

Paper-13: CORPORATE LAWS AND COMPLIANCE

Answer to PTP_Final_Syllabus 2012_Dec 2015_Set 2

	Learning objectives	Verbs used	Definition
LEVEL C	KNOWLEDGE What you are expected to know	List	Make a list of
		State	Express, fully or clearly, the details/facts
		Define	Give the exact meaning of
	COMPREHENSION What you are expected to understand	Describe	Communicate the key features of
		Distinguish	Highlight the differences between
		Explain	Make clear or intelligible/ state the meaning or purpose of
		Identify	Recognize, establish or select after consideration
		Illustrate	Use an example to describe or explain something
	APPLICATION How you are expected to apply your knowledge	Apply	Put to practical use
		Calculate	Ascertain or reckon mathematically
		Demonstrate	Prove with certainty or exhibit by practical means
		Prepare	Make or get ready for use
		Reconcile	Make or prove consistent/ compatible
		Solve	Find an answer to
		Tabulate	Arrange in a table
	ANALYSIS How you are expected to analyse the detail of what you have learned	Analyse	Examine in detail the structure of
		Categorise	Place into a defined class or division
		Compare and contrast	Show the similarities and/or differences between
		Construct	Build up or compile
		Prioritise	Place in order of priority or sequence for action
		Produce	Create or bring into existence
	SYNTHESIS How you are expected to utilize the information gathered to reach an optimum conclusion by a process of reasoning	Discuss	Examine in detail by argument
		Interpret	Translate into intelligible or familiar terms
Decide		To solve or conclude	
EVALUATION How you are expected to use your learning to evaluate, make decisions or recommendations	Advise	Counsel, inform or notify	
	Evaluate	Appraise or asses the value of	
	Recommend	Propose a course of action	

Paper-13: CORPORATE LAWS AND COMPLIANCE

Full Marks: 100

Time Allowed: 3 Hours

This paper contains 3 questions. All questions are compulsory, subject to instructions provided against each question. All workings must form part of your answer. Assumptions, if any, must be clearly indicated.

Question 1: Answer all questions

[20 Marks]

- (a) Is a company incorporated outside India required to pay fees for registration of documents? 3
- (b) State whether contracts entered into by a company before registration continue to be binding after incorporation of the company under the Companies Act, 2013? 3
- (c) Shruti Furniture Limited was willing to purchase teakwood estate in Jharkhand 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 Jharkhand State. The report was found inaccurate. Mr. 'X' purchased the shares of Shruti Furniture 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, in this respect. 3
- (d) Mr. Om is a director of Vidhi Ltd. He intends to construct a residential building for his own use. The cost of construction is estimated at ₹ 1.35 crores, which Mr. Om proposes to finance partly from his own sources to the tune of ₹ 60 lacs and the balance ₹ 75 lacs from housing loan to be obtained from a housing finance company. For the purpose of obtaining the loan, he has approached the housing finance company which has in principle agreed to grant the loan, but has put a condition. The condition put by the housing finance company is that the Company Vidhi Ltd. of which Mr. Om is a director should provide the guarantee for repayment of the loan and interest as per the terms of the proposed agreement for granting the loan to Mr. Om. You are required to advise Mr. Om on the matter with reference to the provisions of the Companies Act, 2013. 3
- (e) State the provisions of the Insurance Act, 1938 relating to refund of deposit. 3
- (f) Do you consider business ethics to be a professional code? 2
- (g) What responsibility towards public should a Management Accountant professional have? 3

Answer:

(a) As per section 385, where any provision contained in this Chapter (viz. Chapter XXIII consisting of sections 379 to 393) requires registration of any document, there shall be paid to the Registrar such fee, as may be prescribed.

As per Rule 8(2) of the Companies (Registration of Foreign Companies) Rules, 2014, fee as provided in the Companies (Registration Offices and Fees) Rules, 2014 shall be paid to the Registrar for registration of any document.

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(b) As per section 369, the registration of a company in pursuance of Part I of Chapter XXI shall not affect its rights or liabilities in respect of any debt or obligation incurred by the company before registration. Similarly, any contract entered into by the company before registration shall not be affected.

(c) Mr. X is entitled to repudiate the allotment since he purchased the shares relying on a misstatement 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.

(d) As per section 185 of the Companies Act, 2013, no company shall, directly or indirectly, give any guarantee in connection with a loan taken by a director. Section 185 does not permit a company to give guarantee even with the approval of the Central Government. However, the prohibition under section 185 shall not apply to a company, which, in the ordinary course of its business, gives guarantees for the repayment of any loan.

In the given case, guarantee cannot be given by Vidhi Ltd. in respect of a loan advanced to Mr. Om by a housing finance company, unless Vidhi Ltd., in the ordinary course of its business, gives guarantees for the repayment of any loan.

(e) As per section 9, where an insurer has ceased to carry on in India all classes of insurance business and his liabilities in India in respect of all classes of insurance business have been satisfied or are otherwise provided for, the court may, on the application of the insurer, order the return to the insurer of the deposit made by him under this Act.

(f) Business ethics is not a pure science but a professional practice, and society expects businessmen to abide by the principles of a civil society, just as it expects professionals from other areas such as medicine, bureaucracy, politics and sports to do so. Thus, instead of a value-free business ethics, we have a value-loaded or value-based business practice.

(g) Members should accept the obligation to act in a way that will serve the public interest, honour public trust and demonstrate commitment to professionalism. A distinguishing mark of a profession is acceptance of its responsibility to the public. The accounting professions public interest of clients, credit grantors, governments, employers, investors, the business and financial community and others who rely on the objectivity and integrity of certified public accountants to maintain the orderly functioning of commerce. This reliance imposes a public interest responsibility on the professionals. The public interest is defined as a collective well being of the community of people and institution the profession serves.

Question 2: Answer any four questions

[60 Marks]

Question 2(a)

(i) Mr. Zeo has been arrested for a cognizable and non-bailable offence punishable for a term of imprisonment for more than three years under the prevention of Money Laundering Act, 2002. Advise, as to how can he be released on bail in this case?

(ii) A producer company has received applications from Mr. Richard, a Director of the company, and Mr. Pichai, a member of the Company, for grant of loan of ₹ 2,00,000 and ₹ 25,000 respectively. Discuss the relevant provisions of the Companies Act, 1956 as to how the applications for grant of loan will be disposed of by the Company.

(iii) Write a short note on non-disclosure of the source of information with respect to an

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investigation of the Company, as per Companies Act, 2013.

[7+6+2 = 15]

Answer:

(i) Analysis of the case of Mr. Zeo as per Prevention of Money Laundering Act, 2002

(a) Conditions for release of accused on bail [Section 45(1)]

Notwithstanding anything contained in the Code of Criminal Procedure, 1973, no person accused of an offence punishable for a term of imprisonment of more than 3 years under Part A of the Schedule shall be released on bail or on his own bond unless -

- (1) the Public Prosecutor has been given an opportunity to oppose the application for such release; and
- (2) where the Public Prosecutor opposes the application, the court is satisfied that there are reasonable grounds for believing that he is not guilty of such offence and that he is not likely to commit any offence while on bail.

(b) Conditions for release of a person aged less than 16 years [First Proviso to Section 45(1)]

Where a person who is under the age of 16 years is a woman or is sick or infirm, he may be released on bail, if the special court so directs.

(c) Cognisance of offences [Second Proviso to Section 45(1)]

The Special Court shall not take cognisance of any offence punishable under section 4 except upon a complaint in writing made by -

- (1) the Director; or
- (2) any officer of the Central Government or State Government authorised in writing in this behalf by the Central Government by a general or special order made in this behalf by that Government.

(d) No power of police officer to investigate [Section 45(1 A)]

Notwithstanding anything contained in the Code of Criminal Procedure, 1973, or any other provision of this Act, no police officer shall investigate into an offence under this Act unless specifically authorised, by the Central Government by a general or special order, and, subject to such conditions as may be prescribed.

(e) Other conditions for grant of bail [Section 45(2)]

The limitation on granting of bail specified in sub-section (1) is in addition to the limitations under the Code of Criminal Procedure, 1973 or any other law for the time being in force on granting of bail.

(ii) Loan to Mr. Richard, the director of the company

As per section 581R, the Board is authorised to do all such acts and things as the company is entitled to do.

However, the Board shall not sanction any loan or advance, in connection with the business activities of the Producer Company to any director or his relative.

As per section 581S, the members may sanction a loan to a director in annual general meeting. Further, the conditions and limits of loan shall also be specified in the resolution so passed in the annual general meeting.

As per section 581ZG, it shall be the duty of the auditor to report on the loans given by the Producer Company to its directors.

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As per section 581ZK, any loan or advance to any director or his relative shall be granted only after the approval by the Members in general meeting.

In the present case, it is permissible for the Board to give a loan of ₹ 2,00,000 to Mr. Richard, a director, only if such a loan is approved by the members in the annual general meeting, and the conditions and limits of loan are specified in the resolution so passed in the annual general meeting.

Loan to Mr. Pichai, a member of the company

The Board may, subject to the provisions made in articles, provide financial assistance to the Members of the Producer Company by way of –

- (a) credit facility, to any Member, in connection with the business of the Producer Company, for a period not exceeding 6 months,
- (b) loans and advances, against security specified in articles to any Member, repayable within a period exceeding 3 months but not exceeding 7 years from the date of disbursement of Such loan or advances.

Accordingly, loan of ₹ 25,000 to Mr. Pichai can be made provided that –

- (a) such loan is secured by any security specified in the articles;
- (b) such loan is repayable after 3 months but within 7 years.

(iii) As per section 457 of Companies Act, 2013, notwithstanding anything contained in any other law for the time being in force, the Registrar, any officer of the Government or any other person shall not be compelled to disclose to any court, Tribunal or other authority, the source from where he got any information which -

- (a) has led the Central Government to order an investigation; or
- (b) is or has been material or relevant in connection with such investigation.

Question 2(b)

(i) Fun Toys Limited and Bright Toys Limited marketing their products in India propose to be amalgamated. The enterprise created as a result of the said amalgamation will have assets of value of ₹ 300 crore and turnover of ₹ 1000 crore. Examine whether the proposed amalgamation attracts the provisions of the Competition Act, 2002?

(ii) Sundar, a citizen of India, left India for employment in Australia on 1st June 2007. Mr. Sundar purchased a flat at New Delhi for ₹ 15 lakhs in September, 2008. His brother, Mr. Satya employed in New Delhi, also purchased a flat in the same building in September, 2008 for ₹ 15 lakhs. Mr. Satya's flat was financed by a loan from a housing finance company and the loan was guaranteed by Mr. Sundar. Examine with reference to the provisions of Foreign Exchange Management Act, 1999, whether purchase of flat and guarantee by Mr. Sundar are capital account transactions and whether these transactions are permissible.

(iii) What power does the Central Government have to make Rules relating to winding up?

[4+6+5 = 15]

Answer:

(i) The given problem relates to section 5 of the Competition Act, 2002.

As per section 5, an amalgamation shall be a combination if the enterprise created as a result of the amalgamation, shall have the assets of the value of more than ₹ 1,000 crores or

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turnover more than ₹ 3,000 crores.

In the given case, the enterprise created as a result of the amalgamation will have assets of value of ₹ 300 crore (i.e. less than the amount specified under section 5, viz. ₹ 1,000 crores) and turnover of ₹ 1,000 crore (i.e. less than the amount specified under section 5, viz. ₹ 3,000 crores). Thus, as per the provisions of section 5, the said amalgamation does not amount to 'combination', and so such amalgamation shall come into effect without obtaining any approval of the Competition Commission of India.

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

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

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

In the given case Mr. Sundar left India for employment in Australia in June 2007. Therefore, he becomes a person resident outside India as from June 2007.

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

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

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

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

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

(iii) Powers of the Central Government to make rules relating to winding up (Section 468 of the Companies Act, 2013)

- (a) The Central Government shall make rules for all matters relating to the winding up of companies.
- (b) The Rules shall be consistent with the Code of Civil Procedure, 1908.
- (c) In particular, and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters, namely:
 - 1) as to the mode of proceedings to be held for winding up of a company by the Tribunal;
 - 2) for the voluntary winding up of companies, whether by members or by creditors;
 - 3) for the holding of meetings of creditors and members;

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- 4) for giving effect to the provisions of this Act as to the reduction of the capital;
- 5) generally for all applications to be made to the Tribunal under the provisions of this Act;
- 6) the holding and conducting of meetings to ascertain the wishes of creditors and contributories;
- 7) the settling of lists of contributories and the rectifying of the register of members where required, and collecting and applying the assets;
- 8) the payment, delivery, conveyance, surrender or transfer of money, property, books or papers to the liquidator;
- 9) the making of calls; and
- 10) the fixing of a time within which debts and claims shall be proved.

Question 2(c)

- (i) State the formalities that has to be followed with respect to registration of prospectus of Companies Incorporated outside India, as per provisions contained in the Companies Act, 2013.
- (ii) A company created a floating charge of its current assets in favour of a bank to secure a current account, which was in debit of ₹ 5 lakhs and also to secure further working Capital facilities provided by the bank. The charge created on 1st January, 2013 was duly registered with the Registrar of Companies. The bank advanced ₹ 10 lakhs subsequent to the creation of charge. The company has gone into voluntary liquidation pursuant to a resolution passed on 1st September, 2013. Examine the validity of the floating charge in case it is a creditors' voluntary winding up, but there is no fraudulent preference. Would your answer be different, if it was a member's voluntary winding up?
- (iii) The issued, subscribed and paid-up capital of Super Supplements Limited is ₹ 2 crore consisting of 20,00,000 equity shares of ₹ 10 each. The said company has 800 members. For the purpose of relief against oppression and mismanagement, a petition was submitted before the appropriate authority duly signed by 90 members holding 1,00,000 equity shares of the said company. Subsequently, 30 members, who signed the petition, withdrew their consent. Decide, under the provisions of the Companies Act, 1956 whether the said petition is maintainable?

[3+7+5 = 15]

Answer:

- (i) The provisions of Registration of Prospectus is contained in section 389 of Companies Act, 2013 and are explained as follows:

- **Conditions for issue or circulation of prospectus**

No person shall issue, circulate or distribute in India any prospectus by which securities are offered for subscription unless before such issue, circulation or distribution, -

- (a) a certified copy of the prospectus is delivered to the Registrar for registration;
- (b) the prospectus states on the face of it that a copy has been so delivered; and
- (c) expert's consent to the issue of the prospectus (as required under section 388) and such documents as may be prescribed are attached to the prospectus.

- **Manner of certification of prospectus**

The copy of the prospectus shall be certified by -

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- (a) the chairperson of the company; and
- (b) 2 other directors of the company.

The provisions of section 389 shall apply with respect to any prospectus of a company -

- (a) incorporated outside India (and whether or not it has established a place of business in India); or
- (b) to be incorporated outside India (and whether or not it will establish a place of business in India).

(ii) As per section 534 of Companies Act, 1956, a floating charge created by the company within 12 months preceding the commencement of its winding up shall be invalid. However, this rule is subject to the following two exceptions:

- (a) A floating charge shall not be invalid where it is proved that the company was solvent immediately after the creation of the charge.
- (b) A floating charge shall be valid upto the amount of any cash paid to the company (whether at the time of creation of charge or thereafter) as a consideration for the charge. Also, interest shall be allowed on that amount at the rate of 5% per annum or such other rate as may be notified by the Central Government in the Official Gazette.

A company had created a floating charge of its assets in favour of a bank to secure a current account which was in debit. The bank advanced monies to the company subsequent to the creation of charge.

The bank would not have advanced such monies if the company had not given the security (by way of creation of floating charge) to the bank. Therefore, it was held that money advanced to the company was in consideration of creation of charge, and so the charge was valid as it fell in the exception mentioned in section 534 [Re, Yeovillove Co. Ltd. (1962) 3 All ER 400].

The facts of the given are exactly similar to the facts of the case discussed above. Therefore, it can be said that the floating charge created by the company on 1st January, 2013 shall be valid to the extent of ₹ 10 lakhs along with interest at the rate of 5% per annum or such other rate as may be notified by the Central Government in the Official Gazette.

Section 534 falls under Chapter V of Part VII of the Companies Act, 1956. The Title of said Chapter V reads, 'Provisions applicable to every mode of winding up'. Therefore, it is evident that section 534 shall apply notwithstanding that it is members' voluntary winding up or creditors' voluntary winding up.

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

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

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(s) during the course of proceedings does not affect the maintainability of the application [Rajahmundri Electric Supply Corporation v Nageshwara Rao AIR 1956 SC 213].

In the present case, the application is valid since it has been made by 90 members (being more than the eligibility criteria of 1/10th of total number of members).

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

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

Question 2(d)

- (i) Discuss whether property of the company before registration vests in the company incorporated under the Companies Act, 2013?**
- (ii) Examine the extent to which the legal representatives of a deceased director against whom misfeasance proceedings were initiated by the liquidator of the company, under the Companies Act 1956, can be held liable.**
- (iii) Answer the following with reference to a scheme of amalgamation of companies explaining the relevant provisions of the Companies Act, 1956.**
 - (a) Whether companies being amalgamated must be companies registered in India.**
 - (b) What is the majority required for approving the scheme of amalgamation in a meeting of members of a company called as per directions of the Court? Is the scheme to be approved by preference shareholders?**
 - (c) When will the Court order dissolution of the Transferor company?**

[5+4+6 = 15]

Answer:

(i) As per section 368 of Companies Act, 2013, all the property belonging to the company before registration, shall pass to the company incorporated under the Companies Act, 2013. In other words, all the property vested in the company before registration of the company shall vest in the company as incorporated under the Companies Act, 2013. The provisions of section 368 shall apply to all property, whether movable or immovable as well as to all actionable claims.

The effect of section 368 is that there is automatic vesting and divesting of the property. The company (before registration) is divested of all the properties, and the company incorporated under the Companies Act, 2013 is vested with all such properties. The vesting of property is as a result of the statute, and therefore, no registered instrument of transfer is necessary [Rama Sundari Ray v Syamendra Lal Ray, ILR (1947) 2 Cal 1].

If the constitution of a partnership firm is changed into that of a company by registering under Part I of Chapter XXI of the Companies Act, 2013, there shall be statutory vesting of title of all the property of the previous firm in the newly incorporated company without any need for a separate conveyance deed or sale deed [Vali Pattabhirama Rao v Sri Ramanuja Ginning & Rice Factory P. Ltd. (1968) 60 Com Cases 568 (AP-DB)].

(ii) Under section 543 of Companies Act, 1956, the Court has the power to initiate misfeasance proceedings against any delinquent director or any other officer of the company.

The Supreme Court has held that misfeasance proceedings initiated under section 543

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against a director of a company in winding up can be continued on his death against his legal heirs for the purpose of determining and declaring the loss or damage caused to the company. The amount declared to be due in the misfeasance proceedings shall be realised from the estate of the deceased in the hands of his legal representatives [Official Liquidator v Parthasarathi Sinha (1983) 53 Comp Cas 163 (SC)]. However, such liability shall not extend to any sum beyond the value of the estate of the deceased in their hands.

(iii)

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

(b) The scheme shall be approved by a majority of the members, who are present and voting. Such majority of members must also be members representing three-fourths in the value of members present and voting at the meeting. It is to be noted that members not present in the meeting or present in the meeting but remaining neutral are not to be counted [Section 391(2)].

Section 391(2) uses the expression 'member', which includes a preference shareholder also. As such, both equity and preference shares shall be taken into account. However, if a separate meeting of preference shareholders and equity shareholders is ordered, then the scheme shall be approved by preference shareholders and equity shareholders in their separate meetings.

(c) The order of the Court may provide for the dissolution, without winding up, of any transferor company [Section 394(1)]. However, the Court will not make such an order unless it receives a report from the official liquidator to the effect that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest [Second Proviso to Section 394 (2)].

Question 2(e)

(i) Elite Ltd. is engaged in the business of construction. Arun, Barun and Kiran, directors of the Elite Ltd. are holding 75% of the capital of this company. The company passed a resolution at its general meeting that it would not be interested in a particular contract for construction of a bridge. Subsequently, the same contract was obtained by Arun, Barun and Kiran in their own names.

(ii) Shyam, a Director of Radha Studio Ltd., was appointed on 1st April, 2014. One of the terms of appointment was that in the absence of adequacy of profits or if the company had no profits in a particular year, he will be paid remuneration in accordance with Schedule V. For the financial year ended 31st March, 2015, the company suffered heavy losses. The company paid him a remuneration of ₹ 50 lacs for the financial year 2014-15. The effective capital of the company is ₹ 150 crores. Referring to the provisions of Companies Act, 2013, as contained in Schedule V, examine the validity of the above payment of remuneration to Shyam.

(iii) The Board of Directors of Laxmi Jewellery Limited propose to donate ₹ 3,00,000 to a school established exclusively for the benefit of children of employees and also donate ₹ 50,000 to a political party during the Financial year ending 31st March, 2010. The average net profits during the three immediately preceding financial years is ₹ 40,00,000.

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Examine with reference to the provisions of the Companies Act, 2013 whether the proposed donations are within the powers of the Board of Directors of the Company.

[4+5+6 = 15]

Answer:

(i) The Majority Rule governs the internal management of the company. As such if any wrong is done to the company, the proper plaintiff to institute a suit is the company itself and the Court would not interfere at the instance of the individual shareholders [Foss v Harbottle (1843) 2 Hare 461]. However, if the majority misuses its powers to defraud or oppress the minority, an action can be brought by an individual member.

Three directors holding 75% of the share capital of the company used their positions as directors and obtained a contract in their own names. As it amounted to breach of duty towards the company, they called a general meeting in which a resolution was passed to the effect that the company had no interest in the contract. It was held that directors utilised the contract belonging to the company for their personal gain and it amounted to a fraud on the minority. The company could claim profits realised by the directors [Cook Deeks (1916) 1 AC 554].

The facts of the given case are identical to the facts specified in the above case and so it can be said that the minority shareholders will succeed.

(ii) Where a company does not make any profits or its profits are inadequate, it may pay remuneration to its managing director or whole time director or manager in accordance with Section II of Part II of Schedule V.

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

In the present case, the effective capital of the company is ₹ 150 crores. As per Schedule V, a company having effective capital of ₹ 100 crore or more, but less than ₹ 250 crore may pay to its managerial person, a maximum remuneration of ₹ 60 lakh per year. Thus, payment of ₹ 50 lakh for the financial year 2014-15 is within the limit specified under Section II of Part II of Schedule V, and is, therefore, valid. No approval of the Central Government shall be required for such payment.

(iii) As per section 181 of the Companies Act, 2013, without the prior consent of the members in the general meeting, the Board shall not contribute to bona fide charitable and other funds, if the amounts contributed in a financial year will exceed 5% of average net profits during immediately preceding 3 financial years:

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

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

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

In the given case, the company satisfies all the conditions prescribed under section 182 of the Companies Act, 2013. Accordingly, it can make political donations upto ₹ 3,00,000 (being 7.5% of ₹ 40,00,000). As in the given case, the Board has donated only ₹ 50,000, the donation is within the limits and is in accordance with section 182 of the Companies Act, 2013. The Board shall make such political contribution only by passing a resolution at a Board meeting. Further, adequate disclosure shall be made in the profit and loss account.

Question 3: Answer any two questions

[20 Marks]

Question 3(a)

1. **What is Project Governance? What are the benefits of Project Governance?**
2. **“Corporate Social Responsibility is to be considered as an investment and not as a charity” –Discuss**

[4+6 = 10]

Answer:

1. Project Governance extends the principle of Governance into both the management of individual projects via Governance structures, and the management of projects at the business level, for example via Business Reviews of Projects. Today, many organisations are developing models for 'Project Governance Structures', which can be different to a traditional Organisation Structure in that it defines accountabilities and responsibilities for strategic decision-making across the project. This can be particularly useful to project management processes such as change control and strategic (project) decision-making. When implemented well, it can have a significantly positive effect on the quality and speed of decision making on significant issues on projects.

Benefits of Project governance:

Project governance will:

- i) Outline the relationships between all internal and external groups involved in the project.
 - ii) Describe the proper flow of information regarding the project to all stakeholders.
 - iii) Ensure the appropriate review of issues encountered within each project.
 - iv) Ensure that required approvals and direction for the project is obtained at each appropriate stage of the project.
2. The originally defined concept of CSR needs to be interpreted and dimensionalised in the broader conceptual framework of how the corporate embed their corporate values as a new strategic asset, to build a basis for trust and cooperation within the wider stakeholder community.

Though there have been evidences that record a paradigm shift from charity to a long-term

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strategy, yet the concept still is believed to be strongly linked to philanthropy. There is a need to bring about an attitudinal change in people about the concept.

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

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

Being treated as a separate entity, there is always a flexibility and independence to carry out the tasks. But often these entities work in isolation without creating a synergy with the other departments of the corporate. There is a need to understand that CSR is not only a pure management directive but it is something that is central to the company and has to be embedded in the core values and principles of the corporate.

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

Charity means the act of donating money, goods, time or effort to support a charitable cause in regard to a defined objective. Charity can be equated with benevolence and charity for the poor and needy. It can be any selfless giving towards any kind of social need that is not served, underserved, or perceived as unserved or underserved. Charity can be by any individual or by a corporate.

Corporate Social Responsibility is about how a company aligns their values to social causes by including and collaborating with their investors, suppliers, employees, regulators and the society as a whole. The investment in CSR may be on people centric issues and/or planet issues. A CSR initiative of a corporate is not a selfless act of giving; companies derive long-term benefits from the CSR initiatives and it is this enlightened self interest which is driving the CSR initiatives in companies.

Question 3(b)

1. What is Corporate Governance? What is the need for Corporate Governance in India?

2. State the advantages of Good Corporate Citizenship.

[5+5 = 10]

Answer:

1. Corporate governance is:

- (i) The system by which companies are directed and controlled -The Cadbury Report, 1992.
- (ii) The process of supervision and control intended to ensure that the company's management acts in accordance with the interests of shareholders -Parkinson, 1994.
- (iii) Corporate Governance is the acceptance by management of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders. It is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the

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management of a company –Report of N.R.Narayana Murthy Committee on Corporate Governance constituted by SEBI (2003).

Need for Corporate Governance:

Corporate Governance is integral to the existence of the company. It is needed to create a corporate culture of transparency, accountability and disclosure.

- i. **Corporate Performance:** Improved governance structures and processes help ensure quality decision-making, encourage effective succession planning for senior management and enhance the long-term prosperity of companies, independent of the type of company and its sources of finance.
- ii. **Enhanced Investor Trust:** Investors consider Corporate Governance as important as financial performance when evaluating companies for investment.
- iii. **Combating Corruption:** Companies that are transparent, and have sound system that provide full disclosure of accounting and auditing procedures, allow transparency in all business transactions, provide environment where corruption will certainly fade out.
- iv. **Better Access to Global Market:** A Good Corporate Governance system attracts investment from global investors, which subsequently leads to greater efficiencies in the financial sector.
- v. **Enhancing Enterprise Valuation:** Improved management accountability and operational transparency fulfill investors' expectations and confidence on management and corporations, and return, increase the value of corporations.
- vi. **Accountability:** An Investor relation 'is essential part of good Corporate Governance. Investors have directly/indirectly entrusted management of the company for creating enhanced value for their investment.
- vii. **Easy Finance from Institutions:** Evidence indicates that well-governed companies receive higher market valuations.
- viii. **Reduced Risk of Corporate Crisis and Scandals:** Effective Corporate Governance ensures efficient risk mitigation system in place

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

- i. CSR creates a favourable public image, which attracts customers. Reputation or brand equity of the products of a company which understands and demonstrates its social responsibilities is very high. Customers trust the products of such a company and are willing to pay a premium on its products. Organizations that perform well with regard to CSR can build reputation, while those that perform poorly can damage brand and company value when exposed. Brand equity is founded on values such as trust, credibility, reliability, quality and consistency.
- ii. CSR activities have its advantages. It builds up a positive image encouraging social involvement of employees, which in turn develops a sense of loyalty towards the organization, helping in creating a dedicated work force proud of its company. Employees like to contribute to the cause of creating a better society. Employees become champions of a company for which they are proud to work.
- iii. Society gains through better neighbourhoods and employment opportunities, while the organization benefits from a better community, which is the main source of its workforce and the consumer of its products.

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- iv. Public needs have changed leading to changed expectations from consumers. The industry/business owes its very existence to society and has to respond to needs of the society.
- v. The company's social involvement discourages excessive regulation or intervention from the Government or statutory bodies, and hence gives greater freedom and flexibility in decision-making.
- vi. The internal activities of the organization have an impact on the external environment, since the society is an inter-dependent system.
- vii. A business organization has a great deal of power and money, entrusted upon it by the society and should be accompanied by an equal amount of responsibility. In other words, there should be a balance between the authority and responsibility.
- viii. The good public image secured by one organization by their social responsiveness encourages other organizations in the neighborhood or in the professional group to adapt themselves to achieve their social responsiveness.
- ix. The atmosphere of social responsiveness encourages co-operative attitude between groups of companies. One company can advise or solve social problems that other organizations could not solve.
- x. Companies can better address the grievances of its employees and create employment opportunities for the unemployed.
- xi. A company with its ear to the ground through regular stakeholder dialogue is in a better position to anticipate and respond to regulatory, economic, social and environmental change that may occur.
- xii. Financial institutions are increasingly incorporating social and environmental criteria into their assessment of projects. When making decisions about where to place their money, investors are looking for indicators of effective CSR management.

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

Question 3(c)

1. 'Corporate Governance is about promoting fairness'. Is it truly beneficial?

2. Write a short note on SA 8000.

[6+4 = 10]

Answer:

1. Corporate Governance deals with promoting corporate fairness, transparency and accountability. It is concerned with structures and processes for decision-making, accountability, control and behavior at the top level of the organizations. It influences how the objectives of an organization are set and achieved, how risk is monitored and assessed and how performance is optimized. It is truly beneficial and it has the following benefits:

- 1. Improved Financial Performance: Socially responsible business practices are linked to positive financial performance.
- 2. Operating Cost Reduction: CSR initiatives can help to reduce operating costs.
- 3. Brand Image and Reputation: CSR helps a company to increase its brand image and reputation among the public, which in turn increase its ability to attract investors and trading partners. Proactive CSR Practices would lead to a favourable public image resulting in various positive outcomes like consumer and retailer loyalty, easier acceptance

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of new products and services, market access and preferential allocation of investment funds.

4. Increased Sales & Customer Loyalty: Businesses must first satisfy customer's key buying criteria, i.e., price, quality, safety and convenience.
5. Productivity and Quality: Improved working conditions, reduced environmental impacts or increased employee involvement in decision-making, leads to (a) increased productivity, and (b) reduced errors.
6. Ability to attract and retain employees: Companies perceived to have strong CSR commitments find it easier to recruit and retain employees, resulting in reduction in turnover and associated recruitment and training costs.

2. Social Accountability 8000:

- SA 8000 is a comprehensive, global, verifiable performance standard for auditing and certifying compliance with corporate responsibility.
- The heart of the standard is the belief that all workplaces should be managed in such a manner that basic human rights are supported and that management is prepared to accept accountability for this.
- SA 8000 is an international standard for improving working conditions. This standard is based on the principles of international human rights norms as described in International Labour Organisation Conventions, the UN Convention on the Rights of the Child and the Universal Declaration of Human Rights.

The requirements of this standard apply regardless of geographic location, industry sector, or company size.