

Test Series: August, 2018

MOCK TEST PAPER - 1

INTERMEDIATE (NEW): GROUP – I

PAPER – 2: CORPORATE AND OTHER LAWS

SUGGESTED ANSWERS/HINTS

1. (a) **Restrictions on purchase by company or giving of loans by it for purchase of its share:** As per section 67 (3) of the Companies Act, 2013 a company is allowed to give a loan to its employees subject to the following limitations:

- (a) The employee must not be a Key Managerial Personnel;
- (b) The amount of such loan shall not exceed an amount equal to six months' salary of the employee.
- (c) The shares to be subscribed must be fully paid shares

Section 2 (51) of the Companies Act, 2013 defines the "Key Managerial Personnel" (KMP) whereby a KMP includes the Chief Executive, Company Secretary, Whole Time Director, Chief Financial Officer, such other officer, not more than one level below the directors who is in whole-time employment, designated as key managerial personnel by the Board; and such other officer as may be prescribed.

In the given instance, Human Resource Manager is not a KMP of the OLAF Ltd. He is drawing salary of Rs. 30, 000 per month and loan taken to buy 500 partly paid up equity shares of Rs. 1000 each in OLAF Ltd.

Keeping the above provisions of law in mind, the company's (OLAF Ltd.) decision is invalid due to two reasons:

- i. The amount of loan being more than 6 months' salary of the HR Manager, which should have restricted the loan to Rs. 1.8 Lakhs.
- ii. The shares subscribed are partly paid shares whereas the benefit is available only for subscribing fully paid shares.

- (b) **Interim Dividend:** According to section 123(3) of the Companies Act, 2013, The Board of Directors of a company may declare interim dividend during any financial year or at any time during the period from closure of financial year till holding of the annual general meeting out of the surplus in the profit and loss account or out of profits of the financial year for which such interim dividend is sought to be declared or out of profits generated in the financial year till the quarter preceding the date of declaration of the interim dividend.

However, in case the company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend shall not be declared at a rate higher than the average dividends declared by the company during the immediately preceding three financial years.

In the instant case, Interim dividend by TAT Ltd. shall not be declared at a rate higher than the average dividends declared by the company during the immediately preceding three financial years [i.e.  $(12+15+18)/3 = 45/3 = 15\%$ ]. Therefore, decision of Board of Directors to declare 15% of the interim dividend for the current financial year is tenable.

- (c) According to section 200 of the Indian Contract Act, 1872, an act done by one person on behalf of another, without such other person's authority, which, if done with authority, would have the effect of subjecting a third person to damages, or of terminating any right or interest of a third person, cannot, by ratification, be made to have such effect. In other words, when the interest of third parties is affected, the principle of ratification does not apply. Ratification cannot relate back to the date of contract if third party has in the intervening time acquired rights.

Thus, in the instant case the notice cannot be ratified by Navin, so as to be binding on Susie.

- (d) As per section 27 of the General Clause Act, 1897, where any legislation or regulation requires any document to be served by post, then unless a different intention appears, the service shall be deemed to be effected by:
- (i) properly addressing
  - (ii) pre-paying, and
  - (iii) posting by registered post.

A letter containing the document to have been effected at the time at which the letter would be delivered in the ordinary course of post.

Thus, where a notice is sent by the landlord by registered post and the same is returned by the tenant with an endorsement of refusal, it will be presumed that the notice has been served.

Hence, in the given situation, a notice was rightfully served to Mr. Wise.

2. (a) (i) **Disqualification of auditor:** According to section 141(3)(d)(i) of the Companies Act, 2013, a person who, or his relative or partner holds any security of the company or its subsidiary or of its holding or associate company a subsidiary of such holding company, which carries voting rights, such person cannot be appointed as auditor of the company. Provided that the relative of such person may hold security or interest in the company of face value not exceeding 1 lakh rupees as prescribed under the Companies (Audit and Auditors) Rules, 2014.

In the case Mr. Nat, Chartered Accountants, did not hold any such security. But Mrs. Kat, his wife held equity shares of DON Limited of face value Rs. 1 lakh, which is within the specified limit.

Hence, Nat & Company can continue to function as auditors of the Company even after 15<sup>th</sup> October 2017 i.e. after the investment made by his wife in the equity shares of DON Limited.

- (ii) **Removal of first auditor:** Section 140(1) stipulates that any auditor appointed under section 139 may be removed from office before the expiry of his term by passing special resolution in general meeting, after obtaining the previous approval of the Central Government in that behalf.

Provided that before taking any action under subsection (1) of Section 140, the auditor concerned shall be given a reasonable opportunity of being heard.

The first auditors appointed by Board of Directors can be removed in accordance with the provision of Section 140(1) of the Companies Act, 2013. Hence, the removal of the first auditor appointed by the Board without seeking approval of the Central Government is invalid. The company contravened the provision of the Act.

- (b) Nomination is a facility whereby a holder of any financial asset (bank a/c, FD, securities etc.) could nominate the name of person who would be entitled to that financial asset in case of his or her death. Generally, such nomination overrides any will. It is a very logical thing to do to avoid legal, procedural tangles related to transmission at a later stage for the near and dear ones.

As per Section 72 of the Companies Act, 2013-

- (1) every holder of securities of a company may, at any time, nominate, in the prescribed manner, any person to whom his securities shall vest in the event of his death.
- (2) Where the securities of a company are held by more than one person jointly, the joint holders may together nominate, in the prescribed manner, any person to whom all the rights in the securities shall vest in the event of death of all the joint holders.

- (3) Notwithstanding anything contained in any other law for the time being in force or in any disposition, whether testamentary or otherwise, in respect of the securities of a company, where a nomination made in the prescribed manner purports to confer on any person the right to vest the securities of the company, the nominee shall, on the death of the holder of securities or, as the case may be, on the death of the joint holders, become entitled to all the rights in the securities, of the holder or, as the case may be, of all the joint holders, in relation to such securities, to the exclusion of all other persons, unless the nomination is varied or cancelled in the prescribed manner.
- (4) Where the nominee is a minor, it shall be lawful for the holder of the securities, making the nomination to appoint, in the prescribed manner, any person to become entitled to the securities of the company, in the event of the death of the nominee during his minority.

Thus, Mr. Siddharth can nominate the shares held by him in Gauri Ltd. to his son.

- (c) (i) As per Section 26 of the Negotiable Instruments Act, 1881, a minor may draw, endorse, deliver and negotiate the instrument so as to bind all parties except himself. Therefore, M is not liable. X can, thus, proceed against A.
- (ii) As per the provision of the Negotiable Instruments Act, 1881 this is not a material alteration as a promissory note where no date of payment is specified will be treated as payable on demand. Hence adding the words "on demand" does not alter the business effect of the instrument.
- (iii) B is a holder but not a holder in due course as he does not get the cheque for value and consideration. His title is good and bonafide. As a holder he is entitled to receive Rs. 1000 from the bank on whom the cheque is drawn.
- (iv) According to Section 85 of the Negotiable Instruments Act, 1881, the drawee banker is discharged when he pays a cheque payable to order when it is purported to be endorsed by or on behalf of the payee. Even though the endorsement of Mr. B is forged, the banker is protected and he is discharged. The true owner, B, cannot recover the money from the drawee bank.

3. (a) Section 8 of the Companies Act, 2013 deals with the formation of companies which are formed to promote the charitable objects of commerce, art, science, education, sports etc. Such company intends to apply its profit in promoting its objects. Section 8 companies are registered by the Registrar only when a license is issued by the Central Government to them. Since, Alfa School was a Section 8 company and it had started violating the objects of its objective clause, hence in such a situation the following powers can be exercised by the Central Government:

- (i) The Central Government may by order revoke the licence of the company where the company contravenes any of the requirements or the conditions of this sections subject to which a licence is issued or where the affairs of the company are conducted fraudulently, or violative of the objects of the company or prejudicial to public interest, and on revocation the Registrar shall put 'Limited' or 'Private Limited' against the company's name in the register. But before such revocation, the Central Government must give it a written notice of its intention to revoke the licence and opportunity to be heard in the matter.
- (ii) Where a licence is revoked, the Central Government may, by order, if it is satisfied that it is essential in the public interest, direct that the company be wound up under this Act or amalgamated with another company registered under this section.

However, no such order shall be made unless the company is given a reasonable opportunity of being heard.

- (iii) Where a licence is revoked and where the Central Government is satisfied that it is essential in the public interest that the company registered under this section should be amalgamated

with another company registered under this section and having similar objects, then, notwithstanding anything to the contrary contained in this Act, the Central Government may, by order, provide for such amalgamation to form a single company with such constitution, properties, powers, rights, interest, authorities and privileges and with such liabilities, duties and obligations as may be specified in the order.

- (b) Section 134(3)(c) of the Companies Act, 2013 provides that there shall be attached to statements laid before a company in general meeting, a report by its Board of Directors, which shall include a number of statements as prescribed in the sub section including Directors' Responsibility Statement.

Further section 134(5) states that the Directors Responsibility Statement shall state that:

- (i) In the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures;
  - (ii) the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit or loss of the company for that period;
  - (iii) the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;
  - (iv) that the directors had prepared the annual accounts on a going concern basis; and
  - (v) the directors, in the case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively; and
  - (vi) the directors had devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively.
- (c) **“Good Faith” [Section 3(22) of the General Clauses Act, 1897]:** A thing shall be deemed to be done in “good faith” where it is in fact done honestly, whether it is done negligently or not;

The question of good faith under the General Clauses Act is one of fact. It is to determine with reference to the circumstances of each case. The term “Good faith” has been defined differently in different enactments. This definition of the good faith does not apply to that enactment which contains a special definition of the term “good faith” and there the definition given in that particular enactment has to be followed. This definition may be applied only if there is nothing repugnant in subject or context, and if that is so, the definition is not applicable.

- (d) (i) **Title:** An enactment would have what is known as ‘Short Title’ and also a ‘Long Title’. The short title merely identifies the enactment and is chosen merely for convenience. The ‘Long title’ describes the enactment and does not merely identify it.

The Long title is a part of the Act and, therefore, can be referred to for ascertaining the object and scope of the Act.

- (ii) **Preamble:** It expresses the scope and object of the Act more comprehensively than the long title. The preamble may recite the ground and the cause for making a statute and or the evil which is sought to be remedied by it.

The preamble like the Long title can legitimately be used for construing it. However, the preamble cannot over ride the provisions of the Act. Only if the wording of the Act gives rise to doubts as to its proper construction (e.g., where the words or a phrase has more than the one meaning and doubts arise as to which of the two meanings is intended in the Act) the preamble can and ought to be referred to arrive at the proper construction.

4. (a) (i) According to section 103 of the Companies Act, 2013, unless the articles of the company provide for a larger number in case of a public company, five members personally present if the number of members as on the date of meeting is not more than one thousand, shall be the quorum.

In this case the quorum for holding a general meeting is 7 members to be personally present (higher of 5 or 7). For the purpose of quorum, only those members are counted who are entitled to vote on resolution proposed to be passed in the meeting.

Again, only members present in person and not by proxy are to be counted. Hence, proxies whether they are members or not will have to be excluded for the purposes of quorum.

If a company is a member of another company, it may authorize a person by resolution to act as its representative at a meeting of the latter company, then such a person shall be deemed to be a member present in person and counted for the purpose of quorum. Where two or more companies which are members of another company, appoint a single person as their representative then each such company will be counted as quorum at a meeting of the latter company.

Further the President of India or Governor of a State, if he is a member of a company, may appoint such a person as he thinks fit, to act as his representative at any meeting of the company. A person so appointed shall be deemed to be a member of such a company and thus considered as member personally present.

In view of the above there are only three members personally present.

'A' will be included for the purpose of quorum. D will have two votes for the purpose of quorum as he represents two companies 'Y Ltd.' and 'Z Ltd.' E, F, G and H are not to be included as they are not members but representing as proxies for the members.

Thus, it can be said that the requirements of quorum has not been met and it shall not constitute a valid quorum for the meeting.

- (ii) Under section 105 (8) of the Companies Act, 2013 every member entitled to vote at a meeting of the company, or on any resolution to be moved thereat, shall be entitled during the period beginning twenty-four hours before the time fixed for the commencement of the meeting and ending with the conclusion of the meeting, to inspect the proxies lodged, at any time during the business hours of the company, provided not less than three days' notice in writing of the intention so to inspect is given to the company.

In the given case, Sirhj has given proper notice.

However, such inspection can be undertaken only during the period beginning 24 hours before the time fixed for the commencement of the meeting and ending with the conclusion of the meeting. So, Sirhj can undertake the inspection only during the above mentioned period and not two days prior to the meeting.

- (b) **Auditor acts in a fraudulent manner or abetted or colluded in any fraud [Section 140(5) of the Companies Act, 2013]**

- (i) **On satisfaction of Tribunal that the auditor of a company has acted in a fraudulent manner etc.:** Without prejudice to any action under the provisions of this Act or any other law for the time being in force, the Tribunal either suo moto or on an application made to it by the Central Government or by any person concerned, if it is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, it may, by order, direct the company to change its auditors.

- (ii) **Requirement for change of auditor:** If the application is made by the Central Government and the Tribunal is satisfied that any change of the auditor is required, it shall within fifteen days of receipt of such application, make an order that he shall not function as an auditor and the Central Government may appoint another auditor in his place.

- (c) **Meaning of rule Harmonious Construction:** When there is doubt about the meaning of the words of a statute, these should be understood in the sense in which they harmonise with the subject of the enactment and the object which the legislature had in view. Where there are in an enactment two or more provisions which cannot be reconciled with each other, they should be so interpreted, wherever possible, as to give effect to all of them. This is what is known as the Rule of Harmonious Construction.

It must always be borne in mind that a statute is passed as a whole and not in sections and it may well be assumed to be animated by one general purpose and intent. The Court's duty is to give effect to all the parts of a statute, if possible. But this general principle is meant to guide the courts in furthering the intent of the legislature, not overriding it.

**Application of the Rule:** The Rule of Harmonious Construction is applicable only when there is a real and not merely apparent conflict between the provisions of an Act, and one of them has not been made subject to the other. When after having construed their context the words are capable of only a single meaning, the rule of harmonious construction disappears and is replaced by the rule of literal construction.

- (d) Section 203(3) of the Companies Act, 2013 provides that whole time key managerial personnel shall not hold office in more than one company except in its subsidiary company at the same time. With respect to the issue that whether a whole time KMP of holding company be appointed in more than one subsidiary companies or can be appointed in only one subsidiary company.

It can be noted that Section 13 of General Clauses Act, 1897 provides that the word 'singular' shall include the 'plural', unless there is anything repugnant to the subject or the context. Thus, a whole time key managerial personnel may hold office in more than one subsidiary company as per the present law.

5. (a) (i) Under section 62 (1) (c) of the Companies Act, 2013 where at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, either for cash or for a consideration other than cash, such shares may be offered to any persons, if it is authorised by a special resolution and if the price of such shares is determined by a valuation report of a registered valuer, subject to the compliance with the applicable provisions of Chapter III and any other conditions as may be prescribed.

In the present case, Mars India Ltd is empowered to allot the shares to Sunil in settlement of its debt to him. The issue will be classified as issue for consideration other than cash must be approved by the members by a special resolution. Further, the valuation of the shares must be done by a registered valuer, subject to the compliance with the applicable provisions of Chapter III and any other conditions as may be prescribed.

- (ii) According to Section 23 of the Companies Act, 2013, a public company can issue securities to the public only by issuing a prospectus. Section 26 (1) lays down the matters required to be disclosed and included in a prospectus and requires the registration of the prospectus with the Registrar before its issue.

In the given case, the company has violated with the above provisions of the Act and hence the allotment made is void. The company will have to refund the entire moneys received and will also be punishable under section 26 of the Act.

- (b) According to section 77(1) of the Companies Act, 2013, the prescribed particulars of the charge together with the instrument, if any by which the charge is created or evidenced, or a copy thereof shall be filed with the Registrar within 30 days after the date of the creation of charge.

In the present case particulars of charge have not been filed within the prescribed period of 30 days.

However, the Registrar is empowered under proviso to section 77 (1) to extend the period of 30 days by another 300 days on payment of such additional fee as may be prescribed. Taking advantage of this provision, Mind Limited, should immediately file the particulars of charge with the

Registrar and satisfy the Registrar that it had sufficient cause, for not filing the particulars of charge within 30 days of creation of charge.

There will be no change in the situation if the charge was created on 12<sup>th</sup> February, 2018.

- (c) According to section 124 of the Indian Contract Act, 1872, a contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person, is called a "contract of indemnity."

There are two parties in this form of contract. The party who promises to indemnify/ save the other party from loss is known as 'indemnifier', where as the party who is promised to be saved against the loss is known as 'indemnified' or indemnity holder.

Example: A may contract to indemnify B against the consequences of any proceedings which C may take against B in respect of a sum of Rs. 5000/- advanced by C to B. In consequence, when B who is called upon to pay the sum of money to C fails to do so, C would be able to recover the amount from A as provided in Section 124.

- (d) According to section 151 of the Indian Contract Act, 1872, in all cases of bailment, the bailee is bound to take as much care of the goods bailed to him as a man of ordinary prudence would, under similar circumstances, take of his own goods of the same bulk, quality and value as the goods bailed.

According to section 152 of the Indian Contract Act, 1872, the bailee, in the absence of any special contract, is not responsible for the loss, destruction or deterioration of the thing bailed, if he has taken the amount of care of it described in section 151.

Thus, Barn is liable to compensate Ashley for his negligence to keep jewelry at his residence. Here, Ashley and Barn agreed to keep the jewelry at the Bank's safe locker and not at the latter's residence.

6. (a) (i) **Creation of debenture redemption reserve (DRR) account:** According to section 71 of the Companies Act, 2013, where debentures are issued by a company under this section, the company shall create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such account shall not be utilised by the company except for the redemption of debentures.

- (ii) **Appointment of Debenture Trustee:** Under section 71 (5) of the Companies Act, 2013, no company shall issue a prospectus or make an offer or invitation to the public or to its members exceeding five hundred for the subscription of its debentures, unless the company has, before such issue or offer, appointed one or more debenture trustees and the conditions governing the appointment of such trustees shall be such as may be prescribed.

A debenture trustee shall take steps to protect the interests of the debenture holders and redress their grievances in accordance with the prescribed rules.

- (b) (1) **Rectification by Central Government in register of charges:** Section 87 of the Companies Act, 2013 empowers the Central Government to make rectification in register of charges. According to the provision-

(1) The Central Government on being satisfied that—

- (i) (a) the **omission to file with the Registrar the particulars of any charge** created by a company or any charge subject to which any property has been acquired by a company or any modification of such charge; or
- (b) the **omission to register any charge within the time** required under this Chapter or the omission to give intimation to the Registrar of the payment or the satisfaction of a charge, within the time required under this Chapter; or
- (c) the **omission or mis-statement of any particular** with respect to any such charge or modification or with respect to any memorandum of satisfaction or other entry made in pursuance of section 82 or section 83,

- was accidental or due to inadvertence or some other sufficient cause or it is

not of a nature to prejudice the position of creditors or shareholders of the company; or

- (ii) **on any other grounds**, it is just and equitable to grant relief,
  - it may on the application of the company or any person interested and on such terms and conditions as it may seem to the Central Government just and expedient, direct that the time for the filing of the particulars or for the registration of the charge or for the giving of intimation of payment or satisfaction shall be extended or, as the case may require, that the omission or mis-statement shall be rectified.

- (2) Where the Central Government extends the time for the registration of a charge, the order shall not prejudice any rights acquired in respect of the property concerned before the charge is actually registered.

**(2) Condonation of delay and rectification of register of charges.** (1) Where the instrument creating or modifying a charge is not filed within a period of 300 hundred days from the date of its creation (including acquisition of a property subject to a charge) or modification and where the satisfaction of the charge is not filed within 30 days from the date on which such payment of satisfaction, the Registrar shall not register the same unless the delay is condoned by the Central Government.

- (2) The application for condonation of delay and for such other matters covered in sub-clause (a), (b) and (c) of clause (i) of sub-section (1) of section 87 of the Act shall be filed with the Central Government along with the fee.

- (3) The order passed by the Central Government under section 87(1) of the Act shall be required to be filed with the Registrar along with the fee as per the conditions stipulated in the said order.

- (c) According to section 133 of the Indian Contract Act, 1872, where there is any variance in the terms of contract between the principal debtor and creditor without surety's consent, it would discharge the surety in respect of all transactions taking place subsequent to such variance.

Here, in the given situation, Megha cannot sue Prem, because a surety is discharged from liability when, without his consent, the creditor makes any change in the terms of his contract with the principal debtor, no matter whether the variation is beneficial to the surety or does not materially affect the position of the surety.

- (d) According to section 82 of the Negotiable Instruments Act, 1881, the maker, acceptor or endorser respectively of a negotiable instrument is discharged from liability thereon -

- (a) **By cancellation**-to a holder thereof who cancels such acceptor's or endorser's name with intent to discharge him, and to all parties claiming under such holder,
- (b) **By release**- to a holder thereof who otherwise discharges such maker, acceptor or endorser, and to all parties deriving title under such holder after notice of such discharge;
- (c) **By payment**-to all parties thereto, if the instrument is payable to bearer, or has been endorsed in blank, and such maker, acceptor or endorser makes payment in due course of the amount due thereon.

Further, as per section 83 of the Negotiable Instruments Act, 1881, if the holder of a bill of exchange allows the drawee more than 48 hours, exclusive of public holidays, to consider whether he will accept the same, all previous parties not consenting to such allowance are thereby discharged from liability to such holder.