MOCK TEST PAPER - 2

FINAL (OLD) COURSE: GROUP – I

PAPER – 4: CORPORATE AND ALLIED LAWS

SUGGESTED ANSWERS

DIVISION A: MULTIPLE CHOICE QUESTIONS (TOTAL OF 30 MARKS)

1. (a)
2. (d)
3. (a)
4. (c)
5. (c)
6. (c)
7. (b)
8. (d)
9. (d)
10. (c)
11. (a)
12. (c)
13. (d)
14. (d)
15. (b)
16. (b)
17. (c)
18. (c)
19. (c)
20. (d)

Descriptive Questions (70 Marks)

1. (a) Section 161(4) of the Companies Act, 2013 provides that if the office of any director appointed by the company in general meeting is vacated before his term of office expires in the normal course, the resulting casual vacancy may, in default of and subject to any regulations in the articles of the company, be filled by the Board of Directors at a meeting of the Board which shall be subsequently approved by members in the immediate next general meeting.

Provided that any person so appointed 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.

(i) In view of the above provisions, in the given case, the appointment of Mr. Samarth in place of the disqualified director Mr. Gap was in order. In normal course, Mr. Samarth could have held his office as director up to the date to which Mr. Gap would have held the same.

(ii) As per facts, Mr. Samarth expired on 15th May, 2018 and again a vacancy has arisen in the office of director owing to death of Mr. Samarth who was appointed by the board and approved by members to fill up the casual vacancy resulting from disqualification of Mr. Gap. Vacancy arising on the Board due to vacation of office by the director appointed to fill a casual vacancy in the first place, does not create another casual vacancy as section 161 (4) clearly mentions that such vacancy is created by the vacation of office by any director appointed by the company in general meeting. Hence, the Board cannot fill in the vacancy arising from the death of Mr. Samarth. So cannot appoint Mr. Able in the office of Mr. Samarth.

The Board may however appoint Mr. Able as an additional director under section 161 (1) of the Companies Act, 2013 provided the articles of association authorises the board to do so, in which case Mr. Able will hold the office up to the date of the next annual general meeting or the last date on which the AGM should have been held, whichever is earlier.

(b) International Technologies Limited, a listed company, being managed by a Managing Director proposes to pay the following managerial remuneration:

(i) **Commission at the rate of 5% of the net profits to its Managing Director, Mr. Kunal:** Part (i) of the second proviso to section 197(1), provides that except with the approval of the company in general meeting by a special resolution, the remuneration payable to any one managing director; or whole time director or manager shall not exceed 5 % of the net profits of the company and if there is more than one such director then remuneration shall not exceed 10 % of the net profits to all such directors and manager taken together.

In the present case, since the International Technologies Limited is being managed by a Managing Director, the commission at the rate of 5% of the net profit to Mr. Kunal, the Managing Director is allowed and no approval of company in general meeting is required.

(ii) The directors other than the Managing Director are proposed to be paid monthly remuneration of Rs. 50,000 and also commission at the rate of 1 % of net profits of the company subject to the condition that overall remuneration payable to ordinary directors including monthly remuneration payable to each of them shall not exceed 2 % of the net profits of the company: Part (ii) of the second proviso to section 197(1) provides that except with the approval of the company in general meeting by a special resolution, the remuneration payable to directors who are neither managing directors nor whole time directors shall not exceed -

(A) 1% of the net profits of the company, if there is a managing or whole time director or manager;

(B) 3% of the net profits in any other case.

In the present case, the maximum remuneration allowed for directors other than managing or whole time director is 1% of the net profits of the company because the company is having a managing director also. Hence, if the company wants to fix their remuneration at not more than 2% of the net profits of the company, the approval of the company in general meeting is required by a special resolution.

(iii) The company also proposes to pay suitable additional remuneration to Mr. Bhim, a director, for professional services rendered as legal counsel, whenever such services are utilized:

(1) According to section 197(4), the remuneration payable to the directors of a company, including any managing or whole-time director or manager, shall be determined, in accordance with and subject to the provisions of this section, either

(i) by the articles of the company, or

(ii) by a resolution or,

(iii) if the articles so require, by a special resolution, passed by the company in general meeting, and

(2) the remuneration payable to a director determined aforesaid shall be inclusive of the remuneration payable to him for the services rendered by him in any other capacity.

(3) Any remuneration for services rendered by any such director in other capacity shall not be so included if—

(i) the services rendered are of a professional nature; and

(ii) in the opinion of the Nomination and Remuneration Committee, if the company is covered under section 178(1), or the Board of Directors in other cases, the director possesses the requisite qualification for the practice of the profession.

Hence, in the present case, the additional remuneration to Mr. Bhim, a director for professional services rendered as legal counsel will not be included in the maximum managerial remuneration and is allowed but opinion of Nomination and Remuneration Committee is to be obtained.

Also, the International Technologies Limited (a listed company) shall disclose in the Board's report, the ratio of the remuneration of each director to the median employee's remuneration and such other details as may be prescribed under the *Companies (Appointment and Remuneration of Managerial personnel) Rules, 2014*.

2. (a) Right to apply for oppression and mismanagement: As per the provisions of Section 244 of the Companies Act, 2013, in the case of a company having share capital, members eligible to apply for oppression and mismanagement shall be lowest of the following:

100 members; or

1/10th of the total number of members; or

Members holding not less than 1/10th of the issued share capital of the company.

The share holding pattern of Mansi Limited is given as follows:

Rs. 8,00,00,000 equity share capital held by 600 members

Particulars of the petition alleging oppression and mismanagement made by members are as follows:

(i) No. of members making the petition – 65

(ii) Amount of share capital held by members making the petition – Rs. 20,00,000

The petition shall be valid if it has been made by the lowest of the following:

100 members; or

60 members (being 1/10th of 600); or

Members holding Rs. 80,00,000 share capital (being 1/10th of Rs. 8,00,00,000)

As it is evident, the petition made by 65 members meets the eligibility criteria specified under section 244 of the Companies Act, 2013 as it exceeds the minimum requirement of 60 members in this case. Therefore, the petition is maintainable.

The consent to be given by a shareholder is reckoned at the beginning of the proceedings. The withdrawal of consent by any shareholder during the course of proceedings shall not affect the maintainability of the petition *[Rajamundhry Electric Corporation Vs. V. Nageswar Rao A.I.R.].*

(b) (i) Section 15G of the Securities and Exchange Board of India (SEBI) Act, 1992 deals with penalty for Insider Trading. According to this, if any insider

(a) either on his own behalf or on behalf of any other person, deals in securities of a body corporate on any stock exchange on the basis of any unpublished price sensitive information; or

(b) communicates any unpublished price sensitive information to any person, with or without his request for such information except as required in the ordinary cause of business or under any law, or

(c) counsels or procures for, any other person to deal in any securities of any body corporate on the basis of unpublished price sensitive information,

Accordingly, Mr. P, is an insider as he communicated unpublished price sensitive information to Mr. X on his request, therefore he shall be liable to a penalty of twenty-five crore rupees or three times the amount of profits made out of insider trading, whichever is higher.

(ii) As per section 23A(a) of the Securities Contract (Regulation) Act, 1956, if any person fails to furnish any information, document, books, returns or report to a recognised stock exchange within the time specified in the listing agreement or conditions or bye-laws of the stock exchange, he shall be punishable with a fine of at least one lakh rupees which may extend to one lakh rupees per day during which such failure continues, subject to a maximum of one crore rupees. Thus, Jaipur Stock Exchange shall be liable to the afore-mentioned penalty under section 23A(a) of the Act for its failure to submit the required documents to SEBI.

3. (a) In terms of the definition of a foreign company under section 2 (42) of the Companies Act, 2013 a "foreign company" means any company or body corporate incorporated outside India which:

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

(b) Conducts any business activity in India in any other manner

According to section 386 of the Companies Act, 2013, for the purposes of the Companies incorporated outside India, "Place of business" includes a share transfer or registration office.

(i) From the above definition, the status of XYZ Ltd. will be that of a foreign company as it is incorporated outside India, has a place of business in India and so may be presumed that it carries on a business activity in India.

(ii) The term "online business "can be related to the term "online mode" of conduct of business. This is to be read with the section 2(42) of the Companies Act, 2013, and with the *Companies (Registration of Foreign Companies) Rules, 2014.* "Electronic mode" means carrying out electronically based, whether main server is installed in India or not, including, but not limited to–

(a) business to business and business to consumer transactions, data interchange and other digital supply transactions;

(b) offering to accept deposits or inviting deposits or accepting deposits or subscriptions in securities in India or from citizens of India;

(c) financial settlements, web based marketing, advisory and transactional services, data base services and products, supply chain management;

(d) online services such as telemarketing, telecommuting, telemedicine, education and information research; and

(e) all related data communication services whether conducted by e-mail, mobile devices, social media, cloud computing, document management, voice or data transmission or otherwise.

Since, RST Ltd. is a company registered in Thailand with no place of business established in India, however doing online business through telemarketing in India. Looking to the above

description as to conduct of business through electronic mode, it can be said that being involved in business activity through telemarketing, RST Ltd., will be treated as foreign company.

(b) **Residential Status:** According to section 2(v) of the Foreign Exchange Management Act, 1999, 'Person resident in India' means a person residing in India for more than 182 days during the course of preceding financial year [Section 2(v)(i)]. However, it does not include a person who has gone out of India or who stays outside India for employment outside India or for any other purpose in such circumstances as would indicate his intention to stay outside India for an uncertain period.

Generally, a student goes out of India for a certain period. In this case, Mr. Sugam who resided in India during the financial year 2016-17 left on 15.7.2017 for Australia for pursuing higher studies in Biotechnology for 2 years, he will be resident for 2017-18, as he has gone to stay outside India for a 'certain period' (If he goes abroad with intention to stay outside India for an 'uncertain period' he will not be resident with effect from 15-7-2017).

Foreign Exchange for studies abroad: According to Para I of Schedule III to *Foreign Exchange Management (Current Account Transactions), Amendment Rule, 2015* dated 26th May, 2015, individuals can avail of foreign exchange facility for the studies abroad within the limit of USD 2,50,000 only. Any additional remittance in excess of the said limit shall require prior approval of the RBI. Further proviso to Para I of Schedule III states that individual may be allowed remittances (without seeking prior approval of the RBI) exceeding USD 2,50,000 based on the estimate received from the institution abroad. In this case the foreign exchange required is only USD 55,000 per academic year and hence approval of RBI is not required.

4. **(a)** As per Section 8 of the Insolvency and Bankruptcy Code, 2016, once a default has occurred, the operational creditor has to deliver a demand notice or a copy of invoice demanding payment of debt in default to the corporate debtor.

Since in the given case, demand notice and copy of invoice was not served to the Rose Garden Ltd., so the requirement for the initiation of the corporate insolvency resolution process by operational creditor under section 9 of the Code, was not in compliance. So, the admission of application in line with the compliance of other required formality as to issue of order of moratorium and other relief, given by the NCLT was against the law.

As Rose Garden Ltd. (Corporate debtor) was aggrieved by the Order of the Adjudicating Authority on the non-compliance of requirement of Section 8, Rose Garden Ltd. will succeed in its appeal filed before the National Company Law Appellate Tribunal.

Further, as IBC is a special law, having an overriding effect on the Companies Act, 2013, therefore serving of notice for winding up as per the Companies Act, will not be considered as a sufficient compliance of the requirement for prevailing of section 8 of the Insolvency and Bankruptcy Code.

(b) **Power of RBI to remove director:** Under section 36AA of the Banking Regulation Act, 1949, RBI can terminate any Chairman, Director, Chief Executive, other officials or any employee of the bank where it considers desirable to do so particularly when RBI is of the opinion that conduct of such persons is detrimental to the interest of the depositors or for securing proper management of the banking company. Before such termination concerned person should be given opportunity to be heard of. Such terminated officials can make appeal to the Central Govt. within 30 days from the date of communication of such termination order. The decision of the Central Government cannot be called into question. In case an order is issued pursuant to this section the concerned person shall cease to hold his office for a period of not exceeding 5 years as may be specified in the order. Contravention of the above provision shall be punishable with a fine, which may extent to Rs. 250 per day.

Any such order shall be valid for a period not exceeding three years or such further periods of not exceeding three years at a time as RBI may specify.

Under section 36AB: RBI is empowered to appoint additional Directors for the banking company with effect from the date to be specified in the order, in the interest of the bank or that of depositors. Such additional directors shall hold office for a period not exceeding three years or such further periods not exceeding three years at a time.

5. (a) (i) The official liquidator can invoke the provisions contained in Section 328 of the Companies Act, 2013 to recover the sale of assets of the company. According to Section 328, if the Tribunal is satisfied that there is a preference transfer of property, movable or immovable, or any delivery of goods, payment, execution made, taken or done by or against a company within six months before making winding up application, the Tribunal may order as it may think fit and may declare such transaction invalid and restore the position.

Since in the present case, the sale of immovable property took place on 15th September, 2017 and the company went into liquidation on an application filed on 10th February, 2018 i.e., within 6 months of making winding up application and such transfer of property has resulted a loss to the company.

The official liquidator will be able to succeed in proving the case under Section 328 by way of fraudulent preference as the property was sold to a Vansh (Pvt.) company, a creditor in which the son of the ex-managing director was interested.

Hence, the transaction made will be regarded as invalid and restore the position of the company as if no transfer of immovable property has been made.

(ii) Determination of rights and liabilities of fraudulently preferred persons: According to section 331 of the Companies Act, 2013, where a company is being wound up and anything made, taken or done after the commencement of this Act is invalid under section 328 as a fraudulent preference of a person interested in property mortgaged or charged to secure the company's debt, then, without prejudice to any rights or liabilities arising, apart from this provision, the person preferred shall be subject to the same liabilities, and shall have the same rights, as if he had undertaken to be personally liable as a surety for the debt,-

- to the extent of the mortgage or charge on the property, or
- the value of his interest,

Whichever is less.

(b) As per the section 3 of the Prevention of Money Laundering Act, 2002, offence of money laundering is said to be committed when whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime including its concealment, possession, acquisition or use and projecting or claiming it as untainted property shall be guilty of offence of money-laundering.

In the given case, Mr. Rajiv Shah and Raghu, is knowingly a party to an offence of lending and accepting of a bribe to move the file, which was *prima facie* rejected by the authority. Both Mr. Rajiv Shah and Raghu, are guilty of offence of money laundering.

Section 4 of the PMLA, specifies punishment for money-laundering. Whoever commits the offence of money-laundering shall be punishable with rigorous imprisonment for a term which shall not be less than three years but which may extend to seven years and shall also be liable to fine.

So accordingly, Mr. Rajiv Shah and Raghu both are punishable in compliance with the above provisions.

6. (a) Under section 177(1) of the Companies Act, 2013 the Board of Directors of every listed company and such other class or classes of companies, as may be prescribed, shall constitute an Audit Committee. Therefore, MNC Ltd. being a listed company will be bound to constitute an audit committee under the Act.

Further under section 177(2) the Audit Committee shall consist of a minimum of three directors with independent directors forming a majority.

Further, the majority of members of Audit Committee including its Chairperson shall be persons with ability to read and understand the financial statement.

The draft Board Resolution for the constitution of an Audit Committee may be as follows:

"Resolved that pursuant to the provision contained in section 177 of the Companies Act 2013 and the applicable clause of Listing Agreement with the Mumbai Stock Exchange, an Audit Committee of the Company be and is hereby constituted with effect from the conclusion of this meeting, with members as under:

1. Mr. A -- An Independent Director.
2. Mr. B -- An Independent Director
3. Mr. C – An Independent Director
4. Mr. D -- An Independent Director
5. Mr. FE -- Financial Executive
6. Mr. MD -- Managing Director

Further resolved that the Chairman of the Committee, who shall be an Independent Director, be elected by the committee members from amongst themselves.

Further resolved that the quorum for a meeting of the Audit Committee shall be the chairman of the Audit Committee and 2 other members (other than the Managing Director).

Further resolved that the terms of reference of the Audit Committee shall be in accordance with the provisions of section 177(4) of the Companies Act, 2013.

Further resolved that the Audit committee shall conduct discussions with the auditors periodically about internal control system, the scope of audit including the observations of the auditors.

Further resolved that the Audit Committee shall review the quarterly and annual financial statements and submit the same to the Board with its recommendations, if any.

Further resolved that the recommendations made by the Audit Committee on any matter relating to financial management including the audit report shall be binding on the Board. However, where such recommendations are not accepted by the Board, the reasons for the same shall be recorded in the minutes of the Board meeting and communicated to the shareholders.

Further resolved that the Company Secretary of the Company shall be the Secretary to the Audit Committee.

Further resolved that the Chairman of the Audit Committee shall attend the annual general meeting of the Company to provide any clarifications on matters relating to audit as may be required by the members of the company.

Further resolved that the Board's Report/Annual Report to the members of the Company shall include the particulars of the constitution of the Audit Committee and the details of the non acceptance of any recommendations of the Audit Committee with reasons therefor."

(b) (i) Agreement

'Agreement' includes any arrangement or understanding or action in concert:

(i) Whether or not, such arrangement, understanding or action is formal or in writing or

(ii) Whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings. [Section 2(b)].

In view of the above definition of 'agreement', an understanding reached by the cement manufacturers to control the price of cement will be an 'agreement' within the meaning of section 2(b) of the Competition Act, 2002 even though the understanding is not in writing and it is not intended to be enforceable by legal proceedings.

(ii) Rule of Ejusdem Generis : The term 'ejusdem generis' means 'of the same kind or species'. Simply stated, the rule means:

Where any Act enumerates different subjects, general words following specific words are to be construed (and understood) with reference to the words that precede them. Those general words are to be taken as applying to things of the same kind as the specific words previously mentioned, unless there is something to show that a wider sense was intended. Thus, the rule of ejusdem generis means that where specific words are used and after those specific words, some general words are used, the general words would take their colour from the specific words used earlier.