not it has established a place of business in India, i.e. whether or not it is a foreign company) to issue Indian Depository Receipts in accordance with the Rules prescribed by the Central Government. Accordingly, -

(i) 'A company incorporated outside India having a share registration office at New Delhi' can issue IDRs.
(ii) 'A company incorporated outside India having shareholders who are all Indian Citizens' can issue IDRs.
(iii) 'A company incorporated in India but all the shares are held by foreigners' cannot issue IDRs.

Question 9:

(a) Explain briefly with reference to Companies Act,1956 the provisions relating to -

(1) Transfer of shares to be void after the commencement of winding up
(2) Disclosure of continuance of liquidation
(3) Submission of information as to pending liquidation

(b) Mr. Scrooge, a director of Donald Ltd. made default in filing of annual accounts and annual returns with the Registrar of Companies for a continuous period of three financial years ending 31st March, 2005. Referring to the provisions of the Companies Act, 1956 examine the validity of the following:

(i) Whether Scrooge can continue to be a director of Donald Ltd., and also Duckky Ltd., where he is a director. Also state whether he can be reappointed as a director in Donald Ltd. as well as Duckky Ltd.
(ii) Would your answer be still the same in case Scrooge is a nominee director of a Public Financial Institution?
(iii) What would be your answer in case the defaulting company (i.e. Donald Ltd.) is a private company?

Answer:

(a)

(1) Transfer of shares to be void (Section 536)

Any transfer of shares and alterations in the status of the members of the company made after the commencement of the winding up shall be void, except if made with the sanction of the liquidator.

(2) Disclosure of continuance of liquidation (Section 547)

Every document of the company on which the name of the company appears, shall contain a statement that it is being wound up, e.g., by writing the words 'in liquidation'. These documents include invoices, orders for goods, letters and other documents, whether issued by the liquidator, receiver or manager of the property of the company.

(3) Submission of information as to pending liquidation (Section 551)

(a) When is submission required? Where the winding up proceedings continue for more than 1

year, the liquidator shall file a statement with respect to the position of the liquidation.

(b) Audit. The statement shall be duly audited by a person who is qualified to act as auditor of the company.

(c) Time limit for filing. The statement shall be filed within 2 months of the end of the first year and thereafter until the winding up is concluded, at intervals of not exceeding 1 year.

(d) With whom to be filed? In case of winding up by the Court or under supervision of the Court, the statement is to be filed with the Court. A copy shall also be filed with the registrar. In case of voluntary winding up, the statement shall be filed with the registrar.

(b) The legal position

1. A director of a public company shall be disqualified from being appointed as a director in any other public company, if the public company of which he is already a director -
   (i) does not file the annual accounts and annual returns for any continuous 3 financial years commencing on and after 1.4.1999; or
   (ii) fails to repay its deposit or interest thereon on due date or redeem its debentures on due date or pay dividend and such failure continues for 1 year or more. Such disqualification shall remain in force for a period of 5 years.

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

3. The disqualification under section 274(l)(g) shall apply if -
   (i) the company which has committed any of the two defaults mentioned under section 274(l)(g) is a public company (i.e. the defaulting company is a public company); and
   (ii) the company in which the director is seeking appointment or reappointment is a public company, other than the defaulting company (i.e. the appointing company is a public company).

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

5. The Department of Company Affairs (Now Ministry of Corporate Affairs) has clarified that nominee directors appointed by the Financial Institutions having non-obstante provisions over the Companies Act, 1956 like IDBI, LIC, UTI, etc., in their respective statutes, shall not be liable to be disqualified under section 274(l)(g) [Department Circular No. 11/2001, dated25.5.2001].

The Given Case

A public company namely Donald Ltd. has made default in filing of annual accounts and annual returns for 3 consecutive financial years ending 31st March, 2005. Mr. Scrooge is a director in Donald Ltd.
Hence,

(i) Non-filing of annual accounts and annual returns for 3 consecutive financial years results in incurring disqualification for appointment or reappointment as a director, but it does not

result in vacation of office. Therefore, Scrooge can continue to be a director in Donald and also in Duckky Ltd.
Scrooge cannot be reappointed as a director in Duckky Ltd. since a director disqualified under section 274(1)(g) is not eligible for reappointment in any other public company. However, Scrooge can be reappointed as a director in Donald Ltd. since a director disqualified under section 274(1)(g) is not disqualified for reappointment in the defaulting company.

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

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

Question 10:

(a) Mr. John has been appointed as additional director on the Board of MCX Ltd. on 12th January, 2006. Mr. John has filed his consent to Act as a director, if appointed, only with the company. Examine with reference to the provisions of the Companies Act, 1956 whether he is also required to file his consent with the Registrar of Companies.

(b) The Articles of Association of Smile Ltd. provide that the qualification of a director shall be holding of at least 10 shares in the company. Mr. Rishab has been appointed as a director in the said meeting on 1st May, 2014. Mr. Rishab applied for 10 equity shares of the company on 30th July, 2014. The said shares were allotted to him on 20th August, 2014 when the Board meeting was held.
Discuss the relevant provisions of the Companies Act, 1956 in the matter of share qualification requirements and the consequences of non-compliance thereof. Also state whether Mr. Rishab has complied with the requirements in this regard.

Answer:

(a) The present problem relates to section 264(2) of the Companies Act, 1956.

The legal position

1. As per section 264(1), every person proposed as a director (subject to certain exceptions) shall file his consent with the company.
2. As per section 264(2), a person shall not act as a director unless he has filed his consent within 30 days with the Registrar. However, following persons need not file their consent with the Registrar:
   (i) A director reappointed after retirement (whether by rotation or otherwise).
   (ii) Additional director, alternate director or a person filling a casual vacancy when appointed as a director or reappointed as an additional or alternate director.
   (iii) A director named in the articles as first registered.

The given case

Mr. John filed his consent under section 264(1), to act as a director, with the company. The issue raised in the given case is "whether Mr. John is required to file his consent under section 264(2), after he is appointed as an additional director?"

Analysis of the case

As per section 264(2), consent is not required to be filed with the registrar when, at an ASM, the tenure of additional director has to come to an end, and he is appointed as a regular director by the members in the same ASM (by complying with the requirements of section 257). Thus, the exemption from filing the consent is available only when at the time of appointment as a regular director at an ASM, the person is already an additional director.
When a person who is not a director at all, is appointed as an additional director, no exemption from filing consent is available under section 264(2). Thus, consent is to filed with the registrar within 30 days of appointment as an additional director.

Hence we can conclude that, Mr. John is required to file his consent with the Registrar within 30 days of his appointment as an additional director.

(b) In the given case, Mr. Rishab was appointed as a director on 1.5.2014 and therefore, he must obtain the qualification shares on or before 1.7.2014. Mr. Rishab applied for shares on 30.07.2014. However, his office of director had already been vacated as on 2.7.2014. As on 30.07.2014, he was not a director, and so question of obtaining qualification shares does not arise. Therefore, Mr. Rishab has not complied with the requirements of qualification shares specified u/s 270. In this case, following consequences shall follow.

(i) Mr. Rishab shall vacate the office of the director on 2.7.2014. The vacation of office shall be automatic and no notice is required to be given to Mr. Rishab.

(ii) If he acts as a director when he knows that the office of director held by him has become vacant, he shall be punishable with fine upto ₹ 5,000 per day for the period he acts as a director [Section 283(2/1) of Companies Act, 1956].

(iii) If after the expiry of 2 months, a person acts as a director when he does not hold the qualification shares, he shall be punishable with fine upto ₹ 500 per day for the period he acts as a director [Section 272 of Companies Act, 1956].

The penalties prescribed under sections 283(2A) and 272 are cumulative.

Question 11:

(a) Board of Directors of M/s. Regal Ltd. in its meeting held on 29th May, 2014 declared an interim dividend payable on paid up Equity Share Capital of the Company. In the Board Meeting scheduled for 10th June, 2014, 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.

(b) Under provisions of Companies Act, 1956, relating to producer company, examine whether the office of director of such company shall fall vacant in the following circumstances:

(i) Asraf, a Director of Rimjhim Ltd., a producer company has made a default in payment of loan taken from a company and default continues for 60 days.

(ii) Zulfi, a Director of the above company could not call the Annual General Meeting for the company due to some natural calamity occurred three days before the Schedule date.

(c) By an oversight, a notice of meeting of the Board was not sent to one of the directors who were in India. Is the meeting valid, as per Companies Act, 1956 ?

Answer:

(a) As per section 2(35) of the Companies Act, 2013, dividend includes any interim dividend.

Therefore, all the provisions applicable to final dividend shall equally apply to interim dividend. Thus, interim dividend once declared, like final dividend, is a debt due from the company. Accordingly, once declared, interim dividend cannot be revoked except under the same circumstances in which the final dividend can be revoked.
The amount of interim dividend is to be compulsorily deposited in a separate bank account, within 5 days of passing the Board resolution declaring the interim dividend [Section 205(1A)].

The provisions contained in sections 205, 205A, 205C, 206, 206A of the Companies Act, 1956 and Section 127 of the Companies Act, 2013 shall, as far as may be, also apply to any interim dividend [Section 205(1C) of the Companies Act, 1956].

As per section 127 of the Companies Act, 2013, 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, 2014, 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 2014.
Therefore, revocation of interim dividend in the Board Meeting held on 10th June is not possible.

(b) The given problem relates to sections 581Q of the Companies Act, 1956, as discussed below: Besides other grounds specified under section 581Q, the office of a director of a Producer Company shall become vacant in the following cases:

- Where the Producer Company, in which he is a director, has made a default in repayment of any advances or loans taken from any company or institution or any other person and such default continues for 90 days.

- Where the annual general meeting or extraordinary general meeting of the Producer Company, in which he is a director, is not called in accordance with the provisions of this Act except due to natural calamity or such other reason.

The given problem is answered as under:

(i) The producer company Rimjhim Ltd. has made a default in payment of loan and such default has continued for 60 days.
This does not result in vacation of office of Asraf, since the said default has not continued for 90 days, which is a pre-requisite for vacation of office under section 581Q.

(ii) The Annual General Meeting could not be called due to some natural calamity.
The office of director of Mr. Zulfi does not fall vacant since the reason for non-calling of the general meeting is some natural calamity.

(c) According to section 286 of Companies Act, 1956, notice of every meeting of the Board shall be given in writing to every director in India and to every other director at his usual address in India. Provisions of section 286 are mandatory and failure to send the notice even to a single director would make the meeting and the resolution passed at the meeting null and void [Kuldip Singh Dhillon v Paragon Utility Financiers (P) Ltd. (1988) 60 Comp Cas 77]. Even an accidental omission to give notice to a director would make the meeting invalid [Parmeshwari Prasad Gupta v Union of India(1974) 44 Comp Cas 1].

<u>Question 12:</u>

(a) One of the directors of Fast Track Company has been prosecuted for non-payment of sales tax by the company. He intends to obtain relief under the Companies Act. Will he suceed, as per provisions of Companies Act, 2013.

(b) In a Board meeting, a few directors raise disagreements on the minutes of the earlier Board meeting alleging that the decisions were recorded wrongly. Advise the chairman, as per Companies Act, 1956.

(c) Decide in the light of the provisions of the Companies Act,2013 the validity and extent of powers of Board of Directors and the procedure to be complied with in the following matters:
Donation of ₹5 lakhs to a political party registered with the appropriate authority.

<u>Answer:</u>

(a) The Court may, in its discretion, relieve an officer of the company from liability, if it appears to the Court that -

(i) he is or may be liable for negligence, default, breach of duty, misfeasance or breach of trust;
(ii) he has acted honestly and reasonably; and
(iii) having regard to all the circumstances of the case, he ought fairly to be excused.

Relief under section 463 of the Companies Act, 2013 cannot be extended in respect of any liability under any Act, other than the Companies Act. The expression any proceedings' occurring in section 463 of the Companies Act, 2013 cannot be read out of context and treated in isolation, and must be confined to the Companies Act only.

Accordingly, section 463 of the Companies Act, 2013 applies to all legal proceedings under the Companies Act only. Otherwise the application of section 463 of the Companies Act, 2013 would result in the penal provisions of other Acts being rendered ineffective. Furthermore, if the parliament had intended that section 463 of the Companies Act, 2013 should apply to other Acts also, it would have specifically provided for it. It is a sound rule of construction to confine the provisions of a statute to itself and therefore section 463 of the Companies Act, 2013 cannot be availed in respect of any proceedings under any other Act [Rabindra Chamaria v ROC[1992) 73 Comp Cas 257].

In the present case a director of the company has been prosecuted under the Sales Tax Act. Since the application of section 463 is restricted to Companies Act only, the Court cannot grant any relief to the director.

(b) The provisions relating to minutes of Board meeting are contained in sections 193 to 195 of Companies Act, 1956. As per section 193, minutes of Board meeting shall be signed by the chairman of the same meeting or chairman of the next succeeding meeting.

The chairman has an absolute discretion in regard to the inclusion or non-inclusion of any matter in the minutes. If minutes have been drafted by the secretary but have not been signed, any alteration may be made in the minutes by the chairman. Such alteration does not require passing of any Board resolution or consent of any of the directors.
However, if minutes have already been signed but certain directors raise disagreements on the minutes, the proper course is to pass a fresh resolution modifying the earlier resolution recorded in the minutes. The old minutes shall not be deleted or crossed out [Re, Cawley and Company, (1889) 42 Ch. D 209].

In the given case it is not clear whether the minutes have already been signed by the chairman or not (since minutes of a Board meeting can be signed even after the conclusion of succeeding Board meeting). If the minutes have not been signed, the chairman may, after considering the objections of the directors, make alterations in the minutes drafted by the secretary. However, if the minutes have already been signed, then the chairman should allow the moving of a motion, for passing a fresh resolution modifying the earlier resolution. Such subsequent resolution would make the earlier resolution inoperative.

(c) As per section 182 of the Companies Act, 2013, a company shall not make a political contribution unless all the following conditions are satisfied:

(i) The company is not a Government company.
(ii) The company has been in existence for 3 or more financial years.
(iii) The aggregate amount of political contribution in a financial year shall not exceed 7.5% of average net profits during immediately preceding 3 financial years.
(iv) The Board shall make a political contribution only by passing a resolution at a Board meeting.
(v) The company shall disclose in its profit and loss account the amount of political contribution and the name of the political party or the person to whom such amount has been contributed.

In the given case, the Board shall be entitled to make the political contribution of ₹ 5 lakh only if -
(i) the company has been in existence for 3 financial years;
(ii) the average net profits of the company during immediately preceding 3 financial years is equal to or more than ₹66,66,667 (i.e. 5,00,000 x 100/7.5); and
(iii) the resolution approving the political contribution is passed at a Board meeting;
The Board shall ensure that adequate disclosures are made in the profit and loss account.

Question 13:

(a) Adil, a 15% shareholder of a company and other shareholders have lost confidence in the Managing Director (MD) of the company. He is a director not liable to retire by rotation and was re-appointed as Managing Director for 5 years w.e.f. 1.4.2005 in the last Annual General Meeting of the company.
Mr. Adil seeks your advise to remove the MD after following the procedure laid down under the Companies Act, 1956.
(i) Specify the steps to be taken by Mr. Adil and the Company in this behalf;
(ii) Is it necessary to state reasons to support the resolution for his removal?

(b) M/s Oasis Builders Limited is contemplating to enter into a joint venture agreement with another construction company for the development of landed properties located at Bangalore. Since it is not possible to convene the Board meeting immediately, as the directors are. at different places in connection with various works, the managing director seeks your advice as to whether the resolution pertaining to the joint venture agreement is required to be passed at the Board meeting convened for the purpose or whether it can be passed by means of a circular resolution. What steps are required to be taken to pass a Board resolution by circulation?

(c) Seven wonders Limited has 9 Directors out of whom 3 Directors have gone abroad. The Chairman had an urgent matter to be approved by the Board of Directors which could not be postponed till the next Board meeting. The Company, therefore, circulated the resolution for approval of the Directors. 4 out of 6 Directors in India approved the resolution. The Company claimed that the resolution was passed. Examine with reference to the provisions of Section 289 of the Companies Act, 1956 the validity of the resolution.

Answer:

(a) Removal of a non-rotational managing director is possible, since section 284 empowers the members to remove any director, whether he is a rotational or non-rotational director, or managing director, whole time director or a non-executive director.

The given problems are answered as under:

(i) Steps to be taken by Mr. Adil
Mr. Adil shall give a special notice to the company at least 14 days before the general meeting.
Steps to be taken by the company
(a) The company shall send a copy of special notice to the managing director.
(b) The managing director has a right to make a representation against his removal.
(c) Representation given by the managing director, if any, shall be sent by the company to every member at least 7 days before the general meeting.
(d) If the representation is not sent to the members, the representation shall be read at the general meeting.
(e) The general meeting shall be held.
(f) The managing director shall have a right to be heard at the meeting. The right to make an oral representation is in addition to, written representation.

(ii) Whether it is necessary for the special notice must disclose the reasons for removal of a director -
It was held in LIC v Escorts Ltd. (1986) 59 Comp Cas 548 that it is not necessary for a member to state the grounds for removal of a director at the time of calling the extraordinary general meeting. The Court held that, under section 173, it is the duty of the management to disclose the material facts in the explanatory statement. Section 173 does not require a member to disclose the reasons for the resolutions proposed at the meeting. In other words, a member cannot be compelled to disclose the reasons for proposing a resolution for removal of a director.

Therefore, non-disclosure of reasons for removal of managing director does not make a special notice invalid. Accordingly, the special notice given by Mr. Adil is as per the requirements of Companies Act, 1956, and the company is required to act on such notice as per the provisions of section 284.

(b) The Board can pass any resolution by circulation except those resolutions which are required by the Act to be passed only at a Board meeting. For example, powers specified under sections 292, 372A, 316 and 386 of Companies Act, 1956 can be exercised only by passing a resolution at a duly convened Board meeting.

The Act does not require holding of a Board meeting for entering into a joint venture agreement. Thus, the Board can enter into a joint venture by passing a resolution by circulation provided the joint venture does not contain any matter which is to be compulsorily exercised in a BM. Also the Board shall ensure the compliance of the following conditions:

(a) The number of directors present in India must not be less than the quorum fixed for a meeting of Board of directors.
(b) The resolution shall be circulated in draft, together with necessary papers, to all the members of Board or committee then in India and to all other members at their usual address in India.
(c) The resolution shall be approved by -
    (i) all the directors who are then in India and are entitled to vote on the resolution; or
    (ii) a majority of all the directors who are entitled to vote on the resolution.

(c) A resolution is said to be duly passed by circulation if the following conditions are satisfied;
    (i) The resolution shall be circulated in draft, together with necessary papers, to all the members of Board or committee then in India and to all other members at their usual address in India.
    (ii) The resolution shall be approved by such of the directors as are then in India or by a majority of such of them as are entitled to vote on the resolution.

In the present case, 3 directors (1/3rd of 9 directors) shall form the quorum for a meeting of Board of directors. Since, 6 directors are present in India, the quorum required for holding a Board meeting is present and so the resolution may be passed by circulation. The resolution shall be passed only if -
(i) any of the 5 directors (whether in India or outside India) vote in favour of the resolution; or
(ii) all the 6 directors who are present in India vote in favour of the resolution.

In the given case, the resolution has been approved by 4 out of 6 directors who are for the time being in India. Since neither the approval of all the directors in India is obtained (viz. 6) nor the approval of majority of those directors who are entitled to vote (whether in India or outside India) is obtained (viz. 5), the resolution shall not be deemed to be passed by circulation. Thus, the resolution is not validly passed.

STUDY NOTE 2 – LAWS AND PROCEDURES FOR CORPORATE RESTRUCTURING:

Question 14:

(a) A meeting of members of a company was convened under the orders of the Court to consider a scheme of compromise and arrangement. The meeting was attended by 200 members holding 5,00,000 shares in aggregate. 70 members holding 4,00,000 shares voted for the scheme. The remaining members voted against the scheme. Examine with reference to the relevant provision of the Companies Act, 1956 whether the scheme is approved by the required majority.

(b) Explain the term 'arrangement'.

Answer:

(a) The given problem relates to section 391 of the Companies Act, 1956.

The legal position

Where the scheme of compromise of arrangement is required to be approved by the members, it must be approved by a majority of the members who are present and voting. Such majority of members must also be the members representing three-fourths in the value of members present and voting at the meeting. In other words, a scheme of arrangement between the company and members must be approved by more than 50% of the members who hold at least 75% of the value of shares. It is to be noted that members or creditors not present in the meeting or present in the meeting but abstain from voting, are not to be counted.

Members or creditors may vote in person or by proxy, where the proxies are allowed.

The given case

Members who attended the meeting	200 members
Shares held by the members who attended the meeting	5,00,000 shares
Members who voted in favour of the scheme	70 members
Shares held by the members who voted in favour of the scheme	4,00,000
Members who voted against the scheme	130 members
Shares held by the members who voted against the scheme	1,00,000

Hence, the scheme has not been approved by the majority of members, present and voting, though it has been approved by the members holding three-fourth of the shares. It is evident that the requirements of approval by members in terms of 'majority in number of members' and 'three-fourths in value of shares' are cumulative, i.e., these are two separate compliances. Accordingly, the scheme has not been approved by the requisite majority, and therefore this scheme shall not be sanctioned by the Court.

(b) Arrangement involves a readjustment of the rights and liabilities of the members or creditors or any class of them. There need not be any dispute for an 'arrangement'. The term is wider in scope than the word 'compromise'. It includes any form of internal reorganisation of the company or its affairs, as well as scheme for amalgamation of two or more companies. A few examples of arrangement are as follows:

(i) Issue of fully paid up shares to pay off debentures.
(ii) Creditors agreeing to waive a part of their dues.
(iii) Preference shareholders surrendering their right of arrears of dividend.
(iv) Exchange of company's assets for shares in a newly formed company.

Arrangement includes reorganisiation of the share capital of the company. It includes the following methods:
(i) the consolidation of shares of different classes; or
(ii) the division of shares into shares of different classes; or
(iii) both these methods.

The words 'compromise' and 'arrangement' imply that both the parties make concessions and give up something. A total surrender of the rights by one party would not amount to a compromise or arrangement. As such, where it was proposed that members should abandon all their rights without any compensating advantage, it was held not to be a compromise or arrangement and hence the Court had no jurisdiction to sanction it [Re, N.F.U. Development Trust Ltd (1972) 1 WLR 1548].

Question 15:

(a) M/s Moonlit Consultants Ltd. had, in the course of its operations over the years acquired various other ventures like plantations and tourism businesses. With a view to consolidate its core business activities, the management decided to hive off its non-core activities by demerging them with an associate company. Advise, with reference to Companies Act, 1956 briefly the steps the management should take to achieve the purpose of demerger.

(b) At the time of filing of the petition for amalgamation, the object clause of both the transferor and transferee Companies does not contain power to amalgamate. Comment on the statement, based on Companies Act, 1956.

Answer:

(a) For effecting the reconstruction of a company, the provisions of section 394 of Companies Act, 1956 need to be complied with. Section 394 requires that an application shall be made to the Court under section 391 (under section 391, an application is made to the Court for entering into a compromise or arrangement). Since, demerger is also a kind of reconstruction, M/s Moonlit Consultants Ltd may demerge its plantation and tourism business by complying with the provisions of section 394, which are as under:

1. Moonlit Consultants Ltd. (known as 'transferor company') shall prepare a draft scheme under which the assets and liabilities of Moonlit Consultants Ltd. as comprised in the plantation and tourism business shall be transferred to the associate company (known as 'transferee company'). The scheme shall specify the necessary details like-
(a) agreed values for transfer of assets and liabilities;
(b) the consideration for the transfer;
(c) where the associate company issues shares to the shareholders of M/s Moonlit Consultants Ltd., the exchange ratio of the shares;
(d) other terms and conditions.
2. An application shall be made to the Court by Moonlit Consultants Ltd. jointly with the Associate company.
3. The Court may order that a meeting of the creditors or members or any class of them be called, held and conducted in the manner directed by the Court.
4. The Court shall give notice of every application seeking a compromise or arrangement to the Central Government. The Central Government is empowered to make a representation and the Court shall take into account such representation while passing any order in respect of the scheme of compromise or arrangement (Section 394A).
5. Where a meeting of creditors or members is called, the notice given to them must contain-
(a) the terms of the compromise or arrangement;
(b) an explanatory statement explaining the effect of compromise or arrangement;
(c) a statement explaining any material interests of the directors, managing director, or manager of the company. The effect of those interests on the scheme should be explained stating if and how they are different from the like interests of other persons.
6. The meeting shall be held and conducted in the manner as directed by the Court. The scheme must be approved by more than 50% of the members who hold at least 75% of the value of shares.
7. The Court has the discretion to sanction the scheme placed before it. Where the Court is Satisfied that the scheme is bona fide, it may sanction the scheme.
8. The scheme becomes effective only after a certified copy of the order is filed with the registrar. Until such filing the sanctioned scheme remains dormant and no creditor or

member can enforce any right under the scheme.

9. After the certified copy of the scheme is filed with the registrar, the company shall annex to every copy of memorar.dum, a copy of such scheme.
10. Necessary Steps shall be taken to give effect to the scheme as approved by the Court.

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

However, to amalgamate with another company is a power of the company, and not an object of the company. Therefore, no power to amalgamate is required in the memorandum of a company before making an application to the Court for effecting amalgamation. Also, the power to amalgamate has been given by the statute under section 394 of Companies Act, 1956. Since there is a statutory provision dealing with amalgamation of companies (which does not require that such a provision must be present in the memorandum or articles of the company), no special power in the objects clause of the memorandum is necessary for its amalgamation with another company. Section 394 is a complete code which gives full jurisdiction to the Court to sanction amalgamation of companies, even though there may be no power in the objects clause of memorandum [Re, EITA India Ltd., AIR 1997 Cal 208; United Bank of India v United India Credit d Development Co. Ltd. (1977) 47 Comp Cos 689, 730 (Cal)].

<u>**Question 16:**</u>

(a) Unhappy Ltd. has gone into liquidation because of the inability of the company to pay its debts. During the course of winding up, a proposal was put forward by the previous management to revive the working of the company through a scheme of arrangement between the company and its creditors. As per the scheme, all the creditors have to forego fifty percent of their dues. Some of the creditors have voiced their opposition to the said scheme. The company approaches you for advice. State the steps that have to be taken by the company in this regard, as per companies Act, 1956.

(b) The members of both Sujata Synthetix Limited and Gita Textiles Limited approved the scheme of amalgamation by overwhelming majority. A reputed firm of Chartered Accountants fixed the exchange ratio. The scheme of amalgamation was submitted, as per procedure, for the sanction of the Court. During pendency of the matter a small group of members of one of the merging companies objected to the amalgamation on the ground that the exchange ratio was unfair.
Decide whether the said objection is likely to be sustained. Would your answer be different if similar objection was raised by the Central Government?

<u>**Answer:**</u>

(a) Section 517, of Companies Act, 1956 provides the opportunity to a company to enter into an arrangement with its creditors even though it is about to be, or is in the course of being, wound up. However, a company can claim the benefit of section 517 only in case of voluntarily winding up (whether members' voluntary winding up or creditors' voluntary winding up).

1. <u>Requirements of section 517:</u>

   The provisions of section 517 are explained as under:
   (a) The scheme of arrangement must be sanctioned by a special resolution of the company.
   (b) The scheme must also be agreed to by three-fourths in number and value of the

creditors.
(c) Any creditor or contributory may, within 3 weeks from the completion of the arrangement, appeal to the Court against the scheme of arrangement.
(d) On an appeal made to the Court, the Court shall have the power to amend, vary, confirm or set aside the arrangement.

2. <u>Procedure under section 517:</u>

A company may enter into a scheme of arrangement with the creditors by following the procedure as given hereunder:
(a) The draft scheme of arrangement shall be considered and approved by the Board of directors.
(b) The company shall apply to the Court for directions to convene the meetings of the members and creditors.
(c) A general meeting of the company shall be held and the special resolution approving the scheme of arrangement shall be passed.
(d) A meeting of creditors shall be held whereat the scheme shall be agreed to by three-fourths in number and value of the creditors.
(e) The company shall approach the Court for approval of the scheme.
(f) On receipt of the Court's order, the company shall file a certified copy of the Court's order with the registrar.

(b) On an application made to the Court for sanctioning a scheme of amalgamation or reconstruction, the Court may make an order sanctioning it. Once statutory formalities are complied with, the onus lies on those opposing the scheme to satisfy the Court that the scheme is unfair or unreasonable or fraudulent [Re, Hindustan General Electric Corporation Ltd. (1959) 29 Comp Cas 46; Re, Sussex Brick Co. Ltd. (1960) 30 Comp Cas 536].

Where, the valuation is confirmed to be fair by eminent firm of Chartered Accountants and is also approved by overwhelming majority, the Court will not find fault with the exchange ratio (Re, Tata Oil Mills Co. Ltd., Re, Hindustan Lever Ltd.).

Where the exchange ration was fixed by two reputed firms of chartered accountants who had examined the accounts, annual reports, working results and financial positions of the two companies and certified on that basis that the share exchange ratio of 5:2 was fair and reasonable, and the scheme was widely advertised, unanimously approved and no objection was raised by any of the affected quarters, and the Central Government had not affirmatively established that the valuation of assets was unfair or inequitable, the Court refused to interfere (M. G. Investment d Industrial Co. Ltd. v New Shorrock Spg. & Mfg. Co. Ltd.).

Thus, if, on overall consideration the Court is satisfied as to feasibility of the scheme, it should not hesitate to grant sanction [Re, Ucal Fuel Systems Ltd.].

Applying the above Court rulings, the given problems are answered as under:
(a) The dissenting shareholders shall not succeed unless they satisfy the Court that the valuation is grossly unfair (Re, Piramal Spg. & Wvg. Mills Ltd.)
(b) Even if exchange ratio is objected by the Central Government, the Court may sanction the scheme, since the representation or opinion made by the Central Government to the Court under section 394A is not binding on the Court.

STUDY NOTE 3 – SEBI LAWS AND REGULATIONS:

Question 17:

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

(b) Referring to the provisions of SEBI Act, 1992, discuss the meaning and functions of the board.

Answer:

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

1. Applicability:

An audit committee shall be set up –(a) All companies seeking listing for the first-time, at the time of seeking in-principle approval for such listing, and (b) all existing listed Companies with a Paid-up Capital of ₹3 crores or more, or Net Worth of ₹25 crores or more, at any time in the history of the Company.

2. Composition:

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

(i) The audit committee shall have minimum 3 directors as members. 2/3rd of the members of audit committee shall be independent directors.
(ii) All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.
(iii) The Chairman of the Audit Committee shall be an independent director;
(iv) The Chairman of the Audit Committee shall be present at Annual General Meeting to answer shareholder queries;
(v) The audit committee may invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit and a representative of the statutory auditor may be present as invitees for the meetings of the audit committee;
(vi) The Company Secretary shall act as the secretary to the committee.

3. Meeting of Audit Committee:

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

4. Powers of Audit Committee

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

(i) To investigate any activity within its terms of reference.
(ii) To seek information from any employee.

(iii) To obtain outside legal or other professional advice.
(iv) To secure attendance of outsiders with relevant expertise, if it considers necessary.

5. Review of Information:

The Audit Committee shall mandatorily review the following:
(i) Management discussion and analysis of financial condition and results of operations,
(ii) Statement of significant Related party Transactions, submitted by management,
(iii) Management Letters/Letters of Internal Control Weaknesses issued by the Statutory Auditors,
(iv) Internal Audit Reports relating to Internal Control Weaknesses, and
(v) Appointment, removal and terms of remuneration of the Chief Internal Auditor.

(b) As per section 2(1)(a) of SEBI Act, 1992, "Board" means the Securities and Exchange Board of India established under section 3;

As per section 3:
(1) With effect from such date as the Central Government may, by notification, appoint, there shall be established, for the purposes of this Act, a Board by the name of the Securities and Exchange Board of India.
(2) The Board shall be a body corporate by the name aforesaid, having perpetual succession and a common seal, with power subject to the provisions of this Act, to acquire, hold and dispose of property, both movable and immovable, and to contract, and shall, by the said name, sue or be sued.
(3) The head office of the Board shall be at Bombay.
(4) The Board may establish offices at other places in India

The functions of the board as per section 11 of SEBI Act, 1992 are as follows:

(1) Subject to the provisions of this Act, it shall be the duty of the Board to protect the interests of investors in securities and to promote the development of, and to regulate the securities market, by such measures as it thinks fit.

(2) Without prejudice to the generality of the foregoing provisions, the measures referred to therein may provide for-

(a) regulating the business in stock exchange and any other securities markets;

(b) registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with securities markets in any manner;

(c) registering and regulating the working of collective investment schemes, including mutual funds;

(d) promoting and regulating self-regulatory organizations;

(e) prohibiting fraudulent and unfair trade practices relating to securities markets;

(f) promoting investors' education and training of intermediaries of securities markets;

(g) prohibiting insider trading in securities;

(h) regulating substantial acquisition of shares and take-over of companies;

(i) calling for information from, undertaking inspection, conducting inquiries and audits of the stock exchange and intermediaries and self-regulatory organizations in the securities market;

(j) performing such functions and exercising such powers under the provision of the Capital Issues (Control) Act, 1947 (29 of 1947) and the Securities Contracts (Regulation) Act, 1956, (42 of 1956) as may be delegated to it by the Central Government;

(k) levying fees or other charges for carrying out the purposes of this section;

(l) conducting research for the above purposes;

(m) performing such other function as may be prescribed

STUDY NOTE 4 – THE COMPETITION ACT AND ITS ROLE IN CORPORATE GOVERNANCE:

Question 18:

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

(b) An arrangement has been made among the Silk Producers that the Silk produced by them will not be sold to mills below a Certain Price. The arrangement is in writing but it not intended to be enforced by legal proceedings. Examine whether the said arrangement can be considered as an arrangement within the meaning of Sec. 2 (b) of the Competition Act, 2002.

Answer:

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

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

2. Combination not to take effect if it has any adverse effect on competition:
Where the Commission is of the opinion that the combination has, or is likely to have, an appreciable adverse effect on competition, it shall direct that the combination shall not take effect.

3. Modification of combination to eliminate the adverse effect:

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

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

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

(iv) Refusal of parties to accept modification
- The parties to the combination may not accept the modification proposed by the Commission.
- In such a case, the parties may, within next 30 working days, submit amendment to the modification proposed by the Commission.
- However, if the parties do not accept the modification proposed by the Commission within 30 days, and also do not submit amendment to the modification proposed by the Commission, the combination shall be deemed to have an appreciable adverse effect on competition.

(v) Commission may agree to the amendments
If the Commission agrees with the amendment submitted by the parties, it shall, by order, approve the combination.

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

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

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

(b) As per Sec. 3(4), Vertical Agreements are amongst enterprises or persons at different stages or levels of the production chain in different markets, in respect of production, supply, distribution, storage sale or price of, or trade in goods (or) provision of services. They include the following arrangements / agreements –

1. Tie-in Arrangement:

Includes any agreement requiring a purchaser of goods, as a condition of such purchase, to purchase some other goods.

2. Exclusive Supply Agreement:

Includes any agreement restricting in any manner the purchaser in the course of his trade from acquiring or otherwise dealing in any goods other than those of the Seller or any other person.

3. Exclusive Distribution Agreement:
Includes any agreement to limit, restrict or withhold the output or supply of any goods, or allocate any area or market for the disposal or sale of goods.

4. Refusal to Deal:
Includes any agreement which restricts, or is likely to restrict, by any method, the persons or classes of persons to whom goods are sold or from whom goods are bought.

5. Resale Price Maintenance:
Includes any agreement to sell goods on condition that the prices to be charged on the resale by the Purchaser shall be the prices stipulate by the Seller, unless it is clearly stated that prices lower than those prices may be charged.

Such Vertical Agreements shall be considered anti-competitive (and hence void), if it causes or is likely to cause an appreciable adverse effect on competition in India.

Note:
Horizontal Agreements are presumed anti-competitive u/s 3(3) and hence void. However, Vertical Agreements are anti-competitive and void u/s 3(4) only when they cause appreciable adverse effect on competition in India.
In the given case, agreement stipulates the Resale Price and does not allow the Purchaser to sell the goods at prices lower than the stipulated prices, hence invalid. It is a Vertical Anti-Competitive Agreement.

STUDY NOTE 5 – LAWS RELATED TO BANKING SECTOR:

Question 19:

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

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

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

(d) Printed Computer is a Singapore based company having several business units all over the world. It has a unit for manufacturing computer printers with its headquarters in Pune. It has a branch in Dubai which is controlled by the headquarters in Pune. What would be the residential status under FEMA, 1999 of printer units in Pune and that of Dubai branch?

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

Answer:

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

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

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

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

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

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

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

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

1. Duties of Banking companies, Financial Institutions and Intermediaries [Section 12(1)]:

Every banking company or financial institution and intermediary shall -

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

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

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

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

Where the principal officer of a banking company or financial institution or intermediary, as the case may be, has reason to believe that a single transaction or series of transactions integrally connected to each other have been valued below the prescribed value so as to defeat the

provisions of this section, such officer shall furnish information in respect of such transactions to the Director within the prescribed time.

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

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

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

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

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

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

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

1. has, on more than one occasion, failed to comply with the directions given to it, in so far as such directions relate to banking policy, or
2. is being managed in a manner detrimental to the interests of its depositors, and that –
   (i) in the interests of the depositors of such banking company, or
   (ii) in the interest of banking policy, or
   (iii) for the better provision of credit generally or of credit to any particular section of the community or in any particular area, it is necessary to acquire the undertaking of such banking company, the Central Government may, after such consultation with the Reserve Bank as it thinks fit, by notified order, acquire the undertaking of such company (hereinafter referred to as the acquired bank) with effect from such date as may be specified in this behalf by the Central Government (hereinafter referred to as the appointed day).

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

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

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

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

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

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

(d) Section 2(u) defines a 'person'. As per this definition, the following shall be covered in the definition of a 'person':
(i) A company.
(ii) Any agency, office or branch owned by a 'person'.

Section 2(v) defines a 'person resident in India'. As per this definition, the following shall be covered in the definition of a 'person resident in India':
(i) An office, branch or agency in India owned or controlled by a person resident outside India.
(ii) An office, branch or agency outside India owned or controlled by a person resident in India.

In the given case, Printed Computers (Singapore), its headquarters in Pune as well as Dubai Branch is a 'person'. Therefore, residential status under FEMA shall be determined for each of them separately.

(i) Printed Computers (Singapore) does not fall under any of the clauses of the definition of a 'person resident in India'. Therefore, Printed Computers (Singapore) is a person resident outside India.
(ii) The Pune Headquarters of Printed Computers is a 'person resident in India' since it falls under the clause 'an office, branch or agency in India owned or controlled by a person resident outside India'.
(iii) The Dubai branch of Printed Computers (Singapore), though not owned, is controlled by the Pune headquarters. The Dubai branch is a 'person resident in India' since it falls under the clause 'an office, branch or agency outside India owned or controlled by a person resident in India'.

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

1. <u>Circumstances in which certificate may be cancelled [Section 4(1)]</u>

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

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

Opportunity of being heard before cancellation in certain cases [Proviso to Section 4(1)].

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

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

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

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

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

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

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

STUDY NOTE 6 – LAWS RELATING TO INSURANCE SECTOR:

Question 20:

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

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

Answer:

(a) The provisions of section 18 may be explained as follows:

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

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

Opportunity to Authority before giving directions [Proviso to Section 18(1)].

The Authority shall, as far as practicable, be given an opportunity to express its views before any direction is given under this sub-section.

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

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

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

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

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

(i) that, on account of circumstances beyond the control of the Authority, it is unable to discharge the functions or perform the duties imposed on it by or under the provisions of this Act; or
(ii) that the Authority has persistently defaulted in complying with any direction given by the Central Government under this Act or in the discharge of the functions or performance of the duties imposed on it by or under the provisions of this Act and as a result of such default the financial position of the Authority or the administration of the Authority has suffered; or
(iii) that circumstances exist which render it necessary in the public interest to supersede the Authority.

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

(i) The Central Government shall be required to issue a notification stating therein the reasons for supersession and the period of supersession, which shall not exceed 6 months.
(ii) Before issuing any such notification, the Central Government shall give a reasonable opportunity to the Authority to make representations against the proposed supersession and shall consider the representations, if any, of the Authority.
(iii) The Central Government shall appoint a person to be the Controller of Insurance under section 2B of the Insurance Act, 1938, if not already done.

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

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

(i) the Chairperson and other members shall, as from the date of supersession, vacate their offices as such;
(ii) all the powers, functions and duties which may, by or under the provisions of this Act, be exercised or discharged by or on behalf of the Authority shall, until the Authority is reconstituted under sub - section (3), be exercised and discharged by the controller of Insurance; and

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

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

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

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

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

Question 21:

(a) What are the provisions in the Insurance Act, 1938 regarding nomination by a Life Insurance Policy Holder? Whether a minor can be a nominee in a Life Insurance Policy

(b) Write short note on management by administrator under The Insurance Act, 1938.

Answer:

(a) The provisions regarding nomination by a Life Insurance Policy Holder are as under:

1. Nomination:

The holder of a policy of life insurance on his own life, may, when effecting the policy or at any time before the policy matures for payment, nominate the person or persons to whom the money secured by the policy shall be paid in the event of his death.

2. Endorsement on the policy:

Any such nomination in order to be effectual shall, unless it is incorporated in the text of the policy itself, be made by an endorsement on the policy communicated to the insurer and registered by him in the records relating to the policy and any such nomination may at any time before the policy matures for payment be cancelled or changed by an endorsement or a further endorsement or a will, as the case may be, but unless notice in writing of any such cancellation or change has been delivered to the insurer, the insurer shall not be liable for any payment under the policy made bona fide by him to a nominee mentioned in the text of the policy or registered in records of the insurer.

3. Acknowledgement:

The Insurer shall furnish to the Policy-Holder a written acknowledgement of having registered a nomination or a cancellation or change thereof, and may charge a fee not exceeding ₹1 for registering such cancellation or change.

4. Assignment u/s 38:

A transfer or assignment of a policy made in accordance with section 38 shall automatically cancel a nomination. The assignment, of a policy to the Insurer who bears the risk on the policy at the time of the assignment, in consideration of a loan granted by that insurer on the security of the Policy within its surrender value, or its reassignment on repayment of the loan shall not cancel a nomination, but shall affect the rights of the nominee only to the extent of the insurer's interest in the policy

5. Minor Nominee:

Where any nominee is a minor, it shall be lawful for the Policy Holder to appoint in the prescribed manner any person to receive the money secured by the policy in the event of his death during the minority of the nominee. Hence, a Minor can be a nominee in a Life Insurance policy.

(b) When Administrator for management of insurance business may be appointed [Section 52A]:

1. If at any time the Authority has reason to believe that an insurer carrying on life insurance business is acting in a manner likely to be prejudicial to the interests of holders of life insurance policies, he may, after giving such opportunity to the insurer to be heard as he thinks fit, make a report thereon to the Central Government.

2. The Central Government, if it is of opinion after considering the report that it is necessary or proper to do so, may appoint an Administrator to manage the affairs of the insurer under the direction and control of the Authority.

3. The Administrator shall receive such remuneration as the Central Government may direct and the Central Government may at any time cancel the appointment and appoint some other person as Administrator.

4. The management of the business of the insurer shall as on and after the date of appointment of the Administrator vest in such Administrator, but except with the leave of the Authority the Administrator shall not issue any further policies.

5. As on and after the date of appointment of the Administrator any person vested with any such management immediately prior to that date shall be divested of that management.

6. The Authority may issue such directions to the Administrator as to his powers and duties as he deems desirable in the circumstances of the case, and the Administrator may apply to the Authority at any time for instructions as to the manner in which he shall conduct the management of the business of the insurer or in relation to any matter arising in the course of such management.

Powers and duties of the Administrator [Section 52B]:

1. The Administrator shall conduct the management of the business of the insurer with the greatest economy compatible with efficiency and shall, as soon as may be possible, file with the Authority a report stating which of the following courses is in the circumstances most advantageous to the general interests of the holders of life insurance policies, namely:

(i) the transfer of the business of the insurer to some other insurer:

(ii) the carrying on of its business by the insurer (whether with the policies of the business continued for the original sum insured with the addition of bonuses that attach to the policies or for reduced amounts);

(iii) the winding up of the insurer; and
(iv) Such other course as he deems advisable.

2. On the filing of the report with the Authority, the Authority may take such action as he thinks fit for promoting the interests of the holders of life insurance policies in general.

3. Any order passed by the Authority under sub-section (2), shall be binding on all persons concerned, and shall have effect notwithstanding anything in the memorandum or articles of association of the insurer, or a company.

STUDY NOTE 7 – LAWS RELATING TO POWER SECTOR:

Question 22:

(b) Discuss the circumstances under which the Appropriate Government may revoke the license under The Electricity Act, 2003.

(c) What are the qualifications to be appointed as members of Central Commission as per 'The Indian Electricity Act, 2003'?

Answer:

(a) The circumstances under which the Appropriate Government may revoke the license under 'The Indian Electricity Act, 2003 has been stated under section 19 of the Act as follows:

1. If the Appropriate Commission, after making an enquiry, is satisfied that public interest so requires, it may revoke a license in any of the following cases, namely:

(a) where the licensee, in the opinion of the Appropriate Commission, makes willful and prolonged default in doing anything required of him by or under this Act or the rules or regulations made there under;
(b) where the licensee breaks any of the terms or conditions of his license the breach of which is expressly declared by such license to render it liable to revocation;
(c) where the licensee fails, within the period fixed in this behalf by his license, or any longer period which the Appropriate Commission may have granted therefore:
    (i) to show, to the satisfaction of the Appropriate Commission, that he is in a position fully and efficiently to discharge the duties and obligations imposed on him by his license; or and obligations imposed on him by his license; or
    (ii) to make the deposit or furnish the security, or pay the fees or other charges required by his license;
(d) Where in the opinion of the Appropriate Commission the financial position of the licensee is such that he is unable fully and efficiently to discharge the duties and obligations imposed on him by his license.

Where in its opinion the public interest so requires, the Appropriate Commission may, on application, or with the consent of the licensee, revoke his license as to the whole or any part of his area of distribution or transmission or trading upon such terms and conditions as it thinks fit.

No license shall be revoked under sub-section (1) unless the Appropriate Commission has given to the licensee not less than 3 months' notice, in writing, stating the grounds on which it is

proposed to revoke the license, and has considered any cause shown by the licensee within the period of that notice, against the proposed revocation.

The Appropriate Commission may, instead of revoking a license under sub-section (1), permit it to remain in force subject to such further terms and conditions as it thinks fit to impose, and any further terms or conditions so imposed shall be binding upon and be observed by the licensee and shall be of like force and effect as if they were contained in the license.

Where the Commission revokes a license under this section, it shall serve a notice of revocation upon the licensee and fix a date on which the revocation shall take effect.

Where an Appropriate Commission has given notice for revocation of license under sub-section (5), without prejudice to any penalty which may be imposed or prosecution proceedings which may be initiated under this Act, the licensee may, after prior approval of that Commission, sell his utility to any person who is found eligible by that Commission for grant of license.

(b) Qualification for appointment of Members of Central Commission [Section 77]:

1. The Chairperson and the Members of the Central Commission shall be persons having adequate knowledge of, or experience in, or shown capacity in, dealing with, problems relating to engineering, law, economics, commerce, finance or, management and shall be appointed in the following manner, namely:

(i) one person having qualifications and experience in the field of engineering with specialisation in generation, transmission or distribution of electricity;
(ii) one person having qualifications and experience in the field of finance;
(iii) two persons having qualifications and experience in the field of economics, commerce, law or management:

2. Notwithstanding anything contained in sub-section (1), the Central Government may appoint any person as the Chairperson from amongst persons who is, or has been, a Judge of the Supreme Court or the Chief Justice of a High Court:

Provided that no appointment under this sub-section shall be made except after consultation with the Chief Justice of India.

3. The Chairperson or any other Member of the Central Commission shall not hold any other office.

4. The Chairperson shall be the Chief Executive of the Central Commission.

STUDY NOTE 8 – CORPORATE GOVERNANCE:

Question 23:

(a) Explain the term "Corporate Governance", in details.

(b) Discuss about the importance and functions of the 'supervisory board' as per the Cromme code of Germany.

Answer:

There is no single, accepted definition of Corporate Governance. There are substantial differences in definition according to which country we are considering. Corporate Governance as a discipline in its own right is relatively new. We consider that the subject may be treated in a narrow or a broad manner, depending on the viewpoint of the policy maker, practitioner, researcher or theorist. It seems that existing definitions of Corporate Governance fall on to a spectrum, with 'narrow' views at one end and more inclusive, 'broad' views placed at the other.

Once approach toward Corporate Governance adopts a narrow view, where Corporate Governance is restricted to the relationship between a company and its shareholders. This is the traditional finance paradigm, expressed in 'agency theory'. At the other end of the spectrum, corporate governance may be seen as a web of relationships, not only between a company and its owners (shareholders) but also between a company and a broad range of other 'stakeholders': employees, customers, supplies, bondholders, to name but a few. Such a view tends to be expressed in 'stakeholder theory'. This is a more inclusive and broad way of treating the subject of corporate governance and one which is gradually attracting greater attention.

Corporate governance is…

- The process of supervision and control intended to ensure that the company's management acts in accordance with the interests of shareholders (Parkinson, 1994). – Strongly agree

- The governance role is not concerned with the running of the business of the company per se, but with giving overall direction to the enterprise, with overseeing and controlling the executive actions of management and with satisfying legitimate expectations of accountability and regulation by interests beyond the corporate boundaries (Tricker, 1984). – Agree

- The governance of an enterprise is the sum of those activities that make up the internal regulation of the business in compliance with the obligations placed on the firm by legislation, ownership trusteeship of assets, their management and their deployment (cannon, 1994). – Agree

- The relationship between shareholders and their companies and the way in which shareholders act to encourage best practice (e.g., by voting at AMs and by regular meetings with companies' senior management). Increasingly, this includes shareholder 'activism' which involves a campaign by a shareholder or a group of shareholders to achieve change in companies (the Corporate Governance Handbook, 1996). – Some agreement

- The structures, process, cultures and systems that engender the successful operation of the Organization (Keasey and Wright, 1993). – Some agreement

- The system by which companies are directed and controlled (The Cadbury Report, 1992) – slight agreement

Theoretical frameworks that suggest companies should be accountable only to their shareholders are not necessarily inconsistent with theoretical frameworks that champion stakeholder accountability. The reason underlying this argument is that shareholders' interest can only be satisfied by taking account of stakeholder interests, as companies that are accountable to all of their stakeholders are over the long term more successful and more prosperous. Definition of Corporate Governance therefore rests on the perception that companies can maximize value creation over the long term, by discharging their accountability to all of their stakeholders and by optimizing their system of Corporate Governance.

Overall, this perception is growing among the professional community and academic research is beginning to provide empirical in support of this view of corporate governance, accountability and corporate profitability. However, this is the 'business case' for corporate governance and, more generally, for corporate social responsibility. Should companies improve corporate governance and discharge accountability to all of their stakeholders purely because it is ethical? We discuss these ethical issues in the subsection on stakeholder theory. In the real world, it is unlikely that businessmen and investors will be interested in acting ethically unless there are positive financial returns to be made from so doing, as there appears to be a strong business case underlying corporate governance reform and stakeholder accountability, then the corporate and financial communities are more likely to embrace these approaches.

(b) The committee on corporate governance in Germany was chaired by Dr. Gerhard Cromme and is usually referred to as the Cromme Report or Cromme Code. The code harmonizes a wide variety of laws and regulations and contains recommendations and also suggestions for complying with international best practice on Corporate Governance.

The Cromme Code was published in 2002 and is split into a number of sections, starting with a section on shareholders and the general meeting. The Cromme Code also reflects some of the latest developments in technology. The Cromme Code was amended in 2005.

Supervisory board:

It is important that the composition of the supervisory board reflects a suitable level of knowledge, ability, and experience to be able properly to carry out the tasks relevant to the business. There should be an adequate number of independent members.

'Independence' will mean no business or personal relations with the company or its management board which cause a conflict of interest. To help maintain its independence, not more than two former members of the management board should be members of the supervisory board. The former management board chairman or a management board member should not generally become supervisory board chairman or chairman of a supervisory board committee. Supervisory board members should · not have director ships or similar positions or indeed have advisory roles with important competitors of the enterprise.

The supervisory board carries out a number of important functions as follows:

1. It provides independent advice and supervision regularly to the management board on the management of the business;
2. The management board and the supervisory board should ensure that there is a long-term succession plan in place;
3. The supervisory board may delegate some duties to other committees, which include compensation and audit committees;
4. The chairman of the supervisory board, who should not be the chairman of the audit committee, co-ordinates work within the supervisory board and chairs its meetings and attends to the affairs of the supervisory board externally.

It is worth elaborating on the committees that may be formed with a remit for various delegated areas. These may include the audit committee (the chairman of the audit committee should not be a former member of the management board of the company); the chairman of the audit committee should have specialist knowledge and experience in the application of accounting principles and internal control processes, and a compensation committee to look at the

compensation of the management board. This committee may also look at the appointment of members of the management board.

The Cromme Code also states that members of the management board of a listed company should not be on more than five supervisory boards in non-group listed companies. The compensation of members of the supervisory board is specified either by a resolution of the general meeting or in the articles of association. Members of the supervisory board may receive performance-related compensation as well as fixed compensation. The compensation of the supervisory board members should be disclosed in the Corporate Governance Report.

An interesting disclosure required by the Cromme Code is that if a supervisory board member takes part in less than half of the meetings of the supervisory board in a financial year, then this will be noted in the report of the supervisory board. Any conflicts of interest should be reported to the supervisory board and the supervisory board would then inform the general meeting of any conflicts of interest together with how these conflicts have been treated.

Question 24:

(a) Discuss about the following reports on Corporate Governance:

1. **Higgs Report**
2. **Smith Report and Guidance**
3. **Combined Code, 2003 and 2006**

(c) Discuss about the importance of Financial Reporting council.

Answer:

(a)

1. **Higgs Report:**

The Higgs Review, chaired by Derek Higgs, reported in January 2003 on the role and effectiveness of non-executive directors. Higgs offered support for the Combined Code whilst making some additional recommendations. These recommendations included : stating the number of meetings of the board and its main committees in the annual report, together with the attendance records of individual directors; that a chief executive director should not also become chairman of the same company; non-executive directors should meet as a group at least once a year without executive directors being present, and the annual report should indicate whether such meetings have occurred; chairmen and chief executives should consider implementing executive development programmes to train and develop suitable individuals in their companies for future director roles; the board should inform shareholders as to why they believe a certain individual should be appointed to a non-executive directorship and how they may meet the requirements of the role; there should be a comprehensive induction programme for new non-executive directors, and resources should be available for ongoing development of directors; the performance of the board, its committees and its individual members, should be evaluated at least once a year, the annual report should state whether these reviews are being held and how they are conducted; a full time executive director should not hold more than one non-executive directorship or become chairman of a major company; no one non-executive director should sit on all three principal board committees (audit, remuneration, nomination). There was substantial opposition to some of the recommendations but they nonetheless helped to inform the Combined Code. Good practice suggestions from the Higgs Report were published in 2006.

Following a recommendation in chapter 10 of the Higgs Review, a group led by Professor Laura Tyson, looked at how companies might utilize broader pools of talent with varied skills and experience, and different perspectives to enhance board effectiveness. The Tyson report was published in 2003.

2. Smith Report and Guidance:

The Smith Review of Audit Committees, a group appointed by the Financial reporting council, reported in January 2003. The review made clear the important role of the audit committee: 'While all directors have a duty to act in the interests of the company, the audit committee has a particular role, acting independently from the executive, to ensure that the interests of shareholders are properly protected in relation to financial reporting and internal control'. The review defined the audit committee's role in terms of a high-level overview-it needs to satisfy itself that there is an appropriate system of controls in place but it does not undertake the monitoring itself .

A new edition of the guidance was issued in October 2008. The main changes to the guidance as detailed on the FRC website are:
Audit committees are encouraged to consider the need to include the risk of the withdrawal of their auditor from the market in their risk evaluation and planning; companies are encouraged to include in the audit committee's report information on the appointment, reappointment or removal of the auditor, including supporting information on tendering frequency, the tenure of the incumbent auditor and any contractual obligations that acted to restrict the committee's choice of auditor; a small number of detailed changes have been made to the section dealing with the independence of the auditor, to bring the guidance in line with the Auditing Practices Board's Ethical Standards [2004, revised 2008) for auditors, which have been issued since the guidance was first published in 2003; and an appendix has been added containing guidance on the factors to be considered if a group is contemplating employing firms from more than one network to undertake the audit.

3. Combined Code, 2003 and 2006:

The revised Combined Code, published in July 2003, incorporated the substance of the Higgs and Smith reviews. However, rather than stating that no one non-executive director should sit on all three board committees, the Combined Code stated that 'undue reliance' should not be placed on particular individuals. The Combined Code also clarified the roles of the Chairman and the Senior Independent director (sid), emphasizing the Chairman's role in providing leadership to the non-executive directors and in communicating shareholders' views to the board; it also provided for a 'formal and rigorous annual evaluation' of the board's, the committees', and the individual directors' performance. At least half the board in larger listed companies was to be independent non-executive directors.

The findings of the Financial Reporting Council (FRC) *Review of the Impact of the Combined Code* were published in December 2007. The overall findings indicated that the Combined Code (2006) had general support and that the FRC would concentrate on improving the practical application of the Combined Code.
In June 2008, the FRC published a new edition of the Combined Code which introduced two changes. These changes were (i) to remove the restriction on an individual chairing more than one FTSE 100 company; and (ii) for listed companies outside the FTSE 350, to allow the company chairman to sit on the audit committee where he or she was considered independent on appointment.

The FRC stated on their website that the revised Code took effect at the same time as new FSA Rules implementing EU requirements relating to corporate governance statements and audit committees. The revised code and new rules will apply to accounting periods beginning on or after 29 June 2008. In practice this means most companies will begin to apply them in 2009, and will report against them for the first time in 2010.

(b) The Financial Reporting Council (FRC) has six operating bodies: the Accounting Standards Board (ASB), the Auditing Practices Board (APB), the Board for Actuarial Standards (BAS), the Professional oversight Board, the Financial Reporting Review Panel (FRRP), and the Accountancy and Actuarial Discipline Board (AADB).

The importance placed on corporate governance is evidenced by the fact that, in March 2004, the FRC set up a new committee to lead its work on corporate governance.
Overall, the FRC is responsible for promoting high standards of corporate governance. It aims to do so by:

- Maintaining an effective Combined Code on Corporate Governance and promoting its widespread application;
- Ensuring that related guidance, such as that on internal control, is current and relevant;
- Influencing EU and Global Corporate Governance developments;
- Helping to promote boardroom professionalism and diversity;
- Encouraging constructive interaction between company boards and institutional shareholders.

The FRC has carried out several consultative reviews of the Combined Code which led to the amended Combined Code in 2006, and subsequently in 2008 (discussed earlier). The latest review took place in 2008. The frequency of the reviews are both an indicator of the FRC's responsibility for corporate governance of UK companies which involves leading public debate in the area and its response to the global financial crisis which has, in turn, affected confidence in aspects of corporate governance.

The FRC website mentions the independent review of the governance of banks and other financial institutions carried out by Sir David Walker. The Walker Review published its draft recommendations in July 2009, some of the recommendations could be taken forward through amendments to the Combined Code. The FRC is considering the extent to which the Walker Review recommendations may be applicable for some or all listed companies in other sectors.

Question 25:

(a) State the responsibilities that the Boards of state-owned enterprises must undertake.

(b) Discuss about the most important challenge in maintenance of good corporate governance in state-owned enterprises.

(c) What is the importance of MoU in Public sector Enterprises?

Answer:

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

1. The boards of SOEs should be assigned a clear mandate and ultimate responsibility for the company's performance. The board should be fully accountable to the owners, act in the best interest of the company, and treat all shareholders equally.

2. SOE boards should carry out their functions of monitoring of management and strategic guidance, subject to the objectives set by the government and the ownership entity. They should have the power to appoint and remove the CEO.

3. The boards of SOEs should be so composed that they can exercise objective and independent judgment. Good practice calls for the chair to be separate from the CEO.

4. SOE boards should carry out an annual evaluation to appraise their performance.

(b) Conflicts of interest are a major challenge to the establishment and maintenance of good governance practices, and can occur and exist irrespective of the ownership structures. While some of the conflicts may be similar in nature, others may be typical to the type of ownership structure.

Most of the conflicts of interest in PSUs occur because of the roles played by bureaucrats and politicians in the running and management of the enterprise. For example, polticians or bureaucrats may try to have their candidate as the chairman and/or managing director in order to push through their private agendas rather than getting the best professional to run the PSU. There have also been many instances where the chairman and/or managing director, or other senior executives of the PSU has placed orders or awarded contracts at rates higher than the best prices, and earned hefty commissions on these. Orders or contracts may also be given to those who do not have the necessary capabilities to execute them. What is best for the PSU usually gets neglected. There may also be issues such as ministers or politicians yielding to recommendations of their cadre and sometimes even creating positions or designations that are not at all needed, leading the PSU to have a bloated workforce and driving it into the sick category. Politicians or bureaucrats may even harp on the flimsy reason that PSUs have employment generation as one of their aims. Most of the conflicts of interest with regret to PSUs dwell on the area of decision-making, which is very often not founded on merit.

(c) After Independence, Public Sector Enterprises (CPSEs) 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 CPSEs 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 CPSEs that have performed very well in competition with private sector enterprises, there are also many CPSEs that have performed very poorly. In an economic environment that has changed considerably in the last two decades, the role of CPSEs 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 CPSEs the necessary flexibility and autonomy to operate effectively in a competitive environment. However, there are a few issues with the operation and management of CPSEs 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.

Question 26:

(a) Discuss about the major developments in governance in India in the last decade.

(b) "MoU in India'. Comment.

Answer:

(a) The Indian economy, on the Twelfth Plan is characterized by strong macro-fundamentals and good performance over the Eleventh Plan period, though clouded by some slowdown in growth in the current year with continuing concern about inflation and a sudden increase in uncertainty about the global economy. The objective of the Eleventh Plan was faster and inclusive growth and the initiatives taken in the Eleventh Plan period have resulted in substantial progress towards both objectives. Inevitably, there are some weaknesses that need to be addressed and new challenges that need to be faced. Some of the challenges themselves emanate from the economy's transition to a higher and more inclusive growth path, the structural changes that come with it and the expectations it generates. There are external challenges also arising from the fact that the global economic environment is much less favourable than it was at the start of the Eleventh Plan. These challenges call for renewed efforts on multiple fronts, learning from the experience gained, and keeping in mind global developments.

The focus on the backdrop of target setting and areas of focus of the Eleventh Plan. India entered the Eleventh Plan period (2007-2012) with an impressive record of economic growth. The vision for the Eleventh Plan prominently included an improvement in governance. Over the years, the governments at the Centre and the States have launched a large number of initiatives at substantial public expense to achieve the objectives of growth with poverty alleviation and inclusiveness. Experience suggests that many of these initiatives have floundered because of poor design, insufficient accountability and also corruption at various levels. Increasingly, there is demand for effective implementation without which expanded government intervention will be infructuous. The strategy for the Eleventh Plan was therefore aimed at bringing about major improvements in governance which would make government-funded programmes in critical areas more effective and efficient. The best possible way of achieving this objective may be by involving communities in both the design and implementation of such programmes, although such involvement may vary from sector to sector. For achieving the vision of the Eleventh Plan, it is extremely important to experiment with programme design to give more flexibility to decision making at the local level. It is especially important to improve evaluation of the effectiveness of how government programmes work and to inject a commitment to change their designs in the light of the experience gained. Evaluation must be based on proper benchmarks and be scientifically designed to generate evidence-based assessment of different aspects of programme design. Along with greater transparency and feedback from community participation, this is particularly important in the case of programmes delivering services directly to the poor. Accountability and transparency are critical elements of good governance. The Right to Information Act (RTI) enacted in 2005 empowers people to get information and constitutes a big step towards transparency and accountability.

(b) Notwithstanding the spectacular performance of CPSEs in several areas, there has been a sense of disillusionment with some aspects of CPSE performance such as low profitability and lack of competitiveness. The extensive regulation of CPSEs by government had stifled the initiative and growth of public sector. The Economic Administration Reforms Commission (Chairman: L. K. Jha) had dwelt on issue of autonomy and accountability. The Commission had

recommended a careful re-consideration of extant concepts and instrumentalities relating to the accountability of public enterprises with a view to ensuring (a) that they do not erode the autonomy of public enterprises and thus hampers the very objectives and purposes for which these enterprises have been set up and given corporate shape and for which they are to be accountable; and (b) accountability has to be secured in the wider sense of answerability for the performance of tasks and achievements of results (EARC-II/Report No. 4, p. 22). The adoption of MoU system in India could be seen as an attempt to operationalize this very vital recommendation.

STUDY NOTE 9 – SOCIAL, ENVIRONMENTAL AND ECONOMIC RESPONSIBILITIES OF BUSINESS:

Question 27:

(a) State with reasons -whether the following statements are correct or incorrect:
“Corporate Social Responsibility is closely linked with the principles of sustainable development.”

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

Answer:

(a) World Business Council for Sustainable Development defines Corporate Social Responsibility as follows:
"Corporate social responsibility is the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large."

CSR advocates moving away from a 'shareholder alone' focus to a 'multi-stakeholder' focus.
Sustainable Development is 'development that meets the needs of the present without compromising the ability of future generations to meet their own needs'.

A business organisation which employs eco-friendly business practices is, no doubt, socially responsible as it takes into account the interest of its stakeholders, viz. the environment and the society at large. As a corollary, a business organisation which is socially responsible would, no doubt, employ eco-friendly business practices.

Only a business organisation which is conscious of its duty towards the environment would employ eco-friendly business practices and adopt the principles of sustainable development.
Thus, it is correct to say that "Corporate Social Responsibility is closely linked with the principles of sustainable development".

(b)

1. Market forces and competition force professionalisation:

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

2. Independent directors will have a say:

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

3. The topmen will not wear two hats:

The practice of one person combining in himself both the positions of Chairman and CEO will sooner rather than later, come to an end.

4. Emergence of board committees:

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

5. Transparency in reporting and full financial disclosures:

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

6. Independent and competent auditors will do their jobs:

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

7. Long term stakeholder interests will be ensured:

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

8. Board’s members' commitment ensured through adequate compensation:

Since boards will have to shoulder greater responsibility, bear risk and manage uncertainty with a great deal of pressure on them to perform, both from internal and external sources, their members would have to be compensated adequately and appropriately.

9. Boards will be committed to corporate social responsibility:

Corporate social responsibility would become part and parcel of the duties of boards of directors. They who draw so much from the society in terms of resources, trained manpower, law and order, public health, infrastructure and well-developed markets to do their business and make profits, have a moral and social responsibility to share with the society at least a part of what they earn and gain, by their ethical practices and catering to the basic needs of

communities they operate-in, supplementing wherever possible, the efforts of public authorities. "Corporates would have to provide demonstratable evidence of their concern for the issues that confront those constituencies.

10. Whistle blower policy will be in place:

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

Question 28:

(a) Explain briefly the key strategies which can be used at the time of implementation of Corporate Social Responsibility policies and practices in a company.

(b) State the relationship between globalization and CSR.

Answer:

(a) The various strategies which may be used at the time of implementation of CSR policies and practices in a company are:

1. Top management initiative:

- The attitude of top management towards CSR can determine whether or not an entity would actually carry out CSR measures. The top management can provide strong and visible support for the entity's commitment towards CSR by incorporating CSR measures in entity's Mission, Vision and Values statements.
- The Mission, Vision and Values statement of a socially responsible business should go beyond 'making profit' and specify that the entity will -
  1. engage in ethical and responsible business practices; and
  2. Promote the interests of all the stakeholders.

2. Integration of CSR in decision making:

- CSR is viewed as a comprehensive set of policies, practices and programs that are integrated into decision-making processes throughout the organisation. Therefore, an entity should incorporate CSR initiatives in its core business operations and strategies.
- The organisation should set specific goals for CSR.
- At the stage of planning, the organisation should lay down the measures for evaluating the progress from time to time.
- As far as possible, the goals should be laid down in quantifiable terms.

3. Management Structure:

- To promote the achievement of its CSR objectives in a more effective manner, an entity should integrate CSR measures in all its operations and business decisions.

- An entity may establish a CSR Committee and other related or sub-committees for promotion and enforcement of CSR. The functions of the CSR Committee should be to identify and evaluate the key CSR issues, and to integrate the key CSR issues in all the functions of management.
- The issues that represent a company's CSR focus vary by nature of business, by size, by sector and even by geographic region. Therefore, there cannot be a universally accepted management structure for promotion of CSR Thus, it has been rightly said, and "Creating a CSR structure is not a 'one size fits all' exercise.

4. Accountability for CSR in job profiles:

- An entity should clearly fix the responsibilities of its managers and employees for promotion and achievement of CSR objectives.
- The job profiles and job descriptions of each manager and employee should be customised to include the guidelines, examples and tools that fit his level of commitment and involvement in CSR.

5. Employee recognition and rewards:

- Employees tend to engage in behaviour that is recognized and rewarded and avoid
- behaviour that is penalised.
- An entity should implement a 'Reward Program' for recognising and rewarding those managers and employees who have contributed towards successful implementation of CSR measures or activities. This would act as a strong motivating force for the workforce to contribute towards entity's CSR objectives.
- The Reward Program may be in the nature of publication of a magazine periodically, including therein the highlights of CSR measures undertaken by the employees, or awarding the employees with letters of appreciation, certificates for excellent performance or small gifts like T-Shirts, mugs, pens, or giving them direct or in direct financial assistance.
- Also, the entity should participate in the award ceremonies organised at State and National level for recognising and rewarding those entities and individuals who have contributed towards CSR

6. Recruitment and promotion policies:

- The recruitment and promotion policies of the entity should clearly highlight the entity's commitment towards CSR.
- The CSR activities undertaken by the managers and employees should carry appropriate weightage at the time of recruitment, selection and promotion.

7. Training programs:

- The entity should regularly conduct comprehensive training and development programs emphasising the importance of CSR.
- The employees should be trained about their roles in implementation of CSR measures and attainment of CSR objectives.
- The training program should serve as a vehicle for sharing experiences and a source for learning and developing best practices throughout the entity. It should serve as an inspiration for continuous improvement.
- Proposals and initiatives by the employees should be welcome and the entity should provide necessary facilities for implementation of all such CSR measures or activities that are in line with entity's CSR objectives.

8. Implementation of CSR:

- CSR requires an entity to integrate social, environmental and ethical concerns into its business process. Therefore, just like any other business function, CSR performance and compliance should also be subject to review and control.
- If CSR performance is neither measured nor rewarded, the employees commitment towards CSR would come down, and the stakeholders would conclude that CSR is of secondary importance.

9. Influencing others to be socially responsible:

- An entity which is, and is recognised by others as, socially responsible, is in a position to influence the behaviour of others, from business partners to industry colleagues to neighbouring businesses. Such entity should play a leadership or pioneer role by sharing its experiences with others and, encouraging others, to be socially responsible.
- An entity, by influencing others to be socially responsible, performs CSR as it is in everyone's best interest to have as many persons as possible honouring the requirements and expectations of CSR.

10. CSR reporting and audit:

- An entity should regularly publish CSR Reports. It would help the entity to build and reinforce trust with all the stakeholders. The CSR Reports should be aimed at increasing the awareness and importance of CSR.
- CSR reports should highlight the CSR activities undertaken by the entity, the employees who played a key role in achievement of CSR initiatives.
- CSR reporting reflects that the top management is serious about its commitment towards CSR, and that CSR is not used just for name sake, or for building image.
- An entity may also decide to obtain an independent third party verification of the CSR report. Alternatively, it may get CSR Audit done by external auditors and publish the results of such audit.

(b) Globalisation and CSR:

As a consequence of cross-border trade, multinational enterprises and global supply chains, there is an increased awareness on CSR concerns related to human resource management practices, environmental protection, and health and safety, among other things. Reporting on the CSR activities by corporates is therefore increasingly becoming mandatory.

In an increasingly fast-paced global economy, CSR initiatives enable corporates to engage in more meaningful and regular stakeholder dialogue and thus be in a better position to anticipate and respond to regulatory, economic, social and environmental changes that may occur.

There is a drive to create a sustainable global economy where markets, labour and communities are able to function well together and companies have better access to capital and new markets.

Financial investors are increasingly incorporating social and environmental criteria when making decisions about where to place their money, and are looking to maximise the social impact of the investment at local or regional levels.

Question 29:

(a) Discuss the steps involved in the whole life-cycle risk process for each stage of the project.

(b) How do asset characteristics influence computation of WLCC?

Answer:

(a) The framework, integrating the five iterative steps, is explained in the following sections:

1. Whole life risk identification:

The process starts with a qualitative stage that focuses on identification of risks related to each of the whole life-cycle processes. Risks that are unidentified and not quantified are unmanaged risks that can have a significant negative outcome on projects and organisations. If any of the unidentified risks occur at any stage of the project life-cycle, this may have serious consequences on stakeholders‟ financial status. Hence, perhaps the most important step in the whole life-cycle risk process is the process of risk identification. The quality of this process has a direct effect on the quality and accuracy of risk analysis, quantification, and development of risk strategy responses, and on the management of risk throughout the life span of projects. The output of risk identification will inform the second quantitative analysis process that focuses on evaluation and assessment of risks associated with each aspect of the life-cycle span of projects.

2. Whole life risk analysis:

Several methodologies are available to deal with WLCC risk analysis. The techniques that can be used in WLCC risk assessment decision making might be summarised as deterministic, probabilistic and AI. Deterministic methods measure the impact on project outcomes of changing one uncertain key value or a combination of values at a time. In contrast, probabilistic methods are based on the assumption that no single figure can adequately represent the full range of possible outcomes of a risky investment (Fuller & Petersen 1996). Rather, a large number of alternative outcomes must be considered and each possibility must be accompanied by an associated probability from a probability distribution, followed by a statistical analysis to measure the degree of risk. Using a deterministic approach, the analyst determines the degree of risk on a subjective basis. AI methods differ from the above approaches and use historical data to model cost and uncertainty in WLCC analysis. None of these techniques can be applied to every situation. The best method depends on the relative size of the project, availability of data and resources, computational aids and skills, and user understanding of the technique being applied.

3. Whole life risk responses:

Developing responses to reduce WLCC risks is the third step in the integrated WLCC risk management framework. Once the building assets and the many different risks and threats to which they are exposed are identified and quantified and the related life-cycle vulnerabilities assessed, necessary steps should be taken to ensure that the entire investment is protected from all sources of external and internal threats. Thus, the third stage is concerned with the identification of strategies that mitigate the effect of anticipated threats to the greatest extent possible. This should be based on the following universal rules: risk avoidance, risk reduction, risk absorption and risk transfer.

4. Whole life risk management plan:

Following the identification, quantification and development of risk responses, the related vulnerabilities of building assets need to be determined and planned for. This provides the basis on which risk management plans and decisions are made. The risk management planning process is concerned with putting in place the procedure for:

- What response actions are needed?
- When these response actions are needed?
- How these actions are implemented?
- Who is responsible for the implementation, control and monitoring of the actual progress of risk responses and management strategies that have been developed to deal with the identified risk?

5. Whole life risk monitoring and feedback:

The issue of risk monitoring is essential for ensuring effective implementation of risk control measures. Active risk monitoring ensures that effective response measures to manage the risks are appropriately implemented. Since we are dealing with the life-cycle of projects, the initial decision conditions may change over time, which could lead to the change of risks. Hence, a feedback and continuous assessment of risk through the entire life span of the project is very important in the process of whole life-cycle costing. This process should include tracking the effectiveness of the planned risk responses, reviewing any changes in priority of response management, monitoring the state of the risks, updating the whole life-cycle analysis accordingly and reviewing the economic performance indicators to check whether the investment decision is still valid or otherwise. In this way risk monitoring not only evaluates the performance of risk response strategies but also serves as a continuing feedback or audit mechanism.

The application of the above framework should take place during the early stages of asset development as well as at every project milestone, and should continue throughout the whole life of the asset. The information generated from the WLCC risk management framework should inform decision makers on which input data has the most impact on the
WLCC result and how robust the final decisions are.

(b) The characteristics (i.e. physical and functional) of new or existing facilities are very important aspects of WLCC computation. The research community has largely ignored this aspect of WLCC. For example, a relationship may exist between building function and mechanical services costs, a particularly important feature of modern facilities. Little research has been published with regard to the impact of building characteristics on WLCC. Experience shows that an indirect link exists through many aspects, including energy costs for example. A poorly insulated building will consume more energy, thus increasing WLCC and possible downtime costs in maintenance (Department of Industry 1977). The characteristics that should be assessed and included in the computation of WLCC include:

- Layout and location
- Functionality
- Construction technology
- Gross floor area
- Number of storeys and storey height
- Glazing area
- Occupancy (m2/person)

- Shape of the facility
- Aesthetics
- Energy-saving measures
- Quality of components
- Type and quality of public health systems
- Type and quality of superstructure building fabric
- Type and quality of internal fabric
- Type and quality of electrical and mechanical services
- Extent of site works.

Question 30:

(a) Why should Corporate Social Responsibility (CSR) look beyond the concept of philanthropy?

(b) "Corporate Citizenship: A new way to market CSR?" Comment.

Answer:

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

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

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

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

- Responsibility
- Accountability
- Sustainability
- Social contact

Responsibility:

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

Accountability:

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

Sustainability:

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

Social Contract:

CSR is related to the social contract between the business and the society in which it operates. At any one time in any one society, there is a set of generally accepted relationships, obligations, and duties between the major institutions and the people. Though business has the bigger responsibility of going beyond philanthropy, one must also keep in mind that each stakeholder also has reciprocal duties with others and the consuming community also has the obligation to make the tradeoff between cost and sustainability and integrity. Different stakeholders also cannot be driven by their selfish interests alone because each stakeholder has an important role to play and one cannot be destroyed for the benefit of the other.

(b) A new terminology that has been gaining grounds in the business community today is Corporate Citizenship. We need to understand the concept of corporate citizenship and how is it 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.