

**Intermediate**  
**Group I**  
**Paper 6 : LAWS & ETHICS**  
**(SYLLABUS – 2016)**

**Objectives**

**Question 1:**

**A. Choose the correct answer from the given four alternatives**

- (i) An agreement which is enforceable at the option of one or more parties thereto but not at the option of other or others is called
- (a) Void contract.
  - (b) Voidable contract.**
  - (c) Void agreement.
  - (d) Unenforceable contract.
- (ii) Which of the following agency is irrevocable under The Indian Contract Act, 1872?
- (a) Agency for fixed period
  - (b) Agency for single transaction
  - (c) Agency coupled with interest**
  - (d) Continuing agency
- (iii) A sort of tacit understanding/agreement among the intending bidders to stifle competition by not bidding against each other in an auction sale is called as
- (a) Damping
  - (b) Knock-out agreement**
  - (c) Puffers
  - (d) By-bidders
- (iv) When an instrument is drawn conditionally or for a special purpose as a collateral security and not for the purpose of transferring property therein, it is called
- (a) Ambiguous
  - (b) Inchoate
  - (c) Escrow**
  - (d) Inland
- (v) Which Committee is constituted by the occupier to promote cooperation between

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the workers and management in maintaining proper safety and health at workplace?

- (a) Safety Committee**

  - (b) Health Committee
  - (c) Management Workers Consultative Committee
  - (d) Maintenance Committee
  
- (vi) Under Payment of Bonus Act, 1965, in disputed cases, bonus must be paid
  - (a) Within 8 months from the close of the accounting year.
  - (b) Within 1 month from the date on which the award becomes enforceable.**
  - (c) Within 2 months from the date on which the award becomes enforceable.
  - (d) Within 6 months from the date of closing of the accounting year.
  
- (vii) The study of ethics can be divided into four operational areas namely meta ethics, normative ethics, descriptive ethics and
  - (a) Positive ethics
  - (b) Physical ethics
  - (c) Applied ethics**
  - (d) Natural ethics
  
- (viii) When a professional promotes a position or opinion to such extent that some objectivity may have to be compromised, this threat is known as
  - (a) Familiarity threat
  - (b) Objectivity threat
  - (c) Advocacy threat**
  - (d) Intimidation threat
  
- (ix) Intimation of reconstruction of changes in a registered partnership is to be given to the Registrar of firms
  - (a) No time limit**
  - (b) Within 30 days
  - (c) Within 60 days
  - (d) Within 90 days
  
- (x) The \_\_\_\_\_ of the company shall contain the regulations for management of the company.
  - (a) Articles**
  - (b) Memorandum
  - (c) Both
  - (d) None of the above
  
- (xi) A person who is not a partner of a Partnership Firm, but he may liable for firm's debt as if he was a Partner. Such a person is called

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- (a) Nominal Partner
  - (b) Sleeping Partner
  - (c) Partner by estoppels**
  - (d) Partner for profit only
- (xii) Under Companies (Registration Offices and Fees) Rules, 2014, every foreign company shall file with the Registrar of Companies along with the financial statement in form — \_\_\_\_\_ which belong to the list of all the places of business established by the foreign company in India.
- (a) FC 4
  - (b) FC 2
  - (c) FC 1
  - (d) FC 3**
- (xiii) The supervisory board under the German Model is known as
- (a) Aufsichtsrat**
  - (b) Kiertsu
  - (c) Vorstand
  - (d) Kyosei
- (xiv) An audit committee has four fold relationship and therefore has to interact with management, internal auditor, public and
- (a) Cost auditor
  - (b) Statutory auditor**
  - (c) Tax auditor
  - (d) Management auditor
- (xv) Business ethics are needed to create a faith about the quality, quantity, price etc. of products. The customers have more trust and faith in the businessmen who follow ethical rules. They feel that such businessmen would not cheat them. Which one of the following is appropriate for it?
- (a) Sefeguarding consumers' right
  - (b) Improve customers' confidence**
  - (c) Survival of business
  - (d) Consumer movement
- (xvi) Holders of public office should not place themselves under any financial or other obligation to outside individuals or organizations that might influence them in the performance or their official duties. This principle of public life is called
- (a) Selflessness
  - (b) Honesty
  - (c) Objectivity

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**(d) Integrity**

- (xvii) There are many types of ethical conflicts in the  
 (a) Business place  
 (b) Office place  
**(c) Work place**  
 (d) Public place
- (xviii) Which one of the following is said to be “unethical behavior”?  
 (a) Encouraging communication  
**(b) Adulteration**  
 (c) Employees awareness  
 (d) Objectivity
- (xix) No fine shall be imposed on employees under the age of \_\_\_\_\_  
**(a) 15**  
 (b) 13  
 (c) 12  
 (d) 18
- (xx) Holder in due course means any person  
 (a) Drawing the instrument  
**(b) Who for consideration came in possession of a promissory note**  
 (c) Named in the instrument to whom or to whom the money is directed to be paid  
 (d) None of the above

**B. Match and Pair:**

	Column A		Column B
1	wagering agreement	A	Voting through electronic means
2	delivery by attornment	B	work of the same kind is carried out by two or more sets of workers during different period of the day
3	Shift	C	a company in which that other company has a significant influence
4	Deduction on account of payment to cooperative societies	D	Code of conduct
5	Drawn without consideration	E	Ultra Vires
6	Associate Company	F	Annual Return
7	Section 108	G	Promise to pay ₹ 1,000 if it rains today.

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8	Beyond (their) powers	H	Accommodation bill
9	Section 92	I	Constructive
10	Business ethics	J	75% of wages

**Answer:**

	Column A		Column B
1	wagering agreement	G	Promise to pay ₹ 1,000 if it rains today.
2	delivery by attornment	I	Constructive
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6	Associate Company	C	a company in which that other company has a significant influence
7	Section 108	A	Voting through electronic means
8	Beyond (their) powers	E	Ultra Vires
9	Section 92	F	Annual Return
10	Business ethics	D	Code of conduct

### C. True False

**(i) Currency note, being a promissory note, is a negotiable instrument**

False

**(ii) A stranger to contract cannot sue upon it.**

True

**(iii) When the affected party treat breach of condition as breach of warranty he cannot repudiate the contract but claim damages only**

True

**(iv) If there is a custom in that particular trade that the risk does not pass with property, in such a case the risk will pass with the property**

False

**(v) If the Tribunal is of the opinion that an LLP can be revived or rehabilitated, it may, direct that an action for revival or rehabilitation may be taken.**

True

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(vi) The expression 'preferential offer' means an issue of shares or other securities, by a company to any select person or group of persons on a preferential basis and includes shares or other securities offered through a public issue.

False

(vii) Rule 12 (6)(b) provides that the company shall have the freedom to specify the lock-in-period for the shares issued pursuant to exercise such option.

True

(viii) The company shall not convert its existing equity share capital with voting rights into equity share capital carrying differential voting rights and vice versa

True

(ix) If more than 150 workers are employed in a factory a canteen or canteens shall be provided and maintained by the occupier.

False

(x) Ethics is a requirement for human life.

True

### D. Fill in the blanks

(i) No suit shall be brought for recovering anything alleged to be won on any \_\_\_\_\_.

Wager

(ii) An agency is terminated by the principle by \_\_\_\_\_ his authority.

Revoking

(iii) \_\_\_\_\_ may appoint qualified medical practitioners to be certifying surgeons.

State Government

(iv) No gratuity payable under this Act shall be liable to \_\_\_\_\_ in execution of any decree or order of any civil, revenue or criminal court.

Attachment

(v) \_\_\_\_\_ includes pension fund, central recordkeeping agency, National Pension System Trust, pension fund adviser, retirement adviser, point of presence and such other person or entity connected with collection, management, recordkeeping and distribution of accumulations

Intermediary

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(vi) An application in Form No. \_\_\_\_\_ along with the fee is filed with the Regional Director for seeking confirmation for shifting the registered office within the same state.

INC 23

(vii) The company shall not use any amount raised through the issue of \_\_\_\_\_ for buying, trading or otherwise dealing in equity shares of any other listed company.

Prospectus

(viii) Sweat equity shares are such equity shares as are issued by a company to its \_\_\_\_\_ or \_\_\_\_\_ at a discount or for consideration, other than cash.

Directors, employees

(ix) Section 95 provides that the register, their indices shall be \_\_\_\_\_ of any matter directed or authorized to be inserted therein.

prima facie evidence

(x) The Seven Principles of Public Life were set out by \_\_\_\_\_ for the first time in the year 1995.

Lord Nolan

### SECTION - A

#### Study Note 1 – Indian Contract Act, 1872

Question 2:

(a) Mr. Paul of his own promised to subscribe to Mahatma Gandhi Memorial Fund by 30.09.2017, but did not pay. Under the circumstances, he can be enforced – Comment.

Answer:

Consideration is essential element of contract without which no promise can be enforced. Therefore a gratuitous promise to contribute to Mahatma Gandhi Memorial Fund cannot be enforced. However if the promisor knew the purpose and also knew that on the faith of such promise, certain obligations are incurred, the promisor would be bound by the promise.

(b) Mr. Dey writes a letter to Mr. Gupta to sell his plot of land for a certain sum of money on 11.12.2017. Mr. Gupta receives the letter on 14.12.2017. Acceptance was communicated by Mr. Gupta 16.12.2017. It reaches Mr. Dey on 20.12.2017. When is the communication of the offer and acceptance binding on the parties?

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**Answer:**

**Communication of offer**

- Communication of offer completes on 14.12.17.
- Offer can be accepted by Mr. Gupta on or after 14.12.17

**Communication of acceptance** - Acceptance is communicated by Mr. Gupta on 16.12.17.

Effect of communication of acceptance:

- (i) Binding on Mr. Dey - on 16.12.17 (i.e., Mr. Dey cannot withdraw his offer on or after 16.12.17).
- (ii) Binding on Mr. Gupta - on 20.12.17 (i.e., Mr. Gupta may withdraw his acceptance before 20.12.17).

**Question 3:**

**(a) Mr. Shaw an industrialist has been fighting a long drawn litigation with Mr. Mishra another industrialist. To support his legal campaign Mr. Shaw enlists the services of Mr. Nandu a legal expert stating that an amount of ₹ 5 lakhs would be paid, if Mr. Nandu does not take up the brief of Mr. Mishra. Mr. Nandu agrees, but at the end of the litigation Mr. Shaw refuses to pay. Decide whether Mr. Nandu can recover the amount promised by Mr. Shaw under the provisions of the Indian Contract Act, 1872.**

**Answer:**

The problem as asked in the question is based on one of the essentials of a valid contract. Accordingly, one of the essential elements of a valid contract is that the agreement must not be one which the law declares to be either illegal or void.

Further Contract Act specifies that any agreements in restraint of trade, marriage, legal proceedings etc., are void agreements.

Thus Mr. Nandu cannot recover the amount of ₹ 5 lakhs promised by Mr. Shaw because it is an illegal agreement and cannot be enforced by law.

**(b) Sanjay holds agricultural land in Bihar on a lease granted by Palash, the owner. The land revenue payable by Palash to the Government being in arrear, his land is advertised for sale by the Government. Under the Revenue law, the consequence of such sale will be termination of Sanjay's lease. Sanjay, in order to prevent the sale and the consequent**



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termination of his own lease, pays the Government, the sum due from Palash. Referring to the provisions of the Indian Contract Act, 1872 decide whether Palash is liable to make good to Sanjay, the amount so paid?

**Answer:**

Yes, Palash is bound to make good to Sanjay the amount so paid. Section 69 of the Indian Contract Act, 1872, provides that "A person who is interested in the payment of money which another is bound by law to pay, and who therefore pays it, is entitled to be reimbursed by the other. In the given case Sanjay has made the payment of lawful dues of Palash in which Sanjay had an interest. Therefore, Sanjay is entitled to get the reimbursement from Palash.

**(c) When is consideration said to be against public policy?**

**Answer:**

A consideration would be considered to be against a public policy in the following cases:

1. Agreement for trading with enemy
2. Agreement interfering with personal liberty
3. Agreement interfering with parental duties
4. Agreement interfering with marital duties
5. Agreement interfering with course of justice
6. Agreement for improper promotion or litigation
7. Agreement for suppressing prosecution
8. Agreement to do an act against the duty of a person
9. Marriage brokerage agreement
10. Agreement not to bid
11. Agreement to create monopolies or reduce competition
12. Agreement for sale of public offices or titles.

**Question 4:**

**(a) State the circumstances when an agent is personally liable for the contracts entered into by him on behalf of the principal?**

**Answer:**

The general rule states that:

- (i) Only the principal can enforce and can be held liable on a contract entered into by an agent.

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- (ii) The agent is not personally liable on a contract entered into by him on behalf of the principal.

The following are the exceptions to the above rule:

1. When agent acts for sale or purchase of goods for a principal resident abroad i.e., foreign principal.
2. Where it is expressly provided in the contract that the agent shall be personally liable.
3. Where agent does not disclose the name/identity of the principal.
4. Where the principal is disclosed but cannot be sued, e.g., foreign sovereigns, ambassadors etc.
5. When the principal is not in existence at the time when the act was done, i.e., the agent acted for a non-existent principal.
6. When the agent exceeds his authority or commits a breach of warranty of authority.
7. When he acts as a pretended agent
8. When he receives or pays money by mistake or fraud.
9. Where an agent signs a negotiable instrument without mentioning that he is signing as an agent.
10. Where the usage of trade or custom makes an agent personally liable.

**(b) Kwality Ltd., contracts with Walls Traders to make and deliver certain machinery to them by 30.6.2014 for ₹ 11.50 lakhs. Due to labour strike, Kwality Ltd. could not manufacture and deliver the machinery to Walls Traders. Later, Walls Traders procured the machinery from another manufacturer for ₹12.75 lakhs. Walls Traders was also prevented from performing a contract which it had made with Zenith Traders at the time of their contract with Kwality Ltd. And were compelled to pay compensation for breach of contract. Advise Walls Traders the amount of compensation which it can claim from Kwality Ltd., referring to the legal provisions of the Indian Contract Act.**

**Answer:**

Section 73 of the Indian Contract Act, 1872 provides for consequences of breach of contract. According to it, when a contract has been broken, the party who suffers by such breach is entitled to receive from the party who has broken the contract, compensation for any loss or damage caused to him thereby which naturally arose in the usual course of things from such breach or which the parties knew when they made the contract, to be likely to result from the breach of it.

Such compensation is not given for any remote and indirect loss or damage sustained by reason of the breach.

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Applying the above principle of law to the given case, Kquality Ltd is liable to compensate for the loss of ₹1.25 lakhs (₹12.75 less ₹11.50 i.e. ₹1.25 lakhs) which had naturally arisen due to default in performing the contract by the specified date.

Regarding the amount of compensation which Walls Traders were compelled to make to Zenith Traders, it depends upon the fact whether Kquality Ltd knew about the contract of Walls Traders for supply of the contracted machinery to Zenith Traders on the specified date.

If he was aware than Kquality Ltd is also liable to reimburse the compensation which Walls Traders had to pay to Zenith Traders for breach of contract. Otherwise Kquality Ltd is not liable.

### Question 5:

#### Comment on the following:

**(a) Piyu requests Sidhartha to sell and deliver her goods on credit. Sidhartha agrees to do so, provided Ajay will guarantees the payment of the price of the goods. Ajay promises to guarantee the payment in consideration of Sidhartha's promise to deliver the goods.**

#### Answer:

All essentials of a valid contract must be present in the contract of guarantee [Sec 126]. Again Sec 127 states that, consideration received by the principal debtor is sufficient consideration to the surety for giving guarantee.

In the given case, there is a sufficient consideration for Ajay's promise. Therefore the guarantee is valid.

**(b) Sidhartha contracts with Piyu for a fixed price to construct a house for Piyu within a stipulated time. Piyu would supply the necessary materials to be used in the construction. Ajay guarantees Sidhartha's performance for the contract. Piyu does not supply the materials. Would Ajay be still liable?**

#### Answer:

Ajay is discharged from the liability since the surety is discharged by any act or omission of the creditor, the legal consequences of which is the discharge of the principal debtor {sec 134}.

In the given case, failure to supply necessary materials by Piyu (the creditor) amounts to an omission on the part of the creditor resulting in the discharge of Sidhartha (the principal debtor) and hence discharging Ajay (the surety).

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**(c) Sidhartha guarantees Ajay against the misconduct of Piyu in an office to which Piyu is appointed by Ajay, and of which the duties are defined by an Act of Legislature. By a subsequent Act, the nature of the office is materially altered. Afterwards, Piyu misconducts himself.**

**Answer:**

As per section 133, if subsequent to the formation of contract of guarantee, any variation is made in the terms and conditions of contract of guarantee and such variation is made without the consent of surety, then the surety shall be released for such transactions, which takes place after such variations.

Material alteration in duties of Piyu amounts to variation in terms and conditions of the guarantee. Although such variations are not due to an agreement between the principal debtor and creditor, yet the surety is discharged.

**(d) Sidhartha guarantees to Ajay payment for iron to be supplied by him to Piyu to the amount of 3,000 tons. Piyu and Ajay have privately agreed that Piyu would pay 5 rupees per ton beyond the market price, such excess to be applied to the liquidation of an old debt. This agreement is concealed from Sidhartha.**

**Answer:**

Section 143 states that, any guarantee which the creditor has obtained by means of keeping silence as to material circumstances is invalid.

Sidhartha is not liable as a surety since Ajay (the creditor) has obtained the guarantee from Sidhartha by means of keeping silence as to material circumstances (i.e. Piyu paying an excess of 5 rupees per ton to be applied in liquidation of an old debt).

### Study Note 2 – Sale of Goods Act, 1930

**Question 6:**

**(a) Raman instructed Soman, a transporter, to send a consignment of apples to Mumbai. After covering half a distance, Soman found that the apples will perish before reaching Mumbai.**

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Hence, he sold the same at a half the market price. Raman sued against Soman. Will he succeed?

**Answer:**

**Agent's Authority in an emergency:**

As per section 189 of the sale of Goods Act, 1930, An agent has the authority in an emergency to do all such acts as man of ordinary prudence would do for protecting his principal from losses which the principal would have done under similar circumstances. A typical case is where the agent handling perishable goods like 'apples' can decide the time, date and place of sale, not necessary as per instructions of the principal, with the intention of protecting the principal from losses.

Here the agent acts in an emergency and act as a man of ordinary prudence. In the given case, Soman had acted in an emergency situation and Raman will not succeed against him.

**(b) Differentiate between a contract of Sale and an Agreement to sell.**

**Answer:**

Basis	Contract of Sale	Agreement to sell
<b>Transfer of property</b>	The property of the goods passes from the buyer to the seller.	The transfer of property takes place at a future time or subject to certain conditions to be fulfilled.
<b>Type of contract</b>	It is an executed contract	It is an executory contract
<b>Type of goods</b>	Sales takes place only for existing and specific goods	Future and contingent goods
<b>Risk of loss</b>	If the goods are destroyed, the loss falls on the buyer despite the goods are in the possession of the seller.	If the goods are destroyed, the loss falls on the seller despite the goods are in the possession of the buyer
<b>Breach of contract</b>	The seller can sue the buyer for price and for damages in case of breach by the buyer	The seller can sue for damages only in case of breach by the buyer
<b>General and particular property</b>	It gives buyer to enjoy the goods as against the world at large including the seller	It gives a right to the buyer against the seller to sue for damages
<b>Insolvency of the buyer</b>	In the absence of lien over the goods the seller is to return the goods to the Official receiver or assignee. He is entitled to get the dividend declared by the Official receiver which will be at the reduced rate.	The seller is not bound to part with the goods until the price is paid to him.
<b>Insolvency of the seller</b>	The buyer, becoming the owner, is entitled to recover the same from the Official receiver or assignee	The buyer cannot claim the goods but the dividend declared by the Official receiver or assignee.

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Question 7:

(a) Justify the following:

- (i) On 30.11.13 Mr. Sham agrees to sell a painting to Mr. Ram for ₹ 5,000 but Mr. Sham died on 8.12.13. Mr. Sham's son claimed ₹ 10,000, Can Mr. Ram obtain the painting at ₹ 5,000 which was agreed to by Mr. Sham?

**Answer:**

A contract of sale of goods is a contract where by the seller transfer or agrees to transfer the property in goods to the buyer for price.

A contract may provide for payment by installment or that the delivery or payment or both shall be postponed.

Subject to the provisions of any law for the time being in force, a contract of sale may be made in writing or by word of mouth.

In this case although the contract was not executed but in view of above, Ram, may enforce 'Sham's heirs for the painting at ₹ 5000 which was agreed to by 'Sham'.

- (ii) Mr. Sham informs Mr. Ram that Mr. Sham's estate is free from encumbrances. Mr. Ram buys the property fully relating on Mr. Sham. Subsequently it revealed that the estate was mortgaged. What will be the position of Mr. Ram?

**Answer:**

In this the contract is voidable at the option of Ram, he may avoid the contract. He may insist on its being carried out and the mortgaged debt redeemed.

- (iii) Mr. Ram gives diamond to Mr. Sham on "sale or return" basis on the same day; Mr. Sham gives those diamonds to Mr. Jadu on "sale or return" basis. Those diamonds were lost from Mr. Jadu on the same day, who will the loss?

**Answer:**

Ownership under sale on return remains with seller until it passes to buyer. Mr. Sham, giving diamonds to Jadu, acquires ownership. Although the diamonds were lost from Mr. Jadu's custody on the same day but he was not owner in this case. The owner i.e. Sham shall bear the loss i.e. Mr. Sham shall pay to Mr. Ram.

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**(iv) Mr. Sham orders on Mr. Ram to deliver certain goods at Mumbai. While the goods are lying at Mumbai Railway Station. The Station Master informs Mr. Sham that the goods are held at station at Mr. Sham's risk, but Mr. Sham became insolvent. Has Mr. Ram has any right as an unpaid seller?**

**Answer:**

Mr. Ram has lost his right of stoppage in transit; the intimation by the station master that the goods are held at the Station at Mr. Sham's rights has transformed the position of station master into a bailee of Mr. Sham instead of Mr. Ram. The transit has thus come to an end.

An unpaid seller can stop the goods in transit in the event of buyers' insolvency. The transit being over, the right is thus lost.

**(b) M/s. Wholesaler agreed to supply 1,000 Pcs. of Cotton Shirts to M/s. Retailer at ₹300 per shirt by 31.05.2014. On 01.02.2014 M/s. Wholesaler informs the Retailer that he is not willing to supply the shirt as the price of shirt increased to ₹350 each. Examine the right of M/s. Retailer.**

**Answer:**

In terms of the provisions of Section 32 and 33 of the Sale of Goods Act, 1930; unless otherwise agreed, delivery of the goods and payment of the price are concurrent conditions, that is to say, the- seller shall be ready and willing to give possession of the goods to the buyer in exchange for the price, and the buyer shall be ready and willing to pay the price in exchange for possession of the goods.

Rights of the Buyer according to the Sale of Goods Act, 1930 include:

- (1) To have delivery of the goods as per contract. (Sec. 31 & 32);
- (2) To sue the seller for recovery of the price, if already paid, when the seller fails to deliver the goods;
- (3) To sue the seller for damages if the seller wrongfully neglects or refuses to deliver the goods to the buyer ( Sec 57);
- (4) To sue the seller for specific performance;
- (5) To sue the seller for damages for breach of a warranty or for breach of a condition treated as breach of a warranty ( Sec 59);
- (6) To sue the seller the damages for anticipatory breach of contract (Sec 60)

In the instant case M/s. Retailer can exercise any of his rights discussed above

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## Study Note 3 – Negotiable Instruments Act, 1881

### Question 8:

- (a) **Atul draws a bill of exchange payable to himself on Sidhartha, who accepts the bill without consideration just to accommodate Atul. Atul transfers the bill to Bikash for good consideration. State the rights of Atul and Bikash. Would your answer be different if Atul transferred the bill to Bikash after maturity.**

### Answer:

Section 43 of Negotiable Instruments Act, 1881 states the following:

- (i) Liability of parties if there is no consideration – A negotiable instrument made, drawn, accepted, endorsed or transferred without consideration, or for a consideration which fails, creates no obligation of payment between the parties to the transaction.
- (ii) Rights of holder for consideration – But if any such party has transferred the instrument to a holder for consideration, such holder, and every subsequent holder deriving title from him, may recover the amount due on such instrument from the transferor for consideration or any prior party thereto.
- (iii) No right of accommodating party to recover from accommodating party – No party for whose accommodation a negotiable instrument has been made, drawn, accepted or endorsed can, if he has paid the amount thereof, recover thereon such amount from any person who became a party to such instrument for his accommodation.

In the given case, Atul is not entitled to sue Sidhartha, since there is no consideration between Atul and Sidhartha and hence there is no obligation to pay.

Again Bikash is entitled to sue Atul and Sidhartha, since Bikash is a holder for consideration. Bikash is entitled to sue the transferor for consideration and every other party prior to him.

Even if Atul has transferred the bill after maturity, Bikash would have the right to sue, since the right to sue the transferor for consideration and every other party prior to him, is available to holder for consideration, even though he is not the 'holder in due course' i.e. even if the holder for consideration obtains the bill after maturity.

- (b) **Rahul accepted a bill of exchange and gave it to Keshav for the purpose of getting it discounted and handing over the proceeds to Rahul. Keshav having failed to discount it returned the bill to Rahul. Rahul tore the bill in two pieces with the intention of cancelling it**



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and threw the pieces in the street. Keshav picked up the pieces and pasted the two pieces together, in such manner that the bill seemed to have been folded for safe custody rather than cancelled. Keshav put it into circulation and it ultimately reached Sidhartha, who took it in good faith and for value. Is Rahul liable to pay the bill under the provisions of the Negotiable Instruments Act, 1881?

**Answer:**

Sidhartha is a holder in due course, since he acquired the bill in good faith and for value; and since he became the possessor of the bill payable to bearer (assumed that the bill was payable to bearer) (Sec. 9)

Rahul cannot deny the validity of the bill, since no drawer or acceptor of a bill shall, in a suit by a holder in due course, be permitted to deny the validity of the bill as originally drawn, and thus, Sidhartha who is the holder in due course, acquires a good title to the bill (Sec. 120).

Sidhartha is entitled to recover the payment of the bill from Rahul and all prior parties, since a holder in due course has the right to sue all the prior parties (Sec. 36)

### Study Note 4 – Indian Partnership Act, 1932

**Question 9:**

**(a) Sunil, Bikash and Rishi were partners under the agreement that they were to share equally in the profits and losses of the firm. In a suit between them for dissolution and accounts, it is ascertained that contributions of Sunil, Bikash and Rishi to the capital of the firm, were ₹ 10,000, ₹ 5,000 and ₹ 1,000 respectively. The assets of the firm after paying debts of the firm and advances made by the partners, as distinguished from their contributions to the capital of the firm, are ₹ 7,000. Comment on the settlement of this partnership Account.**

**Answer:**

The deficiency of capital (which must be regarded as loss) being ₹ 9,000, each partner must contribute to the assets an equal share of the deficiency, i.e. ₹ 3,000. After this is done, the assets then available, ₹ 7,000 + ₹ 9,000 or ₹ 16,000 will be distributed among the partners with the result that each will have suffered a loss of ₹ 3,000.

In actual practice, it will not be necessary for Sunil and Bikash to pay ₹ 3,000 each but the matter will be settled on the basis of notional contributions so that Rishi whose capital is ₹ 1,000 only will pay ₹ 2,000 out of ₹ 9,000 with the firm. Sunil will take ₹ 7,000 and Bikash ₹ 2,000. Assuming that

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Sunil and Bikash contribute to the capital deficiency ₹ 3,000 each and Rishi cannot, Sunil and Bikash will share ₹ 13,000, i.e. ₹ 7,000 plus ₹ 6,000 in the proportion of ₹ 10,000: 5,000. Sunil will suffer a loss of ₹ 4,333 in all and Bikash ₹ 3,667.

**(b) State the rules of partnership by holding out, as per Indian Partnership Act, 1932.**

**Answer:**

As per section 28 of Indian Partnership Act, 1932, partnership by holding out would occur if,

1. Anyone who by words spoken or written or by conduct represents himself or knowingly permits himself to be represented, to be a partner in a firm, is liable as a partner in that firm to anyone who has on the faith of any such representation given credit to the firm, whether the person representing himself or represented to be a partner does or does not know that the representation has reached the person so giving credit.
2. Where after a partner's death the business is continued in the old firm name, the continued use of that name or of the deceased partner's name as a part thereof shall not of itself make his legal representative or his estate liable for any act of the firm done after his death.

### Study Note 5 – Limited Liability Partnership Act, 2008

**Question 10:**

**(a) State the duties of a LLP Liquidator. Would his accounts be audited?**

**Answer:**

Rule 13 provides that on appointment of a LLP liquidator, all the powers of the designated partner and other partner, if any, shall cease, except for the purpose of giving notice of such appointment of the LLP liquidator to the Registrar. Rule 14 prescribes the following duties -

- He shall settle the list of creditors or partners, which shall prima facie evidence of the liability of the persons therein to the creditors or partner;
- He shall obtain approval of partners or creditors for any purpose he may consider necessary;
- He shall maintain register and proper books of accounts in the form and manner as specified;
- He shall settle the debts of the LLP and shall adjust the rights of the partners among themselves;
- He shall observe due care and diligence in the discharge of duties.

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**Audit of LLP liquidator's account** - Rule 15 provides that the accounts of the LLP liquidator shall be audited.

**Supervision of winding up** - Rule 16 provides that the partners or the creditors may appoint such committees as they consider appropriate to supervise the voluntary winding up and assist the LLP liquidator in discharging the functions.

The LLP liquidator shall report quarterly on the progress of the winding up of the LLP in Form No. 8 to the partners or creditors which shall be made before the end of the following quarter. Where the fraud is reported against any person other than a partner or designated partner, the LLP liquidator, before sending a report to the Tribunal, may intimate it to the partners or designated partners and include their views in the report.

The Tribunal is having power to make any order to transfer the winding up proceedings from voluntary winding up to compulsory winding up by Tribunal.

**(b) A limited liability partnership wants to shift its registered office from Udaipur in the State of Rajasthan to Gurgaon in the State of Haryana. What procedure the corporate has to follow?**

**Answer:**

Sec 13 of the LLP Act states that a limited liability partnership may change the place of its registered office and file the notice of such change With the Registrar in form 15 within 30 days. Registered office can be changed from one place to another place in the manner provided in the Partnership Agreement, if the agreement is silent then consent of all partners shall be required for changing the place of registered office of limited liability partnership to another place, where the change in place of registered office is from one State to another State, the limited liability partnership having secured creditors shall also obtain consent of such secured creditors.

Where the change in place of registered office is from one state to another state, a general notice, not less than 21 days before filing any notice with Registrar, is required to be published in a daily newspaper published in English and in the principal language of the district in which the registered office of the limited liability partnership is situated and circulating in that district giving notice of change of registered office. However, there is just change in the jurisdiction of one Registrar to the jurisdiction of another Registrar; the limited liability Partnership shall file the notice in Form 15 with the Registrar from where the Limited liability partnership proposes to shift its registered office with a copy thereof for the information to the Registrar under whose Jurisdiction the registered office is proposed to be shifted. Failure to comply with the provision of this section the limited liability partnership and its every partner is liable to be punishable with fine which shall not be less than two thousand rupees but which may extend to twenty five thousand rupees.

## SECTION - B

### Study Note 6 to 12 – Industrial Laws

#### Question 11:

- (a) **Ajit an employee of Supertech Copper Ltd., continued to occupy the quarter of the company for eight months after superannuation, company decided to forfeit the amount of gratuity of Ajit. Examine the decision taken by the company to forfeit the amount of gratuity in the light of the Payment of Gratuity Act, 1972.**

#### Answer:

The gratuity of an employee, whose services have been terminated for any act, willful omission or negligence causing any damage or loss to, or destruction of, property belonging to the employer, can be forfeited to the extent of the damage or loss so caused. The gratuity payable to an employee may be wholly or partially forfeited:- (i) if the services of such employee have been terminated for his riotous or disorderly conduct or any other act of violence on his part or (ii) if the services of such employee have been terminated for any act which constitutes an offence involving moral turpitude, provided that such offence is committed by him in the course of his employment.

It is not a valid ground for forfeiture of entire gratuity. In such a case, the company is entitled to charge the quarter rent as per rules and after adjustment of such charges, Ajit is entitled to receive the balance gratuity.

- (b) **Explain the procedure for fixing and revising minimum wages under Minimum Wages Act 1948.**

#### Answer:

#### **Procedure for Fixing and revising Minimum Wages (Sec 5)**

In fixing minimum rates of wages in respect of any scheduled employment for the first time or in revising minimum rates of wages so fixed, the appropriate Government shall follow either of the following 2 methods:

- (a) **Appointment of committees.** The appropriate Government shall appoint as many committees and sub-committees as it considers necessary to hold inquiries and advise it in respect of fixation or revision of minimum rates of wages, as the case may be [Sec. 5(1)(a)] ;  
or

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**(b) Publication of proposals in the Official Gazette.** The appropriate Government shall, by notification in the Official Gazette, publish its proposals for the information of persons likely to be affected by the fixation or revision of minimum rates of wages. It shall also specify a date on which the proposals will be taken into consideration. The date so specified shall not be less than 2 months from the date of the notification [Sec. 5(1)(b)].

After considering the advice of the committee or committees [under Sec. 5(1)(a)] or all representations received by it before the date specified in the notification [under Sec. 5(1)(b)], the appropriate Government shall, by notification in the Official Gazette, fix or revise the minimum rates of wages in respect of each scheduled employment. The fixation or revision shall come into force on the expiry of 3 months from the date of the issue of notification, unless the notification otherwise provides [Sec. 5(2)]. The power of the Government under Sec. 5 (2) to issue notification revising minimum wages includes power to give retrospective effect to notification

### Question 12:

**(a) Sushil retired from the services of ABC Limited, on 31st March, 2014. He had a sum of ₹ 10 lakhs in his Provident Fund Account. It has become due for payment to Sushil on 30th April, 2014, but the company made the payment of the said amount after one year. Sushil claimed for the payment of interest on due amount at the rate of 15 per cent per-annum for one year. Decide, whether the claim of Sushil is tenable under the provisions of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952.**

### Answer:

According to Section 7Q of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952, the employer shall be liable to pay simple interest @ of 12% per annum or at such higher rate as may be specified in the Scheme on any amount due from him under this Act from the date on which the amount has become so due till the date of its actual payment.

However, the higher rate of interest specified in the Scheme cannot exceed the lending rate of interest charged by any scheduled bank. As per above provision, Sushil can claim for the payment of interest on due amount @ 12 percent per annum or at the rate specified in the Scheme, whichever is higher, for one year. Here in the absence of specified rate Sushil can claim only 12 percent per annum interest on the due amount. Hence claim of Sushil for interest rate 15% is not tenable.

**(b) ABC Ltd. carrying manufacturing activities with aid of power and with eight workers for last two years ending on 31.03.2014. Three more workers were appointed on 01.04.2014, two**

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workmen left the company on 30.04.2014. Thereafter no workman was employed nor any workmen left. Mr. Basant, one of the workman demanded that Factories Act, 1948 shall be applicable to this company but the management denied. Give your opinion.

**Answer:**

According to Sec 2 (m) of the Factories Act, 1948, 'factory' means any premises including the precincts thereof –

- (i) Wherein 10 or more workers are working or were working on any day of the preceding 12 months, and in any part of which a manufacturing process is being carried on with the aid of power, or is ordinarily so carried on, or
- (ii) Wherein 20 or more workers are working or were working on any day of the preceding 12 months, and in any part of which a manufacturing process is being carried on without the aid of power, or is ordinarily so carried on.

In the given case, during the period 01.04.2014 to 30.04.2014, there were 11 workers carrying manufacturing activities with aid of power. So, the Factories Act, 1948 is applicable on ABC Ltd. Mr. Basant is correct.

**Question 13:**

**(a) Notun Textiles Limited has three separate units at three separate places in the country. Every unit of the said company prepares and maintains separate Balance Sheet and Profit and Loss Account. One of these units is incurring continuous losses and hence bonus is not paid to the employees of this unit. Decide, under the Payment of Bonus Act, 1965 whether the employees of the said unit can claim bonus on the ground that the unit incurring loss is a part of one single establishment?**

**Answer:**

All the 3 units shall be treated as 3 separate establishments since all the 3 units maintain separate B/S and P&L Account.

Employees of the unit which is incurring losses:

- are not entitled to claim bonus on the ground that the unit incurring loss is a part of one single establishment;
- are entitled to minimum bonus as per the provisions of Sec. 10, 12, 13 and 14 of the Act, since minimum bonus is payable whether or not there is any allocable surplus (and whether the establishment has made a profit or incurred a loss).

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- However, for the purpose of computation of bonus, the amount of allocable surplus shall be taken for that particular unit only, and not of all the 3 units taken together.

**(b) Explain the composition of Medical benefit council, under Employees State Insurance Act, 1948.**

**Answer:**

As per section 10 of Employees State insurance Act, 1948, the Central Government shall constitute a Medical Benefit Council consisting of:

1. the Director General, Health Services, ex officio, as Chairman;
2. a Deputy Director General, Health Services, to be appointed by the Central Government;
3. the medical commissioner of the Corporation, ex officio;
4. one member each representing each of the States (other than Union Territories) in which this Act is in force to be appointed by the State Government concerned;
5. three members representing employers to be appointed by the Central Government in consultation with such organizations of employers as may be recognized for the purpose by the Central Government;
6. three members representing employees to be appointed by the Central Government in consultation with such organizations of employees as may be recognized for the purpose by the Central Government; and
7. Three members, of whom not less than one shall be a woman, representing the medical profession, to be appointed by the Central Government in consultation with such organizations of medical practitioners as may be recognized for the purpose by the Central Government.

**Question 14:**

**(a) Examine with reasons, the validity of the following nominations made under the provisions of the Employees' Provident Fund and Miscellaneous Provisions Act, 1952:**

1. J nominated N (his son) as a nominee.
2. M nominated S (his wife) and K (a friend) as nominees.
3. R who does not have a family nominated A (a close relative) as a nominee.

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**4. G nominated N (a friend) as a nominee because he does not have a family at the time of nomination. Later, after one year he gets married to Z.**

**Answer:**

1. Nomination by J in favour of N is valid, since N is a member of the family of J (since son is covered under the definition of 'family').
2. Nomination by M in favour of S is valid, since S is a member of the family of M (since wife is covered under the definition of 'family'); But in favour of K is void, since K is not a member of the family of M (since K is only a friend, and a friend is not covered under the definition of 'family').
3. Nomination by R in favour of A is valid although A is not covered under the definition of family; but if the employee does not have a family, then, nomination may be made in favour of any person.
4. Nomination by G in favour of N is valid but it becomes void immediately on marriage since a nomination made in favour of a person who is not a member of the family, becomes void immediately when the employee subsequently acquires a family.

**(b) Discuss the general duties of an 'occupier' under the Factories Act, 1948**

**Answer:**

General duties of an 'occupier' are discussed in sec 7A of the Factories Act, 1948. These are as follows:

Every occupier shall ensure, so far as is reasonably practicable, the health, safety and welfare of all workers while they are at work in the factory.

Without prejudice to the generality of the provisions of sub-section (1), the matters to which such duty extends, shall include –

- (i) the provision and maintenance of plant and systems of work in the factory that are safe and without risks to health;
- (ii) the arrangements in the factory for ensuring safety and absence of risks to health in connection with the use, handling, storage and transport of articles and substances;
- (iii) the provision of such information, instruction, training and supervision as are necessary to ensure the health and safety, of all workers at work;



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- (iv) the maintenance of all places of work in the factory in a condition that is safe and without risks to health and the provision and maintenance of such means of access to, and egress from, such places as are safe and without such risks;
- (v) the provision, maintenance or monitoring of such working environment in the factory for the workers that is safe, without risks to health and adequate as regards facilities and arrangements for their welfare at work.

Except in such cases as may be prescribed, every occupier shall prepare, and, as often as may be appropriate, revise, a written statement of his general policy with respect to the health and safety of the workers at work and the organisation and arrangements for the time being in force for carrying out that policy, and to bring the statement and any revision thereof to the notice of all the workers in such manner as may be prescribed.

### Question 15:

**(a) How is the amount of Gratuity determined in case of the following employees:**

- (i) A monthly rated employee**
- (ii) A piece rated employee**
- (iii) An employee of a seasonal establishment**

### Answer:

Calculation of amount of gratuity:

(i) In case of monthly rated employee:

- The gratuity shall be payable @ 15 days wages for every completed year of service or part thereof in excess of 6 months.
- 'Wages' means last drawn wages.
- 'Month' means a period of 26 days.
- Thus, gratuity shall be computed as follows:
- Last drawn wages x  $15/26$  x Completed years of service (including a part of year in excess of 6 months).

(ii) In case of piece rated employee:

- Gratuity shall be computed as follows:
- Last drawn wages x  $15/26$  x Completed years of service (including a part of year in excess of 6 months).
- Last drawn wages shall be computed by taking average of the total wages received by him for a period of 3 months immediately preceding the termination of his employment.

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While computing daily wages, the total wages of last 3 months is to be divided by number of days the employee actually worked, and not by the number of days or the number of working days in the said period of 3 months.

- For the purpose of computation of last drawn wages, wages paid for overtime work shall not be included in 'wages'.

(iii) In the case of an employee of a seasonal establishment:

- Such an employee shall be paid gratuity at the rate of 7 days' wages for each season.

**(b) Abhay Textiles Ltd. employed 20 full-time and 5 part-time employees who were drawing salary of less than ₹ 10,000 per month. After completing service of 28 days, in an accounting year, 10 full-time employees submitted their resignations and left the service of the company. The Board of directors of this company decided not to give the bonus to the employees, who resigned, to the remaining full-time employees and to the part-time employees. Against the decision, all the employees applied to the authorities for relief. Decide, stating the provisions of the Payment of Bonus Act, 1965, whether the employees, who resigned, remaining full-time employees and part-time employees will get relief.**

**Answer:**

The Act is applicable to the establishment since the establishment has employed 20 or more persons during any day of the AY; and *if* the provisions of the Act become applicable to an establishment once, they shall continue to be applicable notwithstanding subsequent reduction in the number of persons employed (Sec. 1).

20 full-time and 5 part-time employees are 'employees' within the definition of 'employee' [Sec. 2(13)].

The 10 full-time employees who resigned are not eligible for bonus since they have not worked for 30 days (Sec. 8).

The remaining 10 full-time employees and all the 5 part time employees are eligible for bonus, since they have worked for 30 days or more during the AY (Sec. 8) and even a part-time employee is entitled to bonus (Automobile Karmchari Sangh v Industrial Tribunal).

**Question 16:**

**(a) With whom does the responsibility of fixing minimum rates of wages lie?**

**Answer:**

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This is provided in Sec 3 of the Minimum Wages Act, 1948.

The responsibility of fixing minimum wages lies with appropriate government. The appropriate government shall in the manner hereinafter provided-

- (a) fix the minimum rates of wages payable to employees employed in an employment specified in Part I or Part II of the Schedule and in an employment added to either Part by notification under section 27:

Provided that the appropriate government may in respect of employees employed in an employment specified in Part II of the Schedule instead of fixing minimum rates of wages under this clause for the whole State fix such rates for a part of the State or for any specified class or classes of such employment in the whole State or part thereof;

- (b) review at such intervals as it may think fit such intervals not exceeding five years the minimum rates of wages so fixed and revise the minimum rates if necessary:

Provided that where for any reason the appropriate government has not reviewed the minimum rates of wages fixed by it in respect of any scheduled employment within any interval of five years nothing contained in this clause shall be deemed to prevent it from reviewing the minimum rates after the expiry of the said period of five years and revising them if necessary and until they are so revised the minimum rates in force immediately before the expiry of the said period of five years shall continue in force.

- (b) What do you understand by the term 'Industrial establishment' under the Payment of Wages Act, 1936?**

**Answer:**

According to Section 2(ii) of the Payment of Wages Act, 1923, "industrial or other establishment" means any –

- (a) tramway service or motor transport service engaged in carrying passengers or goods or both by road for hire or reward;
- (aa) air transport service other than such service belonging to or exclusively employed in the military naval or air forces of the Union or the Civil Aviation Department of the Government of India;
- (b) dock wharf or jetty;

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- (c) Inland vessel mechanically propelled;
- (d) mine quarry or oil-field;
- (e) plantation;
- (f) workshop or other establishment in which articles are produced adapted or manufactured with a view to their use transport or sale;
- (g) establishment in which any work relating to the construction development or maintenance of buildings roads bridges or canals or relating to operations connected with navigation irrigation or to the supply of water or relating to the generation transmission and distribution of electricity or any other form of power is being carried on;
- (h) any other establishment or class of establishments which the Central Government or a State Government may having regard to the nature thereof the need for protection of persons employed therein and other relevant circumstances specify by notification in the Official Gazette.

### SECTION - C

#### Study Note 13 – Types, Promotion, Formation of Company

##### Question 17:

**(a) What is Shelf Prospectus? Explain it with relevant provisions.**

**Answer:**

##### **Shelf Prospectus [Section 31]**

- (1) Any class or classes of companies, as the Securities and Exchange Board may provide by regulations in this behalf, may file a shelf prospectus with the Registrar at the stage of the first offer of securities included therein which shall indicate a period not exceeding one year as the period of validity of such prospectus which shall commence from the date of opening of the first offer of securities under that prospectus, and in respect of a second or subsequent offer of such securities issued during the period of validity of that prospectus, no further prospectus is required.
- (2) A company filing a shelf prospectus shall be required to file an information memorandum containing all material facts relating to new charges created, changes in the financial

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position of the company as have occurred between the first offer of securities or the previous offer of securities and the succeeding offer of securities and such other changes as may be prescribed, with the Registrar within the prescribed time, prior to the issue of a second or subsequent offer of securities under the shelf prospectus.

Provided that where a company or any other person has received applications for the allotment of securities along with advance payments of subscription before the making of any such change, the company or other person shall intimate the changes to such applicants and if they express a desire to withdraw their application, the company or other person shall refund all the monies received as subscription within fifteen days thereof.

- (3) Where an information memorandum is filed, every time an offer of securities is made under sub - section (2), such memorandum together with the shelf prospectus shall be deemed to be a prospectus.

Explanation: — For the purposes of this section, the expression "shelf prospectus" means a prospectus in respect of which the securities or class of securities included therein are issued for subscription in one or more issues over a certain period without the issue of a further prospectus.

- (b) Can company registered under the Companies Act, 2013 commence business of banking in India? Comment.**

**Answer:**

No, "company registered" under the Companies Act, 2013 or any act prior to it cannot commence business of banking in India. As per the RBI Act, it is mandatory for a bank to get itself registered with the RBI. This registration authorizes it to conduct its business as a bank. For the registration with the RBI, a company incorporated under the Companies Act, 2013 or any act prior to it and desirous of commencing business of banking, should have an initial minimum paid-up capital of ₹ 200 crore which is to be raised to ₹ 300 crore within three years of commencement of business. The promoters' contribution shall be a minimum of 40% of the paid-up capital of the bank at any point of time. This promoters' contribution of 40% of the initial capital shall be locked in for a period of five years from the date of licensing of the bank.

**Question 18:**

- (a) Ayush Company limited at a general meeting of members of the company passes an ordinary resolution to buy-back 30% of its equity share capital. The articles of the company empower the company for buy-back of shares. The company further decides that the payment for buy-back be made out of the proceeds of the company's earlier issue of**

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equity shares. With reference to the provisions of Companies Act, 2013 comment on the following:

- (i) Whether the company's proposal is in order?
- (ii) Would there be any difference if the company decides to buy-back 20% of equity share capital, in place of 30%?

**Answer:**

As per section 68, where the buy-back is authorized by passing a Special Resolution, the following limits would be applicable:

1. The buy-back shall not exceed 25% of aggregate of paid-up capital and free reserves
2. The buy-back of equity shares in any FY shall not exceed 25% of its total paid-up equity capital in that FY.

Again, where the buy-back is authorized by passing a resolution in a Board Meeting only, the buy back shall not exceed 10% of the aggregate of paid-up equity capital and free reserves.

In the given case,

- (i) The proposal of the company to buy-back its shares is not valid, since the company has passed an Ordinary Resolution in place of a Special Resolution. It also proposed to buy-back 30% of the equity share capital which exceeds the statutory ceiling of 25% of total paid up equity capital. Again the company proposes to buy-back out of the proceeds of an earlier issue of same kind of shares, which is prohibited.
- (ii) The decision to buy back 20% of equity share capital shall also not be valid, since buy-back passing an Ordinary Resolution is violative of Sec 68 and the company proposes to buy-back out of the proceeds of an earlier issue of same kind of shares, which is prohibited.

**(b) What is the 'doctrine of constructive notice'? Explain with case law.**

**Answer:**

A company being an artificial person acts through the instrumentality of its agents/authorized representatives. The sphere or gamut of permissible activities of a company is specified by its Memorandum of Association. The memorandum and articles of association of a company, when registered, become public documents and can be inspected by anyone on payment of nominal fee to the Registrar of Companies. Therefore, every person who intends to entering into a contract with a company has the means of ascertaining and is consequently presumed to know, not only the exact powers of the company but also the extent to which these powers could be delegated to the directors, and of any limitations placed upon the exercise of these

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powers. In other words, every person dealing with the company is deemed to have a "constructive notice" of the contents of its memorandum and articles. In fact, he is regarded not only as having read those documents but also as having understood them according to their proper meaning [Griffith v. Paget, (1877) Ch. D.517]. For example, if the articles provide that a bill of exchange to be effective must be signed by two directors, a person dealing with the company must see that it so signed; otherwise he cannot claim under it. Consequently, if a person enters into a contract which is beyond the powers of the company, as defined in the memorandum or outside the limits set on the authority of the directors, he cannot as a general rule acquire any right under the contract against the company [Mohony v. East Holyfrod Mining Co. (1875) L.R.7HL. 869]. The concept of constructive notice was established in Kotla Venkataswami v. Ram Murli AIR (1932) All 141.

### Question 19:

**(a) Ruby Company Limited is in the process of issuance of prospectus. Kindly enlist the items that are to be disclosed in their prospectus.**

### Answer:

The items that are to be stated in prospectus are as follows:

1. Details of the company, officers, bankers, trustees, underwriters and such other persons as may be prescribed;
2. Date of opening and closing of the issue;
3. Declaration about the issue of allotment letters and returns within the prescribed time;
4. Details of bank account and details of all money is utilized and unutilized monies out of the previous issue;
5. Details about underwriting of the issue;
6. Consent of the directors, auditors, bankers to the issue, expert's opinion etc.,
7. Authority for the issue and the details of the resolution passed;
8. Procedure and time schedule for allotment and issue of securities;
9. Capital structure of the company;
10. Main objects of the public offer, terms of the present issue and such other particulars as may be prescribed;

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11. Main objects and present business of the company, the location of company, schedule of implementation of the project;
12. Details of litigation or legal action pending or taken by Ministry or Department of the Government or a statutory authority against ht promoter during last five years immediately preceding the year of the issue of prospectus;
13. Details of default and non-payment of statutory dues etc.,
14. Details of directors including their appointment and remuneration; their details such name, designation, DIN, the nature of interest;
15. Source of promoters' contribution shall be disclosed;

### **(b) What may be the sources of funds for buy-back of shares?**

**Answer:**

#### **Sources of funds for buy-back of shares:**

Under section 68 (1) of the Companies Act, 2013 a company can purchase its own shares or other specified securities. The purchase should be out of:

- (i) its free reserves: or
- (ii) the securities premium account: or
- (iii) the proceeds of the issue of any shares or other specified securities.

However, buy-back of any kind of shares or other specified securities cannot be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

'Specified securities' includes employees' stock option or other securities as may be notified by the Central Government from time to time. [Explanation (1) under Section, 68].

#### **Question 20:**

### **(a) Can a non-profit organisation be registered as a company under the Companies Act, 2013? If so, what procedure does it have to adopt?**

**Answer:**

#### **Registration of a non-profit organisation as a company:**



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According to section 8 (1) of the Companies Act, 2013, the Central Government may allow a person or an association of persons to be registered as a Company under the Companies Act if it has been set up for promoting commerce, arts, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other useful object and intends to apply its profits or other income in promotion of its objects. However, such company has to prohibit payment of any dividend to its members.

**Procedure:** An association of persons intending to carry any or all or some of the activities mentioned in section 8(1) as mentioned above, has to apply to the Central Government seeking its permission for being set up as a company under the Act. The Central Government if satisfied on the above may by the issue of a licence in such manner as may be prescribed and on such conditions as it may deem fit, allow such association to be registered as a limited company under section 8(1) without the addition of word "Limited" or words "Private Limited" as the case may be, to its name.

After the issue of the licence by the Central Government, an application must be made to the Registrar in the prescribe form after which the Registrar will register the association of persons as a company under section 8(1). Under section 8(2) a company registered under section 8(1) as above, shall enjoy all the privileges and be subject to all the obligations of a limited company.

This licence issued by the Central Government is revocable, and on revocation the Registrar shall put the words 'Limited' or 'Private Limited' against the company's name in the Register. But before such revocation, the Central Government must give the company a written notice of its intention to revoke the licence and provide an opportunity to it to be represented and heard in the matter.

### **(b) Restrictions in alteration of Memorandum. Comment.**

#### **Answer:**

Section 13(8) provides that a company, which has raised money from public through prospectus and still has any unutilized amount out of the money so raised, shall not change its objects for which it raised the money through prospectus unless a special resolution is passed by the company. The special resolution shall be published in the newspapers, one in English and one in vernacular language, which is in circulation at the place where the registered office of the company is situated and shall also be placed on the web site of the company, if any, indicating the justification for such change. The dissenting shareholders shall be given an opportunity to exit by the promoters and shareholders having control in accordance with the regulations to be specified by SEBI.

Rule 29 provides that the change of name shall not be allowed to a company which has defaulted in filing its annual returns or financial statements or any document due for filing with

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the Registrar or which has defaulted in repayment of matured deposits or debentures or interest on deposit or debentures.

An application shall be filed in Form No. INC-24 along with the fee for change in the name of the company and a new certificate of incorporation in Form No. INC-25 shall be issued to the company consequent upon the change.

### Question 21:

#### (a) What are the procedures that have to be followed for signing of Memorandum and Articles?

#### Answer:

Rule 13 provides for signing of memorandum and articles. The Memorandum and articles shall be signed in the following manner:

- The memorandum and articles of association of the company shall be signed by each subscriber to the memorandum. The name, address, description and occupation, if any, are to be added. One witness shall attest the signature of the subscriber. The witness also is to sign and furnish his full details.
- The witness shall state that –“I witness to subscriber/subscriber(s) who has/have subscribed and signed in my presence (date and place to be given); further I have verified his or their Identity details for their identification and satisfied myself of his/her/their identification particulars filled in”.
- Where a subscriber to the memorandum is illiterate, he shall affix his thumb impression or mark which shall be described as such by the person, writing for him, who shall place the name of the subscriber against or below the mark and authenticate by his own signature and he shall also write against the name of the subscriber, the number of shares taken by him;
- Such person shall also read and explain the contents of the memorandum and articles of association to the subscriber and make an endorsement to that effect on the memorandum and articles of the association;
- Where the subscriber is a body corporate, the memorandum and articles of association shall be signed by director, officer or employee of the body corporate duly authorized in this behalf by a resolution of the board of directors of the body corporate.

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- Where the subscriber is an LLP, it shall be signed by a partner of the LLP, duly authorized by a resolution approved by all the partners of the LLP. In either case, the person so authorized shall not, at the same time, be a subscriber to the memorandum and articles of association;
- Where the subscriber is a foreign national residing outside India-
  - in a country in any part of the Commonwealth, his signatures and address on the memorandum and articles of association and proof of identity shall be notarized by a Notary Public in that part of the Commonwealth;
  - in a country which is a party to the Hague Apostille Convention, 1961, his signatures and address on the memorandum and articles of association and proof of identity shall be notarized before the Notary Public of the Country and be duly apostilled in accordance with the Hague Convention;
  - in a country outside the commonwealth and not a party to the Hague Apostille Convention, 1961, his signatures and address shall be notarized before the Notary Public of that country and the certificate of the Notary Public shall be authenticated by a Diplomatic or Consular Officer empowered in this behalf.
  - visited in India and intended to incorporate a company, in such cases the incorporation shall be allowed if, he/she is having a valid Business Visa.

**(b) Define the term 'Small Company' as contained in the Companies Act, 2013.**

**Answer:**

**SMALL COMPANY:**

Under Section 2(85) of the Companies Act, 2013, "small company means a company, other than a public company:-

- (i) having PAID-UP SHARE CAPITAL not exceeding fifty lakh rupees or such higher amount as may be prescribed which shall not be more than five crore rupees; or
- (ii) having TURNOVER as per its last profit and loss account not exceeding two crore rupees or such higher amount as may be prescribed which shall not be more than twenty crore rupees.

EXCEPTIONS: This section shall not apply to:

- (A) a holding company or a subsidiary company;
- (B) a company registered under section 8, or
- (C) a company or body corporate governed by any special Act.

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## Study Note 13 – Directors

### Question 22:

- (a) Discuss the code of professional conduct that needs to be followed by Independent Directors with respect to the following:
- (i) Guidelines of Professional Conduct
  - (ii) Role and Functions
  - (iii) Duties

### Answer:

Adherence to Code by Independent Directors and fulfilment of their responsibilities in a professional and faith" manner will promote confidence of the investment community, particularly Minority Shareholders, Regulators and Company in the institution of Independent Directors.

The Company and Independent Directors shall abide by the provisions specified in Schedule IV, which are as under:

- (i) **Guidelines of Professional Conduct:** An Independent Director shall -
1. uphold **ethical standards** of integrity and probity,
  2. act **objectively** and constructively while exercising his duties,
  3. exercise his responsibilities in a **bonafide** manner in the interest of the Company,
  4. devote sufficient **time and attention** to his professional obligations for informed and balanced decision-making,
  5. **not allow any extraneous considerations** that will vitiate his exercise of objective independent judgment in thfj paramount interest of the Company as a whole, while concurring in or dissenting from the collective judgment of the Board in its decision-making,
  6. **not abuse his position** to the detriment of the Company or its Shareholders or for the purpose of gaining direct or indirect personal advantage or advantage for any associated person,
  7. **refrain** from any action that would lead to loss of his independence,
  8. where circumstances arise which make an Independent Director **lose his independence**,

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the Independent Director must immediately **inform** the Board accordingly,

9. assist the Company in implementing the best **Corporate Governance** Practices.

**(ii) Role and Functions:** The Independent Directors shall -

1. help in bringing an **independent judgment** to bear on the Board's deliberations especially on issues of strategy, performance, risk management, resources, key appointments and standards of conduct,
2. bring an **objective view** in the evaluation of the performance of Board and Management,
3. **scrutinise** the performance of Management in meeting agreed goals and objectives and monitor the reporting of performance,
4. satisfy themselves on the integrity of **financial information** and that financial controls and the systems of risk management are robust and defensible,
5. safeguard the **interests** of all Stakeholders, particularly the Minority Shareholders,
6. **balance** the conflicting interest of the Stakeholders,
7. determine appropriate levels of **remuneration** of Executive Directors, KMP and Senior Management and have a prime role in appointing and where necessary recommend removal of Executive Directors, KMP and Senior Management,
8. moderate and **arbitrate** in the interest of the Company as a whole, in situations of **conflict** between Management and Shareholder's interest.

**(iii) Duties:** The Independent Directors shall -

1. undertake appropriate induction and regularly **update** and refresh their skills, knowledge and familiarity with the Company,
2. seek appropriate **clarification** or amplification of information and, where necessary, take and follow appropriate professional advice and opinion of outside experts at the expense of the Company,
3. strive to attend **all Meetings** of the Board of Directors and of the Board Committees of which he is a Member,
4. participate **constructively and actively** in the Committees of the Board in which they are

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Chairpersons or Members,

5. strive to attend the **General Meetings** of the Company,
6. where they have **concerns** about the running of the Company or a proposed action, ensure that these are addressed by the Board and, to the extent that they are not resolved, insist that their concerns are recorded in the Minutes of the Board Meeting,
7. keep themselves well **informed** about the Company and the external environment in which it operates,
8. **not to unfairly obstruct** the functioning of an otherwise proper Board or Committee of the Board,
9. pay sufficient attention and ensure that adequate deliberations are held before approving **Related Party Transactions** and assure themselves that the same are in the interest of the Company,
10. ascertain and ensure that the Company has an adequate and functional **Vigil Mechanism** and to ensure that the interests of a person who uses such mechanism are not prejudicially affected on account of such use,
11. report concerns about **unethical behaviour**, actual or suspected fraud or violation of the Company's code of conduct or ethics policy,
12. acting within his authority, assist in **protecting** the legitimate interests of the Company, Shareholders and its employees,
13. **not disclose confidential information**, including Commercial Secrets, Technologies, Advertising and Sales Promotion Plans, Unpublished Price Sensitive Information, unless such disclosure is expressly approved by the Board or required by law.

**(b) Directors are agents of the company. Comment.**

**Answer:**

The Company can act only through Directors, and so the relationship between the Company and the Director is that of Principal and Agent. Contract entered into by a person as a Director of a Company, will be binding on the Company. However, Directors are not Agents of Members of the Company.

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Directors have personal liability. They would be personally liable under the following circumstances:

- Director acts in his own name,
- Director enters into an agreement / contract which does not state clearly as to whether the Director signing in his personal capacity or in his representative capacity as an Agent of the Company.

Rights of the Company:

- Contract executed by the Director in excess of his authority, is binding on the Company. However, the Company may claim damages from the Director for breach of implied warranty of authority.
- When Directors act properly on behalf of the Company, they do not incur personal liability, they do not exceed their powers

### Question 23:

**(a) X Ltd. entered into a contract with M and Co. Ltd. for purchase of raw materials of ₹ 2,50,000 at the prevailing market rate. The director of X Ltd., Mr. B, was holding shares of the value of 1% of the paid up capital of M and Co. Ltd. Another Director of X Ltd. Mr. C was holding shares of the value of 1.5% of the paid up capital of M and Co. Ltd. Mr. B at the beginning of the year, gave a general notice to X Ltd. that he was interested in M and Co. Ltd,**

**Mr. B claims that he had given notice to X Ltd. as required under the Companies Act, 2013 and that his holding being only 1% is within the limit under the Companies Act, 2013.**

### Answer:

As per section 184(2), every director who is any way, directly or indirectly, interested in a contract or arrangement shall disclose the nature of his interest. However, section 184(2) shall not apply to a contract or arrangement entered into between two companies, where any of the directors of the one company or two or more of them together holds or hold not more than 2% of the paid up share capital of the other company.

If the aggregate shareholding of two or more directors in the other company exceeds 2% of the paid up share capital of the other company, all such directors shall make a disclosure as required under section 184(2), irrespective of the fact that individual shareholding of each of the directors is not more than 2% of the paid up share capital of the other company.

Section 184(1) requires every director to disclose the nature of his concern or interest (along with the shareholding, if applicable) in any company, body corporate, association of individuals or

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firm. Such disclosure is to be made by the director in the first Board meeting in which he participates as a director, the first Board in every financial year and the first Board meeting held after any change in the interest or concern takes place.

In the present case, the aggregate shareholding of Mr. B and Mr. C is more than 2% of the paid up share capital of M and Co., and so section 184(2) has become applicable. Accordingly, Mr. B and Mr. C, both, are required to disclose the nature of their interest (viz. their shareholding in M and Co. Ltd.) in the Board meeting of X Ltd. in which the contract or arrangement between X Ltd. and M and Co. Ltd. is first discussed.

The requirements specified under section 184(2) is independent of the requirement of section 184(1). In other words, even where a director has disclosed his concern or interest as per section 184(1), he is still required to disclose his concern or interest in each and every contract or arrangement covered under section 184(2), although such contract or arrangement is with a company or body corporate in respect of which disclosure of interest was already given by him in terms of section 184(1).

The general notice given by Mr. B in terms of section 184(1) is not a sufficient compliance of the requirements of section 184(2), and so Mr. B has contravened the provisions of section 184(2). Also, Mr. C has not disclosed his concern or interest in the Board meeting in which the contract or arrangement is first discussed, and so, Mr. C has also contravened the provisions of section 184(2).

Consequences of contravention of section 184(2) shall be as follows:

- Mr. B and Mr. C shall vacate the office of director held by them (Section 167).
- As per Section 184(4), Mr. B and Mr. C shall be punishable with -
  - (a) imprisonment upto 1 year; or
  - (b) fine which shall not be less than ₹50,000 but which may extend to ₹ 1 lakh; or
  - (c) both.
- The contract or arrangement entered into by X Limited shall be voidable at the option of X Limited [Section 184(3)].

### **(b) Provisions for entering into contracts that by One person Company. Comment.**

**Answer:**

The provisions of section 193 of the Companies Act, 2013 are explained as follows:

#### **1. Applicability of section 193**

Section 193 applies where -



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- (a) the company is a One Person Company;
- (b) it enters into a contract with its sole member; and
- (c) the sole member is also the director of the company.

## 2. Legal requirements

- (a) The contract entered into between the company and the sole member shall be in writing.
- (b) If the contract is not in writing, the company shall ensure that the terms of the contract are contained in a memorandum or are recorded in the minutes of the first Board meeting held next after entering into such contract.

## 3. Non-applicability of section 193

Section 193 shall not apply where a contract is entered into by the company in the ordinary course of its business.

## 4. Duty of the company to inform the Registrar

- (a) Where a contract is entered into by One Person Company and recorded in the minutes of the Board meeting in accordance with the provisions of this section, the company shall inform the Registrar about such contract.
- (b) Such information shall be given to the registrar within 15 days of the date of approval by the Board of Directors.

Section 193 shall apply to One Person Company, irrespective of the fact as to whether it is limited by shares or by guarantee.

### Question 24:

- (a) A company sold one of its flats to one of the directors and received 50% of the price in cash and agreed to receive the balance in installments. Would u consider this as a loan granted to director?**

### Answer:

As per section 185 of the Companies Act, 2013, no company shall, directly or indirectly, give any loan to a director.

In the given case, the debt arose not out of an advance but out of a transaction of sale of a flat by the company to its director.

The company gave time to the director to pay a part of the purchase price.

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The essential requirement of a 'loan' is the advance of money upon the understanding that it shall be returned back and it may or may not carry interest. Where a company sells a flat to one of its directors and receives half the price in cash and agrees to receive the balance in installments, the transaction amounts to a credit sale; it does not amount to even an 'indirect loan'.

The word 'indirectly' used in section 185 of the Companies Act, 2013 only means that company shall not give a loan to a director through the agency of one or more intermediaries. The word 'indirectly' cannot be read as converting 'what is not a loan' into 'a loan'.

Therefore, in the given case, there is no contravention of Section 185 of the Companies Act, 2013.

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

**Answer:**

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

- (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 Board shall be entitled to make the political contribution of Rs. 5 lakh only if -

- (a) the company has been in existence for 3 financial years;
- (b) the average net profits of the company during immediately preceding 3 financial years is equal to or more than ₹ 66,66,667 (i.e.  $5,00,000 \times 100/7.5$ ); and
- (c) the resolution approving the political contribution is passed at a Board meeting;

The Board shall ensure that adequate disclosures are made in the profit and loss account.

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## Question 25:

- (a) Z was appointed as director of the company in an annual general meeting. He took over the office and carried on his functions as director. Subsequently, it was found that there were some irregularities in voting and hence the appointment was declared invalid. Would the act done by Z, while in office as director, be binding upon the company?

## Answer:

The provisions relating to validity of acts of directors are contained in section 176. The provisions of section 176 are discussed below in detail:

Section 176 seeks to give protection to the company and third parties where certain acts are done by a director in good faith and without notice that these are done wrongly or illegally. Thus, section 176 validates the *bona fide* acts of *de facto* directors. These provisions may be explained as follows:

### 1. Acts of a director - Validated

No act done by a person as a director shall be deemed to be invalid, notwithstanding that it was subsequently noticed that –

- (a) his appointment was invalid by reason of any defect or disqualification; or
- (b) his appointment was terminated by virtue of any provision contained in the Act or in the articles.

### 2. Acts of managing director - Not validated

Acts done by a director in his capacity as managing director are not validated under section 176. Accordingly, where a managing director ceased to hold his office, all his subsequent acts were held to be invalid. It was not an irregular exercise of power, but exercise of power by a person who had no authority at all [*Varkey Souriar v Keraleeya Banking Co. Ltd.* AIR 1957 Ker97].

### 3. Acts of a director - Not validated in certain cases

In the following cases, the acts of a director shall not be valid:

- (a) where his appointment is illegal or there is no appointment at all;
- (b) where his appointment has been shown to the company as invalid or terminated, *i.e.* where such defect comes into the knowledge of the company, all subsequent acts done by such a director shall be invalid;
- (c) where the acts of a director are *ultra vires* the Companies Act, 2013.

### 4. Acts of a chairman - Not validated

The provision of validity of acts is not applicable to chairman. Therefore, the resolutions passed by casting vote of chairman are not valid, if his appointment is invalid.

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### 5. Action by third parties - When permissible?

Persons who deal with the directors after having notice of the defect or disqualification of the directors are not protected by section 176. A person cannot take advantage of the protection given by the section if he is aware of some defect or disqualification.

Where an appointment of a managing director, whole-time director or manager is not approved by the company at a general meeting, no prior act done by him shall be deemed to be invalid [Section 196(5)].

### (b) Board meetings were held on 24th November, 2014 and 15th December, 2014. Mr. Rameshwar, who was the chairman of these two Board meetings died on 20th December, 2014, without signing the minutes. How should the minutes be signed and by whom?

#### Answer:

As per section 118, the minutes of a Board meeting may be signed by the chairman of the said meeting or the chairman of the next succeeding meeting. The minutes shall be prepared and signed within 30 days of the conclusion of the Board meeting.

In the present case, the minutes of the meeting held on 24.11.2014 could be signed either by the chairman of the meeting held on 24.11.2014 or by the chairman of the next meeting held on 15.12.2014. Incidentally, the chairman of these two meetings is the same, i.e. Mr. Rameshwar, who has died. The result is that the minutes of the two previous Board meetings, held on 24.11.2014 and 15.12.2014, have remained unsigned.

There is no legal provision covering the above situation. Therefore, it is advisable to convene a Board meeting and appoint a chairman who shall be authorised to sign the minutes of both the meetings held on 24.11.2014 and 15.12.2014.

### (c) A Board meeting of PQR Limited was called to be held on 19.01.2015 at 3 pm at Shah Auditorium, Delhi. However, due to lack of quorum, the meeting could not be held. Discuss the consequences.

#### Answer:

As per section 174(4), 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;

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- (b) at the same time;
- (c) at the same place.

In the instant case, the Board meeting could not be held for want of quorum, and so the provisions of section 174(4) shall become applicable. In the next week, same day happens to be a national holiday (viz. 26.01.2015), and so, the adjourned Board meeting cannot be held on 26.01.2015. The next succeeding day which is not a public holiday is 27.01.2015. Therefore, the adjourned Board meeting shall be held on 27.01.2015 at 3 pm at Shah Auditorium.

For absence of information in the question, it has been assumed that the articles of the company do not contain any provision with respect to the consequences where a Board meeting is not held for want of quorum.

### Question 26:

**(a) Referring to the provisions of the Companies Act, 2013, examine the validity of the following: On the request of bank providing financial assistance the Board of directors of PQR Limited decides to appoint on its Board Mr. Peter, as nominee director. Articles of Association of the company do not confer upon the Board of Directors any such power. Further, there is no agreement between the company and the bank for any such nomination.**

### Answer:

As per section 161(3) of the Companies Act, 2013, the Board may appoint any person as a director nominated by any institution in pursuance of the provisions of any law for the time being in force or of any agreement. The provisions of section 161(3) are subject to any provision contained in the articles of the Company.

In the given case, no agreement has been entered into between PQR Limited and the bank providing the financial assistance with respect to appointment of nominee director. Also, no provision contained in any law for the time being in force authorises the appointment of nominee director. Further, the articles of the company do not confer any power on the Board to appoint the nominee directors. Thus, the appointment of Mr. Peter as nominee director is not valid.

**(b) Mr. Sachin was appointed as an additional Director of Conservative Finance Ltd. w.e.f. 1st October, 2014 in a casual vacancy by way of a circular resolution passed by the Board of Directors. The next annual general meeting of the company was due on 31st March, 2015, but the same was not held due to delay in the finalisation of the accounts. Some of the shareholders of the company have questioned the validity of the appointment of Mr. Sachin and his continuation as additional director beyond 31st March, 2015. Advise the company on the complaints made by the shareholders.**

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## Answer:

The given problem relates to sections 161(1) and 161(4) of the Companies Act, 2013.

### The Legal Position

Additional Directors [Section 161(1) of the Companies Act, 2013]:

- The Board may appoint the additional directors in pursuance of the provisions of section 161(1).
- The Board may, in its discretion, appoint the additional directors whenever it deems fit.
- The appointment of additional directors may be made by the Board either by passing a resolution at a Board meeting or by passing a resolution by circulation.
- An additional director holds office upto the date of next annual general meeting. However, if AGM is not held upto the last date for holding ASM as per the provisions of section 96, the additional director shall vacate his office on the last day on which the AGM should have been held.

### Director filling a casual vacancy [Section 161(4) of the Companies Act, 2013]

- The Board is authorised to fill a casual vacancy arising in the office of a director appointed in general meeting.
- The director filling a casual vacancy shall hold office only up to the date up to which the director in whose place he is appointed would have held office if it had not been vacated.
- A casual vacancy cannot be filled by passing a resolution by circulation under section 175.

### The given case

- The Board has appointed Mr. Sachin as an additional director in a casual vacancy.
- The appointment of Mr. Sachin has been made by passing a circular resolution.
- The last date for holding the annual general meeting was 31st March, 2015. The annual general meeting has not been held till 31st March, 2015.
- So it is to be decided, whether appointment of Mr. Sachin is valid or not?; and if he can continue after 31st March, 2015?

### Analysis of the case

1. Neither section 161(1) nor section 161(4) authorises the Board to appoint an additional director to fill the casual vacancy.
  - If appointment of Mr. Sachin is made as an additional director, then, the provisions of section 161(1) apply, and so such appointment cannot amount to filling a casual vacancy.
  - If Mr. Sachin is appointed to fill a casual vacancy, then, the provisions of section 161(4) apply to him, and so Mr. Sachin shall not be an additional director.

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- Thus, a combined reading of sections 161(1) and 161(4) makes it clear that the appointment of Mr. Sachin as an additional director to fill the casual vacancy is not possible at all.
2. Mr. Sachin has been appointed to fill the casual vacancy by passing a circular resolution. Since, the appointment of a director filling a casual vacancy requires passing of a resolution in a board meeting only, therefore, the appointment of Mr. Sachin is in contravention of section 161(4), and is therefore, invalid.

### Conclusion

- The complaint made by the shareholders is valid.
- The appointment of Mr. Sachin is not valid since it is in contravention of sections 161(1) and 161(4). Mr. Sachin cannot continue as a director after the date of annual general meeting, since his very appointment is void ab initio.

## SECTION - D

### Study Note 14 – Ethics

#### Question 27:

#### (c) What is 'Business Ethics'?

#### Answer:

According to Andrew Crane "Business ethics is the study of business situations, activities and decisions where issues of right and wrong are addressed.

Raymond C. Baumhart contend – "The ethics of business is the ethics of responsibility. The businessman must promise that he will not harm knowingly".

Business ethics concerns itself with adhering to the social principles of the situations in which business takes place. The analysis of this definition leads us to the following discussion.

Thus, Business Ethics (also called Corporate Ethics) is a form of applied ethics or professional ethics that examines ethical principles and moral or ethical problems that arise in a business environment. It applies to all aspects of business conduct, and is relevant to the conduct of individuals and the entire organizations. It deals with morality in business environment. It involves moral judgment based on understanding of the society. It extends beyond the legal questions

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and involves moral judgment based on understanding of the society. It extends beyond the legal questions and involves goodness and badness of an act.

- (1) Business ethics refers to the application of everyday moral or ethical norms to business. It requires an awareness of how the products and services of an organizations and the action of its employees, can affect its stakeholders and society as a whole, either positively or negatively.
- (2) Ethics in business organization relates to a corporate culture of values, leadership program and enforcement.

It is that set of principles or reasons which governs the conduct of business at the individual or collective level by the application of ethical reasoning to specific business situations and activities.

**(d) What are circumstances leading to actual happening of threats for an Accounting professionals working as Consultants or Auditors?**

**Answer:**

Sl. No.	Types of threats	Accounting professional working as Consultants or Auditors
1.	Self interest threat	(i) A financial interest in a client. (ii) Undue dependence on fees from a client. (iii) Close business relationship with a client. (iv) Fear of losing a client. (v) Potential employment with a client. (vi) Contingent fees relating to an assurance engagement.
2.	Self review threat	(i) Discovery of a significant error of the work of the professional. (ii) Reporting on the operation of the designed financial systems. (iii) Being a Director or Officer of the client. (iv) Being employed by the client in a position to exert influence over the subject-matter of the engagement.
3.	Advocacy threat	(i) Promoting shares in a Listed Entity of a client. (ii) Acting as an advocate on behalf of client in litigation or disputes with third parties
4.	Familiarity threat	(i) Close relationship with a Director or Officer of the client (ii) Accepting gifts or preferential treatment from a client
5.	Intimidation threat	(i) Being threatened with litigation. (ii) Fear of losing work from client. (iii) Being threatened with replacement.



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**Question 28:**

**(a) 'Fairness and honesty are the pillars of success in business'. Comment.**

**Answer:**

The success of the business depends very much on fairness and honesty in the business. Fairness and honesty are at the heart of the business ethics and relate to the general values of decision makers. At a minimum, business professionals and persons are expected to follow all applicable laws and regulation. Even then, they are expected not to harm customers, employees, clients or competitors knowingly through deception, misrepresentation, coercion or discrimination. One aspect of fairness and honesty is related to disclosure of potential harm caused by product use. Another aspect of fairness relates to competition. Although numerous laws have been passed to foster competition and make monopolistic practices illegal, companies sometimes gain control over markets by using questionable practices that harm competition.

Rivals of Microsoft, for example, accused the software giants of using unfair and monopolistic practices to maintain market dominance with its Internet explorer browser.

These aforesaid examples show that fairness and honesty pay in the long run; they secure the stability of the business and overall reputation in the business world. Therefore we may say that fairness and honesty are the pillars of success in the business.

**(b) What is meant by Conflicts Resolution Process? What steps should be taken to resolve the conflict issues?**

**Answer:**

A finance and accounting professional should determine the appropriate course of action and weigh the consequences of each possible course of action. If the matter remains unresolved, the professional should consult with other appropriate persons within the firm and if required, with persons responsible for governance of the organisation (e.g. Board of Directors).

The following steps are suggested to resolve the issues:

**(a) Documentation:** He should document the substance of the issue and details of any discussions held or decisions taken, concerning that issue.

**(b) Legal Advice:** If a significant conflict cannot be resolved, a professional may obtain advice from the relevant professional body or legal advisors without breach of confidentiality.

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- (c) **Withdrawal:** If, after exhausting all relevant possibilities, the ethical conflict remains unresolved, a professional should, where possible, refuse to remain associated with the matter creating the conflict, withdraw from the engagement team or specific assignment or resign from the employing organization.

### Question 29:

- (a) **State the evolution of ethics.**

#### Answer:

Social conduct has evolved along with the evolution of society. When our elders tell us 'Do not cheat', they are referring to a social code of conduct. Social conduct has developed in society over hundreds of years. The codes of conduct have been passed down from generation to generation, and there is a pattern to the evolution of such codes. Acceptable behaviour is promoted and elevated as a social value, and unacceptable behaviour is rejected and condemned. The laws of country are based on the customs or moral codes of its society. Penalties are prescribed for bad actions, actions that contradict the established laws. The laws are a measure against those people who cross the limits of the code of social conduct, and ensure that good citizens are protected from the negative consequences of the law-breakers. The object of the social codes of conduct is to maintain, promote and elevate harmonious relationships.

- (b) **Explain two broad categories of safeguards created by business enterprise to eliminate threats.**

#### Answer:

It is important to have safeguards created by the Finance and Accounting profession, to identify or deter unethical behavior. Such safeguards to eliminate or reduce threats may be classified in two broad categories:

- Safeguards created by the Finance and Accounting profession, Legislation or Regulation.
- Safeguards in the work environment.

(A) Safeguards created by the Finance and Accounting profession, Legislation or Regulation:

- Educational, training and experience requirements for entry into the profession.
- Continuing professional development requirements.
- Corporate Governance Regulations.
- Professional standards.
- Professional or regulatory monitoring and disciplinary procedures.
- External review of reports by a legally empowered third party.

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(B) Safeguards in the work environment:

- The employing organization's ethics and conduct programs.
- Employing competent staff.
- Strong internal controls.
- Appropriate disciplinary processes.
- Leadership or cultivating ethical behavior to encourage employees to act in ethical manner.
- Policies and procedures to implement and monitor the quality of employee performance.
- Timely communication of organisation's policies and procedures.
- Employee training and education on policies and procedures.
- Encourage employees to communicate ethical issues without fear of retribution, organisation's system of corporate overview.

## Short Notes

**Question 30:**

**Write short notes on:**

**(i) Points of a valid offer**

**Answer:**

The following points are to be taken into account for a valid offer -

- The offer must be in clear, definite, complete and final terms.
- It should not be vague in terms;
- The offer must be communicated to the offeree. The offer becomes effective only when it has been communicated to the offeree so as to give him an opportunity to accept or reject the offer;
- The communication may be in writing or oral;
- The communication may be in expressed terms or in implied terms;
- The offer may be general or specific – if an offer is made to a specific person it is called specific offer. Such offer can be accepted by such specific person; if an offer is made to the world at large, it is a general offer. It can be accepted by any member of the general public by fulfilling the condition laid down in the offer;
- Communication of offer is complete when it comes to the knowledge of the person to whom it is made.

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### (ii) Exceptions to 'Risk Prima Facie passes with the property'

#### Answer:

The rule regarding risk passes with the property enshrined in section 26 is subject to the following exceptions:

- (a) This rule of 26 will apply only if there is no agreement to the contrary. It is permissible for the parties to provide in the agreement that although the property does not pass, the risk passes and they may fix the point of time when it is to pass.
- (b) Where delivery has been delayed through the fault of either party the buyer or the seller, the goods are at the risk of the party at fault as regards any loss which might not have been occurred but for such loss. The goods are at the risk of the party who is at fault in delay of delivery.
- (c) If there is a custom in that particular trade that the risk does not pass with property, in such a case the risk will pass as per the custom.
- (d) Risk and property may be separated by agreement between the parties. Section 40 of the Act also provides that where the seller agrees to deliver the goods at his own risk at a distant place from where they are, the buyer shall unless otherwise agreed, not take any risk of deterioration in the goods incidental to the transit.

### (iii) Inchoate stamped instruments

#### Answer:

Where one person signs and delivers to another a paper stamped in accordance with the law relating to negotiable instruments for the time being in force in India and either wholly blank or having written thereon an incomplete negotiable instrument, he thereby gives prima facie authority to the holder thereof to make or complete, as the case may be, upon it a negotiable instrument, for any amount specified therein and not exceeding the amount covered by the stamp. The person so signing shall be liable upon such instrument, in the capacity in which he signed the same, to any holder in due course for such amount provided that no person other than a holder in due course shall recover from the person delivering the instrument anything in excess of the amount intended by him to be paid there under.

### (iv) Admission of new partner

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### Answer:

Admission of a partner is one of the modes of reconstitution of a partnership firm. A new partner may be admitted in a partnership firm either for the increase of capital of the firm or to strengthen the management of the firm. A new partner may be admitted with the consent of all existing partners as per the provisions of the agreement of the firm. The new partner is entitled the following rights-

- The right to share in the assets of the partnership firm; and
- The right to share the profits in the business.

The following are to be taken care of while admitting a new partner -

- Computation of new profit sharing ratio and sacrifice ratio;
- Accounting treatment of goodwill;
- Revaluation of assets and liabilities;
- Treatment of undisbursed profits and accumulated losses;
- Adjustment of capital accounts.

### (v) Penalty for contravention of the provisions relating to hazardous process

#### Answer:

Section 96A provides that whoever fails to comply with or contravenes any of the provisions of Section 41B, 41C or 41H or the rules made there under, shall, in respect of such failure or contravention, be punishable with imprisonment for a term which may extend to seven years and with fine which may extend to ₹2 lakhs and in case of the failure or contravention continues, with additional fine which may extend to ₹5000/- for every day during which such failure or contravention continues after the conviction for the first such failure or contravention. If the failure or contravention continues beyond a period of one year after the date of conviction, the offender shall be punishable with imprisonment for a term which may extend to ten years.

### (vi) Dispute as to the amount of gratuity payable

#### Answer:

Section 7(4) provides that if there is a dispute as to the amount of gratuity payable to the employee, the employer shall deposit the gratuity with the Controlling Authority. The controlling authority shall, after due inquiry and after giving the parties to the dispute a reasonable opportunity of being heard, determine the amount of gratuity payable to an employee. If as a result of such inquiry any amount in excess of the amount deposited by the employer is found to

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be payable, the controlling authority shall direct the employer to pay such amount as is in excess of the amount deposited by him.

Then the Controlling Authority shall pay the amount of the deposit-

- to the applicant where he is the employee; or
- where the applicant is not the employee, to the nominee or heir of the employee if the controlling authority is satisfied that there is no dispute as to the right of the applicant to receive the amount of gratuity.

### **(vii) Features of National Pension System**

#### **Answer:**

The National Pension System shall, on the commencement of this Act, have the following basic features, namely:—

- (a) every subscriber shall have an individual pension account under the National Pension System;
- (b) withdrawals, not exceeding twenty-five per cent of the contribution made by the subscriber, may be permitted from the individual pension account subject to the conditions, such as purpose, frequency and limits, as may be specified by the regulations;
- (c) the functions of recordkeeping, accounting and switching of options by the subscriber shall be effected by the central recordkeeping agency;
- (d) there shall be a choice of multiple pension funds and multiple schemes:  
Provided that—
  - (a) the subscriber shall have an option of investing up to hundred per cent of his funds in Government Securities; and
  - (b) the subscriber, seeking minimum assured returns, shall have an option to invest his funds in such schemes providing minimum assured returns as may be notified by the Authority;
- (e) there shall be portability of individual pension accounts in case of change of employment;
- (f) collection and transmission of contributions and instructions shall be through points of presence to the central recordkeeping agency;
- (g) there shall not be any implicit or explicit assurance of benefits except market-based guarantee mechanism to be purchased by the subscriber;

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- (h) a subscriber shall not exit from the National Pension System except as may be specified by the regulations; and
- (i) at exit, the subscriber shall purchase an annuity from a life insurance company in accordance with the regulations.

### **(viii) Payment of commission to any person in connection with the subscription to its securities**

#### **Answer:**

Rule 13 provides that a company may pay commission to any person in connection with the subscription or procurement of subscription to its securities, whether absolute or conditional, subject to the following conditions:

- the payment of such commission shall be authorized in the company's articles of association;
- the commission may be paid out of proceeds of the issue or the profit of the company or both;
- the rate of commission paid or agreed to be paid shall not exceed, in case of shares, 5% of the price at which the shares are issued or a rate authorized by the articles, whichever is less, and in the case of debentures, shall not exceed 2.5% of the price at which the debentures are issued, or as specified in company's articles, whichever is less;
- the prospectus of the company shall disclose the name of the underwriters, the rate and amount of the commission payable to the underwriter and the number of securities which is to be underwritten or subscribed by the underwriter absolutely or conditionally;
- commission shall not be paid to any underwriter on securities which are not offered to the public for subscription;
- a copy of the contract for the payment of commission is delivered to the Registrar at the time of delivery of the prospectus for registration.

### **(ix) Qualification of independent directors**

#### **Answer:**

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Rule 5 prescribes the qualification of independent directors. An independent director shall possess appropriate skills, experience and knowledge in one or more fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical operations or other disciplines to the company's business.

Section 149, further provides that an independent director shall not be entitled to any stock option. He may receive remuneration by way of sitting fee and the reimbursement of expenses for participation in the Board and other meetings and profit related commission as may be approved by the members. An independent director shall not hold office for a term of office up to five consecutive years on the Board of a company. He shall be eligible for re-appointment on passing a special resolution by the company. The Board's report shall disclose the same. No independent director shall hold office for more than two consecutive terms. He shall be eligible for appointment after the expiration of three years of ceasing to become an independent director. The provisions for retirement of directors shall not be applicable to independent directors.

Independent directors may be selected from a data bank containing the details of persons who are eligible and willing to act as independent directors by any agency as notified by the Central Government. The appointment of independent director shall be approved by the company in general meeting.

### **(x) Importance of ethics**

#### **Answer:**

Ethics is a requirement for human life. It is our means of deciding a course of action. Without it, our actions would be random and aimless. There would be no way to work towards a goal because there would be no way to pick between a limitless numbers of goals. Even with an ethical standard, we may be unable to pursue our goals with the possibility of success. To the degree which a rational ethical standard is taken, we are able to correctly organize our goals and actions to accomplish our most important values. Any flaw in our ethics will reduce our ability to be successful in our endeavours.

A proper foundation of ethics requires a standard of value to which all goals and actions can be compared to. This standard is our own lives, and the happiness which makes them liveable. This is our ultimate standard of value, the goal in which an ethical man must always aim. It is arrived at by an examination of man's nature, and recognizing his peculiar needs. A system of ethics must further consist of not only emergency situations, but the day to day choices we make constantly. It must include our relations to others, and recognize their importance not only to our physical survival, but to our well - being and happiness. It must recognize that our lives are an end in themselves, and that sacrifice is not only not necessary, but destructive.