MOCK TEST PAPER 1

INTERMEDIATE: GROUP – I

PAPER – 2: CORPORATE AND OTHER LAWS

ANSWERS

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

1. (a) As per the requirement of the question, disclosures which are the deciding factors in an allotment of shares are laid down in section 39 of the Companies Act, 2013.

According to section 39(1), no allotment of any securities of a company offered to the public for subscription shall be made unless-

- the amount stated in the prospectus as the minimum amount has been subscribed, and
- the sums payable on application for the amount so stated have been paid to and received by the company by cheque or other instrument.

The amount payable on application on every security shall not be less than 5% of the nominal amount of the security or such other percentage or amount, as may be specified by the Securities and Exchange Board by making regulations in this behalf.

In the question, Kite Limited issued shares to public by issuing of prospectus, disclosing minimum subscription, sum payable on application for the amount; and the amount received on share application is more than 5% of the nominal amount of the security.

Further, it revealed that Kite Limited has applied for listing of shares in 3 recognized stock exchanges of which all three applications were rejected.

In the given instance, there is compliance to section 23, as nothing is talked about matters required to be included in the prospectus under section 26 (1) and about filing with the registrar; assuming that the said requirements have been complied with, requirement of section 39 as regards obtaining of minimum subscription and the minimum amount receivable on application (not less than 5% of the nominal value of the securities offered) are fulfilled.

The provisions of section 40 of the Companies Act, 2013 states that every company making public offer shall, before making such offer, make an application to one or more recognized stock exchange or exchanges and obtain permission for the securities to be dealt with in such stock exchange or exchanges.

The above provision is very clear that not only the company has to apply for listing of the securities at a recognized stock exchange, but also obtain permission thereof from the stock exchanges where it has applied, before making the public offer. Since all three recognized stock exchanges, where the company has applied for enlisting, have rejected the application and the company has proceeded with making the offer of shares, it has violated the provisions of section 40. Therefore, this shall be deemed to be irregular allotment of shares.

Consequently, Kite Limited shall be required to refund the application money to the applicants in the prescribed manner within the stipulated time frame.

(b) Section 105 of the Companies Act, 2013 deals with the provisions of proxy for meetings.

Section 105(1) of the Act provides that any member of a company entitled to attend and vote at a meeting of the company shall be entitled to appoint another person as a proxy to attend and vote at the meeting on his behalf.

Further, section 105(4) of the Act provides that a proxy received 48 hours before the meeting will be valid even if the articles provide for a longer period.

In the given case, the company received a proxy form 54 hours before the time fixed for start of the meeting. The Company refused to accept proxy on the ground that articles of the company provides filing of proxy before 60 hours of the meeting. In the said case, in line with requirement of the above stated legal provision, a proxy received 48 hours before the meeting will be valid even if the articles provide for a longer period. Accordingly, the proxy holder can compel the company to admit the proxy.

(c) According to the provisions of 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.

In the instant case, Vineet (Creditor) cannot sue Shiraj (Surety), because Shiraj is discharged from liability when, without his consent, Abhay (Principal debtor) has changed the terms of his contract with Vineet (creditor).

(d) As per the provisions of section 86 of the Negotiable Instruments Act, 1881, if the holder of a bill of exchange agrees to a qualified acceptance, or one limited to part of the sum mentioned in the bill, or which substitutes a different place or time for payment, or which, where the drawees are not partners, is not signed by all the drawees, all previous parties whose consent is not obtained to such acceptance are discharged as against the holder and those claiming under him, unless on notice given by the holder they assent to such acceptance.

Explanation to the above section states that an acceptance is qualified where it undertakes the payment of part only of the sum ordered to be paid.

In view of the above provisions, the bill, which has been drawn by N for ₹ 10,000/-, has been

accepted by P only for ₹ 7,000/-. It is a clear case of qualified acceptance, which may either be rejected by N or he may give assent to the acceptance of ₹ 7,000/- only.

2. (a) According to Rule 2(1)(c) of the Companies (Acceptance of Deposits) Rules, 2014, the following category of receipt is not considered as deposit:

Any amount received and held pursuant to an offer made in accordance with the provisions of the Companies Act, 2013 towards subscription to any securities, including share application money or advance towards allotment of securities, pending allotment, so long as such amount is appropriated only against the amount due on allotment of the securities applied for;

It is clarified by way of Explanation that if the securities for which application money or advance for such securities was received cannot be allotted within 60 days from the date of receipt of the application money or advance for such securities and such application money or advance is not refunded to the subscribers within 15 days from the date of completion of 60 days, such amount shall be treated as a deposit under these rules.

Further, it is clarified that any adjustment of the amount for any other purpose shall not be treated as refund.

In the given question, Hello Limited has received ₹ 50 Lakh as share application money on 01.06.2023. It failed to allot shares within the prescribed limit. Further, on 30.07.2023 the company adjusted the amount of ₹ 5 Lakh received from Diwas (a customer of the company), by way of book adjustment towards the dues payable by him to the company.

In the light of the facts of the question and provisions of Law:

(1) If such application money or advance is not refunded to the subscribers within 15 days from the date of completion of 60 days, such amount shall be treated as a deposit. In the question, the prescribed limit of 60 days will end on 31.07.2023 and the company has 15 more days to refund such application money to the subscribers. Otherwise, after lapse of such 15 days, the amount not so refunded will be treated as deposit. Hence, the Company Secretary of Hello Limited is not correct in treating the entire amount of ₹ 50 Lakh as 'Deposits' on 31.07.2023.

(2) Any adjustment of the amount for any other purpose shall not be treated as refund. Thus, the amount of ₹ 5 Lakh adjusted against payment due to be received from Diwas, cannot be treated as refund.

(b) According to the provisions of section 138 of the Companies Act, 2013, read with Rule 13 of the Companies (Accounts) Rules, 2014, the following class of companies shall be required to appoint an internal auditor which may be either an individual or a partnership firm or a body corporate, namely:

(1) every listed company;

(2) every unlisted public company having-

(A) paid up share capital of 50 crore rupees or more during the preceding financial year; or

(B) turnover of 200 crore rupees or more during the preceding financial year;

(C) outstanding loans or borrowings from banks or financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or

(D) outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year.

Besides, some private companies are also required to appoint an internal auditor which may be either an individual or a partnership firm or a body corporate.

Thus, *New Limited* (which is a listed company) is required to appoint an internal auditor, irrespective of its paid-up share capital or turnover (as the limit of paid- up share capital or turnover is applicable for unlisted public company).

Hence, the advice of the Company Secretary is not correct.

(c) **(i)** According to section 198 of the Indian Contract Act, 1872, no valid ratification can be made by a person whose knowledge of the facts of the case is materially defective.

In the instant case, Shambhoo has given authority to Naveen to buy certain goods at the market rate. Naveen buys the goods at a higher rate than the market rate. However, Shambhoo accepted the purchase inspite of higher rate. Afterwards, Shambhoo comes to know that the goods belonged to Naveen himself. The ratification is not binding on Shambhoo.

(ii) As per section 194 of the Indian Contract Act, 1872, where an agent, holding an express or implied authority to name another person to act for the principal in the business of the agency, has named another person accordingly, such person shall be an agent of the principal for such part of the business of the agency as is entrusted to him.

In the instant case, Harish, authorizes Arun, a merchant in Mumbai, to recover dues from A & Co. Arun instructs Deepak, a solicitor, to take legal proceedings against A & Co. for recovery of the money.

Here, Deepak, a solicitor, is a substituted agent to act for the principal in the business of the agency, to take legal proceedings for recovering of money.

(d) **(i)** **Alteration of rate of interest specified in the Promissory Note is not a material alteration:** Not valid

Reasoning: An alteration is material which in any way alters the operation of the instrument and affects the liability of parties thereto. Hence, Alteration of rate of interest is material alteration.

(ii) **Conversion of the blank indorsement into an indorsement in full is not a material alteration and it does not require authentication:** Valid

Reasoning: Conversion of a blank indorsement into an indorsement in full [under Section 49 of the Negotiable Instruments Act, 1881] is not a material alteration. It has been authorised by the Act and do not require any authentication.

3. **(a)** As per the provisions of sub-section (1) of section 52 of the Companies Act, 2013, where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to a "securities premium account".

Application of Securities Premium Account: As per the provisions of sub-section (2) of section 52 of the Companies Act, 2013, the securities premium account may be applied by the company—

(a) towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;

(b) in writing off the preliminary expenses of the company;

(c) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;

(d) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or

(e) for the purchase of its own shares or other securities under section 68.

(b) According to section 124 of the Companies Act, 2013:

(1) **Unpaid or Unclaimed Dividend to be transferred to the Unpaid Dividend Account** - Where a dividend has been declared by a company but has not been paid or claimed within thirty (30) days from the date of declaration, the company shall, within seven (7) days from the expiry of the said period of 30 days, transfer the total amount of unpaid or unclaimed dividend to a special account called the Unpaid Dividend Account (UDA). The UDA shall be opened by the company in any scheduled bank.

(2) **Transfer of Unclaimed Amount to Investor Education and Protection Fund (IEPF)** - Any money transferred to the Unpaid Dividend Account which remains unpaid or unclaimed for a period of seven (7) years from the date of such transfer shall be transferred by the company along with interest accrued thereon to the Investor Education and Protection Fund.

(3) **Transfer of Shares to IEPF**- All shares in respect of which dividend has not been paid or claimed for 7 consecutive years or more shall be transferred by the company in the name of Investor Education and Protection Fund along with a statement containing the prescribed details.

(4) **Right of Owner of 'transferred shares' to Reclaim** - Any claimant of shares so transferred to IEPF shall be entitled to reclaim the 'transferred shares' from Investor Education and Protection Fund in accordance with the prescribed procedure and on submission of prescribed documents.

As per the provisions of sub-section (3) of section 125 of the Companies Act, 2013, read with rule 7 of Investor Education and Protection Fund Authority (Accounting, Audit, Transfer and Refund) Rules, 2016, any person, whose unclaimed dividends have been transferred to the Fund, may apply for refund, to the Authority, by submitting an online application.

In the given question, Mr. Ambrish did not claim the payment of dividend on his shares for a period of more than 7 years (i.e. expiry of 30 days from 31.08.2014 to last week of September 2022). As a result, his unclaimed dividend (₹ 2,000) along with such shares (1,000 equity shares) must have been transferred to Investor Education and Protection Fund Account. Therefore, the company is justified in refusing to accept the request of Mr. Ambrish for the payment of dividend of ₹ 2,000 (declared in Annual General Meeting on 31.8.2014).

In terms of the above stated provisions, Mr. Ambrish should be advised as under:

(i) If Mr. Ambrish wants to reclaim the transferred shares, he should apply to IEPF authorities along with the necessary documents in accordance with the prescribed procedure.

(ii) He is also entitled to get refund of the dividend amount, which was transferred to the above fund; in accordance with the prescribed rules.

(c) According to Section 57 of the Negotiable Instruments Act, 1881, the legal representative of a deceased person cannot negotiate by delivery only, a promissory note, bill of exchange or cheque payable to order and indorsed by the deceased but not delivered. An agent can complete the instrument if he is authorized by the principal to do so. But, a legal representative is not an agent of the deceased.

The rights in the instrument are not transferred to the indorsee unless after the indorsement, the same has been delivered. If a person makes the indorsement of instrument but before the same could be delivered to the indorsee, the indorser dies, the legal representatives of the deceased person cannot negotiate the same by mere delivery thereof.

Therefore, a legal representative cannot complete the instrument if the instrument was executed by the deceased but could not be delivered because of his death.

Hence, in the said case, Mr. R, son of Mr. A (the deceased) cannot complete the instrument which was executed by Mr. A but could not be delivered to Mr. B, because of his death.

(d) External aids are the factors that help in interpreting/construing an Act and have been given the convenient nomenclature of 'External Aids to Interpretation'. Apart from the statute itself there are many matters which may be taken into account when the statute is ambiguous. These matters are called external aids.

Dictionary Definitions: Dictionary Definitions is one of the External Aids to interpretation. First, we have to refer to the Act in question to find out if any particular word or expression is defined in it. Where we find that a word is not defined in the Act itself, we may refer to dictionaries to find out the general sense in which that word is commonly understood. However, in selecting one out of the several meanings of a word, we must always take into consideration the context in which it is used in the Act. It is the fundamental rule that the meanings of words and expressions used in an Act must take their colour from the context in which they appear. Further, judicial decisions laying down the meaning of words in construing statutes in '*pari materia*' will have greater weight than the meaning furnished by dictionaries. However, for technical terms reference may be made to technical dictionaries.

4. (a) As per the provisions of sub-section (2) of section 42 of the Companies Act, 2013, private placement shall be made only to a select group of persons who have been identified by the Board (herein referred to as "identified persons"), whose number shall not exceed 50 or such higher number as may be prescribed, in a financial year subject to such conditions as may be prescribed.

It is also provided that any offer or invitation made to qualified institutional buyers, or to employees of the company under a scheme of employees' stock option as per provisions of section 62(1)(b) shall not be considered while calculating the limit of two hundred persons.

According to Rule 14 (2) of the Companies (Prospectus and Allotment of Securities) Rules, 2014, an offer or invitation to subscribe securities under private placement shall not be made to persons more than two hundred in the aggregate in a financial year.

As per Explanation given in this Rule, it is clarified that the restrictions aforesaid would be reckoned individually for each kind of security that is equity share, preference share or debenture.

Referring to the above mentioned provisions of sub-section (2) of section 42 of the Companies Act, 2013 and Rule 14 the Companies (Prospectus and Allotment of Securities) Rules, 2014, we can conclude as follows:

(i) The company is correct in proposing that private placement shall be made only to a select group of identified persons not exceeding 200 in a financial year. This part of the proposal is correct.

The company is also correct in proposing that the aforesaid ceiling of identified persons shall not apply to offer made to the qualified institutional buyers, but the company is not correct in saying that the said ceiling is applicable to employees covered under the Company's Employee Stock Option Scheme. Hence, the second part of the proposal is only partially correct.

(ii) The Companies (Prospectus and Allotment of Securities) Rules, 2014 provides that an offer or invitation to subscribe securities under private placement shall not be made to persons more than 200 in aggregate in a financial year.

Keeping the ceiling of 200 persons in aggregate during a financial year, offer of private placement can be made more than once in a financial year. Therefore, the second statement is not fully correct.

(b) According to Rule 2(1)(e) of the Companies (Acceptance of Deposits) Rules, 2014, an "eligible company" as referred to in section 76(1) of the Companies Act, 2013 means a public company, having a net worth of not less than one hundred crore rupees or a turnover of not less than five hundred crore rupees and which has obtained the prior consent of the company in general meeting by means of a special resolution and also filed the said resolution with the Registrar of Companies before making any invitation to the public for acceptance of deposits.

However, an 'eligible company', which is accepting deposits within the limits specified under section 180 (1) (c), may accept deposits by means of an ordinary resolution.

According to Rule 4 (a) of the Companies (Acceptance of Deposits) Rules, 2014, an 'eligible company' shall accept or renew any deposit from its members, if the amount of such deposit together with the amount of deposits outstanding as on the date of acceptance or renewal of such deposits from members does not exceed ten per cent. of the aggregate of the paid-up share capital, free reserves and securities premium account of the company.

A Limited is having a net worth of ₹ 200 crore. Hence, it falls in the category of 'eligible company'.

The fact that turnover has not been stated in the question will not affect this answer, since fulfilling any one criteria will be sufficient.

Thus, A Limited has to ensure that acceptance of deposits from its members together with the amount of deposits outstanding as on the date of acceptance or renewal of such deposits from the members, in no case, exceeds 10% of the aggregate of the paid-up share capital, free reserves and securities premium account of the company.

(c) **(i)** According to section 10 of the General Clauses Act, 1897, where by any legislation or regulation, any act or proceeding is directed or allowed to be done or taken in any court or office on a certain day or within a prescribed period then, if the Court or office is closed on that day or last day of the prescribed period, the act or proceeding shall be considered as done or taken in due time if it is done or taken on the next day afterwards on which the Court or office is open.

In the given question, the court fixed the date of hearing of dispute between Kiran and Naman, on 29.04.2023, which was subsequently announced to be a holiday.

Applying the above provisions we can conclude that the hearing date of 29.04.2023, shall be extended to the next working day.

(ii) According to section 3(23) of the General Clauses Act, 1897, 'Government' or 'the Government' shall include both the Central Government and State Government.

Hence, wherever, the word 'Government' is used, it will include Central Government and State Government both.

Thus, when the Income Tax Act, 1961, provides that gratuity paid by the government to its employees is fully exempt from tax, the exemption from gratuity income will be available to the State Government employees also.

(d) **Rule of Literal Construction**

Normally, where the words of a statute are in themselves clear and unambiguous, then these words should be construed in their natural and ordinary sense and it is not open to the court to adopt any other hypothetical construction. This is called the rule of literal construction.

This principle is contained in the Latin maxim "*absoluta sententia expositore non indeget*" which literally means "an absolute sentence or preposition needs not an expositor". In other words, plain words require no explanation.

Sometimes, occasions may arise when a choice has to be made between two interpretations – one narrower and the other wider or bolder. In such a situation, if the narrower interpretation would fail to achieve the manifest purpose of the legislation, one should rather adopt the wider one.

When we talk of disclosure of 'the nature of concern or interest, financial or otherwise' of a director or the manager of a company in the subject-matter of a proposed motion (as referred to in section 102 of the Companies Act, 2013), we have to interpret in its broader sense of referring to any concern or interest containing any information and facts that may enable members to understand the meaning, scope and implications of the items of business and to take decisions thereon. What is required is a full and frank disclosure without reservation or suppression, as, for instance where a son or daughter or father or mother or brother or sister is concerned in any contract or matter, the shareholders ought fairly to be informed of it and the material facts disclosed to them. Here a restricted narrow interpretation would defeat the very purpose of the disclosure.

In the given question, Nehul (a director) did not disclose his interest in a matter placed before the Board Meeting (in which his sister has interest), as he is not personally interested or concerned in the proposal.

Here, he ought to have considered broader meaning of the provision of law; and therefore, even though he was personally not interested or concerned in the proposal, he should have disclosed the interest.

5. (a) As per section 67(2) of the Companies Act, 2013, no public company shall give, whether directly or indirectly and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of, or in connection with, a purchase or subscription made or to be made, by any person of or for any shares in the company or in its holding company.

As per the provisions of section 67(3)(c) of the Companies Act, 2013, nothing stated above, shall apply to the giving of loans by a company to persons in the employment of the company other than its directors or key managerial personnel, for an amount not exceeding their salary or wages for a period of six months with a view to enabling them to purchase or subscribe for fully paid-up shares in the company or its holding company to be held by them by way of beneficial ownership.

If we analyse the provisions of section 67(3)(c) of the Companies Act, 2013, we can come to know that the relaxation given here can be availed only when all the following three conditions are fulfilled:

1. The loan has been given to the employees of the company other than its directors or key managerial personnel. Therefore, this condition has been fulfilled;
2. The amount does not exceed their salary or wages for a period of six months- This condition has not been fulfilled.
3. The amount should be utilized by the employee for purchase of fully shares or subscribe for fully paid-up shares in the company or its holding company to be held by them by way of beneficial ownership. Here, Mr. Money is going to purchase the shares in Paper Limited, which is neither his employer company, nor holding company of his employer company and the shares are not fully paid-up. Therefore, this condition has also not been fulfilled.

Therefore, we can conclude that the decision of the Board of Directors of Paper Limited is not valid.

(b) Doctrine of Indoor Management

According to this doctrine, persons dealing with the company cannot be assumed to have knowledge of internal problems of the company. They can simply assume that all the required

things were done properly in the company.

Stakeholders need not enquire whether the necessary meeting was convened and held properly or whether necessary resolution was passed properly. They are entitled to take it for granted that the company had gone through all these proceedings in a regular manner.

The doctrine helps protect external members from the company and states that the people are entitled to presume that internal proceedings are as per documents submitted with the Registrar of Companies.

The doctrine of indoor management was evolved around 150 years ago in the context of the doctrine of constructive notice. The role of doctrine of indoor management is opposed to of the role of doctrine of constructive notice. Whereas the doctrine of constructive notice protects a company against outsiders, the doctrine of indoor management protects outsiders against the actions of a company. This doctrine also is a possible safeguard against the possibility of abusing the doctrine of constructive notice.

Basis for Doctrine of Indoor Management

1. What happens internal to a company is not a matter of public knowledge. An outsider can only presume the intentions of a company, but not know the information he/she is not privy to.
2. If not for the doctrine, the company could escape creditors by denying the authority of officials to act on its behalf.

Exceptions to Doctrine of Indoor Management (Applicability of doctrine of constructive notice)

Knowledge of irregularity: In case this 'outsider' has actual knowledge of irregularity within the company, the benefit under the rule of indoor management would no longer be available. In fact, he/she may well be considered part of the irregularity.

Negligence: If, with a minimum of effort, the irregularities within a company could be discovered, the benefit of the rule of indoor management would not apply. The protection of the rule is also not available in the circumstances where company does not make proper inquiry.

Forgery: The rule does not apply where a person relies upon a document that turns out to be forged since nothing can validate forgery. A company can never be held bound for forgeries committed by its officers.

The above doctrines have been well considered while framing the provisions of various Acts pertaining to the companies worldwide. The Companies Act, 2013 and the earlier Acts relevant for the Companies in India are no exception to the same.

(c) Contract of guarantee: As per the provisions of section 126 of the Indian Contract Act, 1872, a contract of guarantee is a contract to perform the promise made or discharge the liability, of a third person in case of his default.

Three parties are involved in a contract of guarantee:

Surety- person who gives the guarantee,

Principal debtor- person in respect of whose default the guarantee is given,

Creditor- person to whom the guarantee is given.

(d) Good Faith

In general, anything done with due care and attention, which is not malafide is presumed to have been done in good faith.

But, according to 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.

It is therefore understood that the General Clauses Act, 1897 considers the honesty in doing the act as a primary test to constitute the thing done in good faith and therefore the act done honestly but with negligence may also be termed as done in good faith as per the General Clauses Act, 1897.

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.