Paper-13: CORPORATE LAWS AND COMPLIANCE

	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
		Identity	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]**

(i) Manish applies for shares on the basis of prospectus which contains mis-statement. The shares were allotted to him, who afterwards transfers them to Nishant. Can Nishant bring an action for a recession on the ground of mis-statement? Decide under the provisions of Companies Act, 2013. [3]

(ii) Gagan Ltd. an engineering company has distributed ₹ 20 lacs to scientific institutions for furtherance of scientific education and research. Referring to the provisions of Companies Act, 2013 decide whether the said distribution of money was 'ultra vires' the company? [3]

(iii) Arun, a member of Priya & co Ltd., holding some shares in his own name on which final call money has not been paid, is denied by the company voting right at a general meeting on the ground that the articles of association do not permit a member to vote if he has not paid the calls on the shares held by him.
With reference to the provisions of Companies Act, 2013 examine the validity of company's denial to Arun of his voting rights. [3]

(iv) The minutes of the meeting must contain fair and correct summary of the proceedings thereat. Can the chairman direct exclusion of any matter from the minutes? Some of the shareholders insist on inclusion of certain matters which are regarded as defamatory of a director of the company. The chairman declines to do so. State how the matter can be resolved based on Companies Act, 2013. [3]

(v) The apple producers from Kashmir have formed an association to control production of oranges. Examine whether it will be considered as a cartel within the meaning of sec 2© of the Competition Act, 2002.

(vi) Write a note on CSR reporting. [3]

(vii) State the role of 'Audit Committee' in regulating Corporate Governance. [2]

Answer

(i) This case is based on the provisions of **Sec 35 of Companies Act, 2013**. Nishant is not the original allottee of the shares, since he obtained the shares by way of transfer from Manish. Nishant cannot claim damages from the company since Nishant is not an original allottee of shares and he did not subscribe for shares on the faith of a misleading prospectus. [Peek v Gurney]

(ii) Donation of ₹ 20 lacs for furtherance of scientific education and research is permissible since it is incidental or ancilliary to the main object of the company and it is conducive to the continued growth of the company as engineering goods manufacturers as was held in Evans v Brunner, Mood & Co. Ltd.

(iii) The decision of the company is valid since the member is restrained from exercising his voting right on one of the grounds specified under **section 106 of Companies Act, 2013** (viz. non-payment of calls on shares). And the ground restricting voting rights is contained in the articles.

(iv) It relates to the provisions of **Sec 118 of Companies Act, 2013**. Chairman has the power to determine whether a matter is defamatory of any person or not and to direct not to include in the minutes any matter which is defamatory of any person. Hence, refusal by chairman is valid since the matter discussed in General Meeting is, in the opinion of the Chairman, defamatory of a director.

(v) As per **Sec 2(c) of Competition Act, 2002**, 'cartel' includes an association of producers, sellers, distributors, traders or service providers who, by agreement amongst themselves, limit control or attempt to control the production, distribution, sale or price of, or, trade in goods or provision of services. In the given case, the association that has been formed is that of apple producers. It clearly falls within the definition of 'cartel' as given under Sec 2(c) of Competition Act, 2002.

(vi) CSR reports highlights the CSR activities undertaken by the entity and details of employees who played a key role in achievement of CSR initiatives. CSR reporting reflects seriousness of top management towards CSR. It helps the entity to build and reinforce trust with all the stakeholders. CSR reports are aimed at increasing the awareness and importance of CSR. CSR report also encourages internal efforts to achieve the CSR objectives.

(vii) The 'Audit Committee' ensures and reports to the Board the adequacy of internal control systems. It periodically reviews the financial statements. It periodically holds discussions with

the auditors relating to the internal control system, scope of audit and observation of auditors.

Question 2: Answer any four questions **[60 Marks]**

Question 2(a)

(i) Sita & Co. Ltd. made a loss of ₹ 20 lakhs after providing for depreciation for the year ended 31st March, 2015 and as a result the company was not in a position to declare any dividend for the said year out of profits. However, the Board of Directors of the company announced the declaration of dividend of 15% on the equity shares payable out of the free reserves. The paid up share capital of the company and its free reserves as on 31st March, 2015 are ₹ 2 crores and ₹ 10 crores respectively. The average dividend declared by the company in the last three years is 25%. Examine the validity of declaration of Dividend.

(ii) The Board of directors of a company decides to revise the accounts which have been submitted to the auditors, but the auditors have not yet given their report. Examine the validity.

(iii) How is the subsequent auditor appointed in case of a government company? Answer with reference to Companies Act, 2013.

[8+2+5 = 15]

Answer

(i) The fundamental principle with respect to payment of dividend is that dividend is to be paid only out of profits. In other words, the dividend can be paid only out of the following sources:
(a) Profits of current financial year
(b) Undistributed profits of previous financial years, i.e., accumulated profits of previous years
(c) Moneys provided by the Central Government or State Government in pursuance of a guarantee given by it.

Payment of dividend out of reserves

As per **Rule 3 of the Companies (Declaration and Payment of Dividend) Rules, 2014**, dividend can be declared out of the profits transferred to the reserves by complying with the following conditions:

(a) The rate of dividend declared shall not exceed the average of the rates at which dividend was declared by it in the 3 years immediately preceding that year.
(b) The total amount to be drawn from such accumulated profits shall not exceed I/10th of the sum of its paid-up share capital and free reserves as appearing in the latest audited financial statement.

(c) The amount so drawn shall first be utilised to set off the losses incurred in the financial year in which dividend is declared before any dividend in respect of equity shares is declared.
(d) The balance of reserves after such withdrawal shall not fall below 15% of its paid up share capital as appearing in the latest audited financial statement.
(e) No company shall declare dividend unless carried over previous losses and depreciation not provided in previous year or years are set off against profit of the company of the current year.

The present case is discussed as under:

(a) The average rate of dividend declared by the company during the preceding 3 financial years is 25%. So, for the current financial year, the rate of dividend shall not exceed 25%.

(b) The maximum amount that may be drawn from the reserves shall not exceed 10% of (₹2 crore + ₹10 crore), i.e. ₹1.2 crore.

(c) Out of the amount drawn from the reserves (viz. ₹ 1.2 crore), loss for the current financial year (viz. ₹ 0.20 crore) shall first be set off. Thus, maximum amount that can be utilized for dividend shall be ₹ 1.2. crore less ₹ 0.20, viz. ₹ 1 crore (i.e. rate of dividend shall not exceed 50%).-

(d) After the dividend is declared out of reserves, the balance of reserves shall not fall below 15% of paid up share capital, viz. 15% of ₹ 2 crore, viz. ₹ 30 lakh. Thus, maximum amount that can be utilized for dividend shall be ₹ 10 crore less ₹ 20 lakh less ₹ 30 lakh, viz. ₹ 9.5 crore (i.e. rate of dividend shall not exceed 475%).

(e) There is no carried over previous losses or depreciation.

Thus, in the present case, the company may distribute dividend at the rate of 25% in accordance with the conditions contained in Rule 3 of the Companies (Declaration and Payment of Dividend) Rules, 2014.

(ii) Where the auditors have not yet given their report, the Board may revise the accounts. The revised accounts shall be approved by the Board and thereafter signed on behalf of the Board in accordance with the provisions of section 134 of the Companies Act, 2013. Then, the revised accounts shall be submitted to the auditors. The auditors' report shall be based on the revised accounts submitted by the Board.

(iii) The provisions relating to appointment of subsequent auditor in case of a government company are discussed as follows:

1. Applicability of Section 139(5) of Companies Act, 2013

(a) Government companies
(b) Any other company owned or controlled, directly or indirectly, by –
  (i) the Central Government; or
  (ii) one or more State Government; or
  (iii) partly by the Central Government and partly by one or more State Government.

2. Appointment or reappointment of auditor

In case of aforementioned companies, CAG shall, in respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor of companies under this Act, within 180 days from the commencement of the financial year.

3. Tenure

The auditor shall hold office till the conclusion of the AGM.

Question 2(b)

(i) M/s. Super India Ltd. issued shares of the nominal value of ₹10 per share, out of which ₹5 was payable on application and balance ₹5 was payable on call. The call money was invited by the Board of directors but some shareholders, including a non-executive director, failed to pay the same within the prescribed period. Explain the status of director who defaulted in paying call money. Answer with reference to Companies Act, 2013.

(ii) Mr. Abhinav is named as a director for life in the articles of association of M/s. Aarti Private Limited which was incorporated on 1st April, 1977. The articles of association of the company also provide that he cannot be removed by the members in general meeting. Some of the members want to remove 'Abhinav' by passing an ordinary resolution in general meeting. State with reference to the relevant provisions of the Companies Act, 2013 whether the proposed action is valid.

(iii) Vibrant Ltd. has 12 Directors on its Board and has the following clause in its Article of Association:

"The question arising at any meeting of the Board of Directors or any Committee thereof shall be decided by a majority of votes, except in cases where the Companies Act, 2013 expressly provides otherwise."

In one of the meeting of the Board of Directors of Vibrant Ltd 8 Directors were present. After completion of discussion of matter, voting was done. 3 Directors voted in favour of the motion, 2 Directors voted against the motion while 3 Directors abstained from voting.

State whether the motion was carried or not. It is clarified that the motion being voted up to was not concerning a matter which requires consent of all the Directors present in the meeting.

[4+5+6 = 15]

Answer

(i) As per **section 167 read with section 164 of the Companies Act, 2013**, a director shall vacate his office if he fails to pay a call on the shares of the company held by him within 6 months from the last day fixed for the payment of the call. Similarly, a person shall be disqualified from becoming a director if he fails to pay a call on the shares of the company held by him within 6 months from the last day fixed for the payment of the call (Section 164).

In the given case, a non-executive director has failed to pay a call on the shares of the company. If the call is not paid for 6 months from the last date fixed for the payment of the call, he shall vacate the office of director held by him. The vacation of office shall be automatic, i.e. the non-executive director shall forthwith (i.e. immediately on expiry of 6 months from last date of payment of call) vacate the office of director held by him. Also, in such a case, he shall be disqualified from being appointed as a director in M/s Super India Ltd.)

(ii) Section 169 of Companies Act, 2013 gives a statutory right to the shareholders to remove any director before the expiry of his term by following the prescribed procedure. It applies to both public and private companies.

Any provision in the articles that a director shall not be removed, violates the statutory right given to the shareholders, and is ultra vires the Act as provided by section 6 of Companies Act, 2013. Section 6 stipulates that the provisions of the Act have an overriding effect on clauses contained in the memorandum, articles or any other agreement, if they are not in conformity with the provisions of the Act.

The articles of a company entitled a director to hold office for life. The Court held that section 169 has been enacted to enable the shareholders to exercise control over the directors and therefore the shareholders have been empowered to remove the directors. Therefore, the said permanent director could be removed from the office [Tarlok Chand Khanna v Rajkumar Kapoor (1983) 54 Comp Cas 12].

In the present case the articles of the company provide that Abhinav shall be a director holding office for life and he shall not be removed by the members in general meeting. In view of the over-riding effect of section 6, this clause is repugnant to section 169 and is therefore void. Accordingly, the proposed action of removal of Abhinav by passing an ordinary resolution in general meeting is valid subject to compliance of the procedure laid down in section 169.

(iii) As per **Regulation 68 of Table F contained in Schedule I of Companies Act, 2013,** except where the Act requires a unanimous resolution, questions arising at a Board meeting shall be decided by a majority of votes.

In the given case, the articles of Vibrant Ltd. contain a Regulation similar to Regulation 68 of Table F. The articles of Vibrant Ltd. state that a resolution shall be deemed to be passed in a Board meeting if it is approved by a majority of votes. In this regard, following points are worth noting:

(a) In a Board meeting, every director has one vote only.
(b) Only those directors who are present in the meeting and vote on a resolution are considered while determining majority, i.e. following directors are not considered while ascertaining the result of a resolution:
   - A director who is absent at a Board meeting.
   - A director who abstains from voting.

In the given case, the company has 12 directors, out of which only 8 are present in the Board meeting. Out of 8 directors present, 3 directors have voted in favour, 2 directors have voted against the resolution, and 3 directors have abstained from voting. The directors absent in the Board meeting, and the directors present but abstaining from voting shall be ignored. The number of votes cast in favour of the resolution exceeds the number of votes cast against the resolution, and therefore the said resolution is passed. Following assumptions have been made in the above case:

(a) No director voting in favour of the resolution is interested in the resolution, as per the provisions of section 184.
(b) At least 4 disinterested directors are present in the Board meeting to form the quorum required at the time of passing the resolution (section 174).
(c) The resolution does not require consent of all the directors present in Board meeting.

Question 2(c)

(i) The Board of directors of ABC Ltd. met thrice in the year 2015 and the 4th meeting, though called could not be held for want of quorum. Examine with reference to the relevant provisions of the Companies Act, 2013, the following:
   1. Whether any provisions of the Companies Act, 2013 have been contravened?
   2. Is a director bound to attend the Board meetings and when his frequent absence from the Board meetings may be excused?

(ii) Mr. Deva was appointed as the managing director of Sure Leather Industries Ltd. for a period of five years with effect from 01.04.2012 on a salary of ₹12 lakhs per annum with other perquisites. The Board of Directors of the company, oncoming to know of certain questionable transactions, terminated the services of the managing director from 01.03.2015. Mr. Deva termed his removal as illegal and claimed compensation from the company. Meanwhile the company paid a sum of ₹5 lakhs on ad hoc basis to Mr. Deva pending settlement of his dues. Discuss whether:

1. **The company is bound to pay compensation to Mr. Deva, and, if so, how much.**
2. **The company can recover the amount of ₹5 lakhs paid on the ground that Mr. Deva is not entitled to any compensation, because he is guilty of corrupt practices.**

(iii) Discuss in brief the issue of certificate of registration of existing companies, under Companies Act, 2013

[6+6+3 = 15]

Answer

(i)

1. The present problem relates to **sections 173 and 174 of the Companies Act, 2013**.
   A. As per section 173, at least four Board meetings shall be held in each calendar year and not more than 120 days shall intervene between two consecutive meetings of the Board.
   B. As per section 174, if a Board meeting could not be held for want of quorum, then, unless the articles of the company otherwise provide, the meeting shall automatically stand adjourned -
      (a) to the same day in the next week, or if that day is a national holiday, till the next succeeding day, which is not a national holiday;
      (b) at the same time;
      (c) at the same place.
   C. An adjourned Board meeting cannot be held, if the quorum is not present.
   D. The issues raised in the given problem are answered as under:
      Under the Companies Act, 2013, if a Board meeting is duly called but it is not held for want of quorum, and as a consequence the minimum number of 4 Board meetings in a calendar year as required under Section 173 is not held, it would amount to a contravention of Section 174.

Conclusion: The Company has violated the provisions of section 173.

2. A director should endeavor to attend the maximum number of Board meetings. But he is not duty bound to attend all the Board meetings.
   However, if loss is caused to the company because of continuous absence of a director from the meetings of the Board, it would amount to negligence and breach of duty. Moreover, a director shall vacate his office if he absents himself, with or without obtaining leave of absence from the Board, from all the Board meetings 'held during a period of 12 months [Section 167(1)(b)].

(ii) As per **section 202 of Companies Act, 2013** –

- Compensation can be paid only to a managing director or whole time director or manager.

- The compensation payable shall not exceed the remuneration which he would have earned if he had been in office for the unexpired residue of his term or for 3 years, whichever is shorter.
- Where the director has been guilty of fraud or breach of trust or gross negligence in the conduct of the affairs of the company, he shall not be paid any compensation.

The answers to the given problem are as under:

1. The company is not bound to pay compensation to Mr. Deva if he has been found guilty of any fraud or breach of trust. However, it is not proper for the company to withhold the payment of compensation on the basis of allegations, unless there is a proper finding on the involvement of Mr. Deva in corrupt practices.
   The compensation payable shall not exceed ₹25 lakhs, i.e. at the rate of ₹12 lakhs per annum for unexpired period of 25 months.

2. As per the decision in Bells v Lever Bros [1932] AC 161 House of Lords, the compensation of ₹5 lakh already paid by the company to Mr. Deva cannot be recovered back if the company later comes to know that Mr. Deva was guilty of serious breaches of duty and corrupt practices which would have entitled the company to end the employment of Mr. Deva without any compensation. It was also held that the managing director was under no obligation to disclose to the company the breach of duty so as to give an opportunity to the company to remove him without paying compensation.

(iii) The provisions of Section 367, of Companies Act, 2013 with respect to certificate of registration are as follows:

1. On compliance with the requirements with respect to registration, and on payment of prescribed fees, the Registrar shall issue a certificate of registration to the existing company.
2. The certificate shall be signed by the Registrar.
3. The certificate shall state that the company applying for registration has been incorporated as a company under Companies Act, 2013.
4. The company shall be incorporated from the date of issue of the certificate.
5. In case the company has been registered as a limited company, the certificate shall state that the company is a limited company.

Question 2(d)

(i) Explain the provisions relating to investigation into the affairs of a company as per Companies Act, 2013.

(ii) As per provisions of the Companies Act, 2013, what is the status of Star Ltd., a company incorporated in London, U.K., which has a share transfer office at Mumbai? Would the case have been the same, if Star ltd. would have been formed by Indian citizens, but it did not have its Mumbai branch?

(iii) Examine, with reference to the provisions of the Foreign Exchange Management Act, 1999, the residential status of the branches mentioned below:

1. **Mita Limited, an Indian company having its Registered Office at Mumbai, India established a branch at New York U.S.A. on 1st April, 2004.**
2. **Wella Ltd., a company incorporated and registered in London established a branch at Chandigarh in India on 1st April, 2004.**
3. **Wella Ltd.'s Singapore branch which is controlled by its Chandigarh branch.**

[5+4+6 = 15]

Answer

(i)

1. Power of CG to order investigation [Section 210(1)]

Where the Central Government is of the opinion, that it is necessary to investigate into the affairs of a company, -

(a) on the receipt of a report of the Registrar or inspector under section 208;

(b) on intimation of a special resolution passed by a company that the affairs of the company ought to be investigated; or

(c) in public interest,

it may order an investigation into the affairs of the company.

2. Duty of CG to order investigation [Section 210(2)]

Where an order is passed by a court or the Tribunal in any proceedings before it that the affairs of a company ought to be investigated, the Central Government shall order an investigation into the affairs of that company.

3. Appointment of inspectors by CG [Section 210(3)]

For the purposes of this section, the Central Government may appoint one or more persons as inspectors to investigate into the affairs of the company and to report thereon in such manner as the Central Government may direct.

(ii) As per Section 2(42) of the Companies Act, 2013, 'foreign company' means any company or body corporate incorporated outside India which -

(a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and

(b) conducts any business activity in India in any other manner.

The answer to the given problem is as follows:

1. 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 Mumbai; the company is a foreign company.

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

(iii) Section 2(u)of FEMA, 1999 defines a 'person'. As per this definition, the following shall be covered in the definition of a 'person':
   (a) A company
   (b) 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':
   (a) Any person or body corporate registered or incorporated in India.
   (b) An office, branch or agency in India owned or controlled by a person resident outside India.
   (c) An office, branch or agency outside India owned or controlled by a person resident in India.

The answer to the given problem is as under:

1. Mita Limited as well as the New York branch of Mita Limited is a 'person'. Therefore, residential status under FEMA shall be determined for each of them separately.
   - Mita Limited is incorporated in India. Therefore, it is a 'person resident in India'.
   - Mita Limited (a 'person resident in India') has established a branch outside India. Therefore, the New York branch of Mita Limited falls under the clause 'an office, branch or agency outside India owned or controlled by a person resident in India' and so the New York branch is a 'person resident in India'.

2. Wella Ltd. as well as Chandigarh branch of Wella Ltd. is a 'person'. Therefore, residential status under FEMA shall be determined for each of them separately.
   - Wella Ltd. (a foreign company) does not fall under any of the clauses of the definition of a 'person resident in India'. Therefore, Wella Ltd. is a person resident outside India.
   - The Chandigarh branch of Wella Ltd. 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'.

3. The Singapore branch of Wella Ltd., though not owned, is controlled by the Chandigarh branch. The Singapore 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'.

Question 2(e)

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

(ii) Is the Authority required to furnish any returns to the Central Government, as per provisions of IRDA Act, 1999?

(iii) State the provisions relating to incorporation of Insurance Association of India, as per Insurance Act, 1938.

(iv) Point out the circumstances where under the following powers may be exercised by the Securities and Exchange Board of India:

1. **Prohibiting a company from issuing or publishing any document or advertisement soliciting money from public for the issue of securities.**
2. **Pass cease and desist order in relation to any listed company.**

What remedies are available to the companies against such orders under the Securities and Exchange Board of India Act, 1992.

[4+4+3+4 = 15]

Answer

(i) Section 11 of the Competition Act, 2002 empowers the Central Government to remove the Chairperson or any member of the Competition Commission of India in certain cases. One of the grounds mentioned in section11 is, "where he has become physically or mentally incapable of acting as a Member."

However, in the following two cases, the Chairperson or a Member may be removed from office only if the matter is referred by the Central government to the Supreme Court, and the Supreme Court makes an order that the Chairperson or Member ought to be removed:

1. Where he has acquired such financial or other interest as is likely to affect prejudicially his functions as a Member.

2. Where he has so abused his position as to render his continuance in office prejudicial to the public interest.

In the given case, the ground under which the Central Government has ordered removal of a Member does not fall under any of the above two grounds. So, the matter is not required to be referred to the Supreme Court. Therefore, the order of removal made by the Central Government is valid and lawful.

(ii) The provisions of section 20 may be explained as follows:

1. **Furnishing of returns, statements etc. [Section 20(1)]**
   The Authority shall furnish to the Central Government at such time and in such form and manner as may be prescribed, or as the Central Government may direct to furnish such returns, statements and other particulars in regard to any proposed or existing programme for the promotion and development of the insurance industry as the Central Government may, from time to time, require.

2. **Furnishing of Report describing its activities [Section 20(2)]**
   Without prejudice to the provisions of sub-section (1), the authority shall, within 9 months after the close of each financial year, submit to the Central Government a report giving a true and full account of its activities including the activities for promotion and development of the insurance business during the previous financial year.

3. **Laying of Report before the Parliament [Section 20(3)]**
   Copies of the reports received under sub-section (2) shall be laid, as soon as may be after they are received, before each House of Parliament.

(iii) The provisions relating to incorporation of Insurance Association of India are explained below:

1. **Insurance Association of India to be a body corporate [Section 64A(1)]**
   All insurers are hereby constituted a body corporate by the name of the Insurance Association of India.

2. **Members of the Association [Section 64A(2)]**
   All insurers shall be known as members of the Insurance Association of India.

3. **Characteristics of the Association [Section 64A(3)]**
   The Insurance Association of India shall have perpetual succession and a common seal and shall have power to acquire, hold and dispose of all property, both movable and immovable, and shall by the said name sue and be sued.

(iv) Section 11D empowers SEBI to pass an order requiring a person to cease and desist from committing or causing the violation of the Act or rules made thereunder. SEBI may pass a cease and desist order by complying with the following 2 requirements:

(a) SEBI shall cause an inquiry to be made to determine whether any person has violated, or is likely to violate, any provisions of this Act or any rules or regulations made thereunder.

(b) SEBI shall not pass a cease and desist order against any listed company or a public company which intends to get its securities listed on any recognised stock exchange, unless it has reasonable ground to believe that such company has indulged in insider trading or market manipulation.

Question 3: Answer any two questions **[20 Marks]**

Question 3(a)

(i) "The German Corporate Governance system is based around a dual board system". Elucidate the statement.

(ii) Discuss the various reasons for Corporate Social Responsibility (CSR). **[5+5 = 10]**

Answer

(i) 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 was amended in 2005.

The German Corporate Governance system is based around a dual board system, and essentially, the dual board system comprises a **management board (Vorstand)** and a **supervisory board (Aufsichtsrat)**.

The management board is responsible for managing the enterprise. Its members are jointly accountable for the management of the enterprise and the chairman of the management board co-ordinates the work of the management board. On the other hand, the supervisory board appoints, supervises, and advises the members of the management board and is directly involved in decisions of fundamental importance to the enterprise. The chairman of the supervisory board co-ordinates the work of the supervisory board. The members of the supervisory board are elected by the shareholders in general meetings. The co-determination principle provides for compulsory employees representation. So, for firms or companies which

have more than five hundred or two thousand employees in Germany, employees are also represented in the supervisory board which then comprises one-third employee representative or one-half employee representative respectively. The representatives elected by the shareholders and representatives of the employees are equally obliged to act in the enterprise's best interests.

The idea of employee representation on boards is not always seen as a good thing because the employee representatives on the supervisory board may hold back decisions being made that are in the best interests of the company as a whole but not necessarily in the best interests of the employees as a group. An example, would be where a company wishes to rationalize its operations and close a factory but the practicalities of trying to get such a decision approved by employee representatives on the supervisory board, and the repercussions of such a decision on labour relations, prove too great for the strategy to be made a reality.

(ii) The rationale for CSR has been articulated in a number of ways. In essence, it is about building sustainable businesses, which need healthy economies, markets and communities. The major reasons for CSR can be outlined as:

1. Globalisation

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.

2. International Legal Instruments and Guidelines

In the recent past, certain indicators and guidelines such as the SA 8000, a social performance standard based on International Labour Organization Conventions have been developed. International agencies such as United Nations and the Organization for Economic Co-operation and Development have developed compacts, declarations, guidelines, principles and other instruments that set the tone for social norms for organisations, though these are advisory for organisations and not mandatory.

One of the United Nations Millennium Development Goals calls for increased contribution of assistance from country states to help alleviate poverty and hunger, and states in turn are advising corporates to be more aware of their impact on society. In order to catalyze actions in support of the MDGs, initiatives such as Global Compact are being put in place to instrumentalise CSR across all countries.

As the world's largest, global corporate citizenship initiative by the UN, the Global Compact, a voluntary initiative is concerned with building the social legitimacy of business.

The Global Compact is a framework for businesses that are committed to aligning their business operations and strategies with ten universally accepted principles that postulate that companies should embrace, support and enact, a set of core values in the areas of human rights, labour standards, the environment, and anti-corruption.

3. Changing Public Expectations of Business

Globally companies are expected to do more than merely provide jobs and contribute to the economy through taxes and employment. Consumers and society in general expect more from the companies whose products they buy. This is coherent with believing the idea that whatever profit is generated is because of society, and hence mandates contributing a part of business to the less privileged.

Further, separately in the light of recent corporate scandals, which reduced public trust of corporations, and reduced public confidence in the ability of regulatory bodies and organisations to control corporate excess. This has led to an increasing expectation that companies will be more open, more accountable and be prepared to report publicly on their performance in social and environmental arenas.

4. Corporate Brand

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

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

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

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

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

Question 3(b)

(i) Briefly discuss the various issues regarding the MoU System in Indian CPSEs.

(ii) "The typical organizational structure of PSUs makes it difficult for the implementation of corporate governance practices as applicable to other publicly-listed private enterprises." In view of the above, list the difficulties encountered in governance.

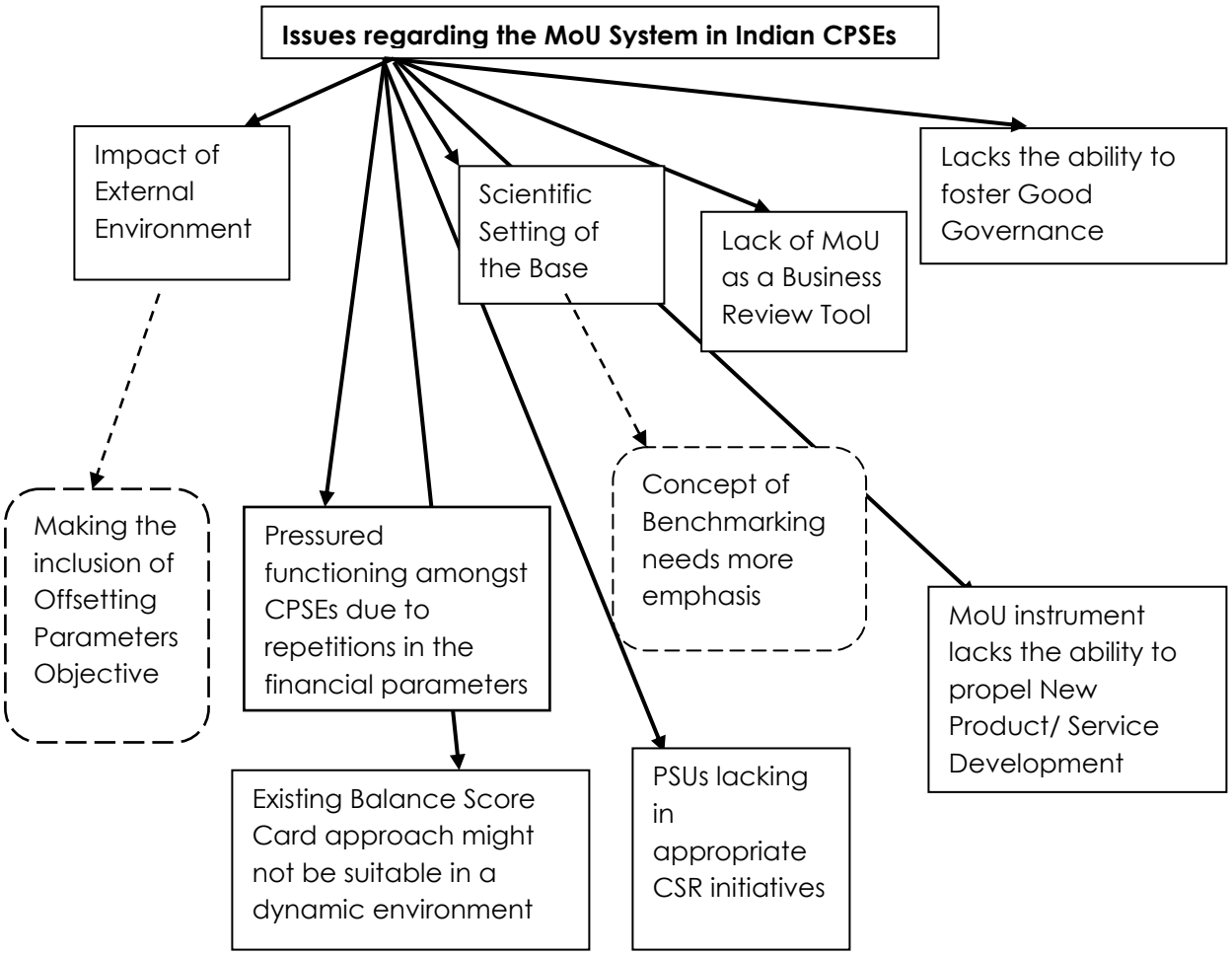
[5+5 = 10]

Answer

(i) The Memorandum of Understanding (MoU) is a negotiated document between the Government, acting as the owner of Centre Public Sector Enterprise (CPSE) and the Corporate Management of the CPSE. It contains the intentions, obligations and mutual responsibilities of the Government and the CPSE and is directed towards strengthening CPSE management by results and objectives rather than management by controls and procedures.

The beginnings of the introduction of the MoU system in India can be traced to the recommendation of the Arjun Sengupta Committee on Public Enterprises in 1984. The first set of Memorandum of Undertaking (MoU) was signed by four Central Public Sector Enterprises for the year 1987-88. Over a period of time, an increasing number of CPSEs was brought within the MoU system. Further impetus to extend the MoU system was provided by the Industrial Policy Resolution of 1991 which observed that CPSEs will be provided a much greater degree of management autonomy through the system of Memorandum of Undertaking.
Broadly speaking, the obligations undertaken by CPSEs under the MoU are reflected by three types of parameters i.e., (a) financial (b) physical and (c) dynamic.

The Figure below clearly brings out the several challenges which the MoU system in India, currently faces.



- Dark Lines Connect Broad Themes (Issues)
- Dotted lines connect Sub-Themes (Issues)

Despite the overwhelming success of the MOU system, there is a need to strengthen the exercise further to make it more value added. Some of the suggestions in this regard are as follows:

- CPSEs may detract themselves from soft targeting. This could be seen from the fact that your MOU goals set by most of the CPSEs are achieved in the third quarter of a financial year itself.
- The internal systems need to be revamped to contribute to MOU effectiveness. This may mean making the internal budgeting, pricing, materials control, MIS, performance appraisal, recruitment systems to be brought in line with the goals set in MOU.
- There is a need to percolate MOU system down the line.
- The wage negotiations should go beyond the managerial cadre in the same split and form as in the case of the process followed relating to executives.
- Balance scorecard concept should be stressed further to yield a composite MOU index.

- The basic targets need to be fixed very carefully and questioning the very logic of taking the previous year's accomplishments as good.

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

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

Question 3(c)

(i) Write short notes on:

1. **Influence of Cromme code on Corporate Governance in Germany**
2. **Risk and uncertainty in Whole Life Cycle Costing**

(ii) According to "Altered Images: The 2001 State of Corporate Responsibility in India Poll"' a survey conducted by Tata Energy Research Institute (TERI), the evolution of CSR in India has followed a chronological evolution of 4 thinking approaches. Explain the same.

[(2.5 × 2) + 5 = 10]

Answer

(i)

1. Influence of Cromme code on Corporate Governance in Germany:

The German corporate governance system could be termed an 'insider' system. The German Corporate Governance system is based around a dual board system, and essentially, the dual board system comprises a management board (Vorstand) and a supervisory board (Aufsichtsrat). The management board is responsible for managing the enterprise. Its members are jointly accountable for the management of the enterprise and the chairman of the management board co-ordinates the work of the management board. On the other hand, the supervisory board appoints, supervises, and advises the members of the management board and is directly involved in decisions of fundamental importance to the enterprise. The chairman of the supervisory board co-ordinates the work of the supervisory board. The members of the Supervisory board are elected by the shareholders in general meetings. The co-determination principle provides for compulsory employees representation. So, for firms or companies which have more than five hundred or two thousand employees in Germany, employees are also represented in the supervisory board which then comprises one-third employee representative or one-half employee representative respectively. The representatives elected by the shareholders and representatives of the employees are equally obliged to act in the enterprise's best interests.

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.

Table: Key characteristics influencing German corporate governance

Feature	Key characteristic
Main business form	Public or private companies limited by shares
Predominant ownership structure	Financial and non-financial companies
Legal system	Civil law
Board structure	Dual
Important aspect	Compulsory employee representation on supervisory board.

2. Risk and uncertainty in Whole Life Cycle Costing:

'Whole life-cycle costing (WLCC) is a dynamic and ongoing process which enables the stochastic assessment of the performance of constructed facilities from feasibility to disposal. WLCC decisions are complex and usually comprise an array of significant factors affecting the ultimate cost decisions. WLCC decisions generally have multiple objectives and alternatives, long-term impacts, multiple constituencies in the procurement of construction projects, generally involve multiple disciplines and numerous decision makers, and always involve various degrees of risk and uncertainty. Project cost, design and operational decision parameters are often established very early in the life of a given building project. Often, these parameters are chosen based on owner's and project team's personal experiences or on an ad hoc static economic analysis of the anticipated project costs. While these approaches are common, they do not provide a robust framework for dealing with the risks and decisions that are taken in the evaluation process. Nor do they allow for a systematic evaluation of all the parameters that are considered important in the examination of the WLCC aspects of a project. The existing methods also do not adequately quantify the true economic impacts of many quantitative and qualitative parameters.

Decisions about building-related investments typically involve a great deal of uncertainty about their costs and potential savings. Performing a WLCCA greatly increases the likelihood of choosing a project that saves money in the long run. Yet, there may still be some uncertainty associated with the WLCC results. WLCCAs are usually performed early in the design process when only estimates of costs and savings are available, rather than certain dollar amounts. Uncertainty in input values means that actual outcomes may differ from estimated outcomes.

There are techniques for estimating the cost of choosing the "wrong" project alternative. Deterministic techniques, such as sensitivity analysis or breakeven analysis, are easily done without requiring additional resources or information. They produce a single-point estimate of how uncertain input data affect the analysis outcome. Probabilistic techniques, on the other hand, quantify risk exposure by deriving probabilities of achieving different values of economic worth from probability distributions for input values that are uncertain. However, they have greater informational and technical requirements than do deterministic techniques. Whether one or the other technique is chosen depends on factors such as the size of the project, its importance, and the resources available. Since sensitivity analysis and break-even analysis are two approaches that are simple to perform, they should be part of every WLCCA.

(ii) According to "Altered Images: the 2001 State of Corporate Responsibility in India Poll", a survey conducted by Tata Energy Research Institute (TERI), the evolution of CSR in India has followed a chronological evolution of 4 thinking approaches:

Ethical Model (1930 –1950): One significant aspect of this model is the promotion of "trusteeship" that was revived and reinterpreted by Gandhiji. Under this notion the businesses were motivated to manage their business entity as a trust held in the interest of the community. The idea prompted many family run businesses to contribute towards socioeconomic development. The efforts of Tata group directed towards the well being of the society are also worth mentioning in this model.

Statist Model (1950 –1970s): Under the aegis of Jawahar Lal Nehru, this model came into being in the post independence era. The era was driven by a mixed and socialist kind of economy. The important feature of this model was that the state ownership and legal requirements decided the corporate responsibilities.

Liberal Model (1970s –1990s): The model was encapsulated by Milton Friedman. As per this model, corporate responsibility is confined to its economic bottom line. This implies that it is sufficient for business to obey the law and generate wealth, which through taxation and private charitable choices can be directed to social ends.

Stakeholder Model (1990s – Present): The model came into existence during 1990s as a consequence of realisation that with growing economic profits, businesses also have certain societal roles to fulfill. The model expects companies to perform according to "triple bottom line" approach. The businesses are also focusing on accountability and transparency through several mechanisms.