Test Series: April, 2021

MOCK TEST PAPER 2

FINAL (OLD) GROUP – I

PAPER 4: CORPORATE AND ALLIED LAWS

SUGGESTED ANSWER

MCQs Answers

1. (d)

2. (d)

3. (c)

4. (a)

5. (c)

6. (a)

7. (a)

8. (d)

9. (d)

10. (d)

11. (c)

12. (b)

13. (c)

14. (d)

15. (d)

16. (d)

17. (d)

18. (d)

19. (c)

20. (a)

Descriptive Answers

1. (A) As per the section 164 (2) of the Companies Act, 2013, no person who is or has been a director of a company which—

(a) has not filed financial statements or annual returns for any continuous period of three financial years; or

(b) has failed to repay the deposits accepted by it or pay interest thereon or to redeem any debentures on the due date or pay interest due thereon or pay any dividend declared and such failure to pay or redeem continues for one year or more,

-shall be eligible to be re-appointed as a director of that company or appointed in other company for a period of five years from the date on which the said company fails to do so.

Provided that where a person is appointed as a director of a company which is in default of clause (a) or clause (b), he shall not incur the disqualification for a period of six months from the date of his appointment.

Further section 167 (1) of the Companies Act, 2013 states that the office of a director shall become vacant in case he incurs any of the disqualifications specified in section 164. Provided that where he incurs disqualification under sub-section (2) of section 164, the office of the director shall become vacant in all the companies, other than the company which is in default.

Accordingly following are the answers to the questions:

(a) In the given case, the petitioners have incurred disqualification under sub-section (2) of section 164, and falling under section 167, whereby the office of the directors shall become vacant in all the companies, except in the defaulted company. The petitioners, being disqualified under section 164(2) have to vacate the directorship in all the other companies except in NPP Ltd.

(b) On the basis of the section 167(1), Mr. X has to vacate directorship in GPS Ltd. and CDM Ltd.

(c) Offer of directorship to Mr. Z by RSM Ltd. was within a year of commission of default, so it's not valid. As per section 164(2), disqualified director shall not be eligible to be appointed in other company for a period of five years from the date on which the said company committed the default.

(d) Petitioner, Mr. Y was appointed one month before in NPP Ltd. which is in default, he shall not incur the disqualification for a period of six months from the date of his appointment as he is freshly appointed.

(B) As per section 188 (3) of the Companies Act, 2013, where any contract or arrangement is entered into by a director or any other employee, without obtaining the consent of the Board or approval by a resolution in the general meeting and if it is not ratified by the Board or, as the case may be, by the shareholders at a meeting within three months from the date on which such contract or arrangement was entered into, such contract or arrangement shall be voidable at the option of the Board or, as the case may be, of the shareholders and if the contract or arrangement is with a related party to any director, or is authorised by any other director, the directors concerned shall indemnify the company against any loss incurred by it.

In the given case, Mr. Rajat, a Manging director, was authorised by Mr. Giri, the director in the Board of the XYZ Ltd., to enter into contract with Mr. Kushal, a brother in law of Mr. Giri for supply of furniture's during the setup of new branch in the city. Mr. Rajat enquires with Mr. Giri for seeking approval of the Board as per the requirement of the law and Mr. Giri stated that there is no need for such approval however we may get it ratified by the Board in the meeting.

As per the requirement of the provision in the given case, contract entered into by a Mr. Rajat, on being authorised by Mr. Giri with Mr. Kushal, who is his relative without obtaining the consent of the Board, and is required to be ratified by the Board within the prescribed three months from the date on which such contract was entered into.

(i) Therefore, the said contract entered by the Mr. Rajat with Mr. Kushal for supply of furniture's for setup of new office can be said to valid if same has been ratified by the Board within the 3 months from the date on which such contract made.

(ii) In case of non-compliance of the above requirements, such a contract shall be voidable at the option of the Board and if the contract is with a related party to any director, or is authorised by any other director, the directors concerned shall indemnify the company against any loss incurred by it.

It shall be open to the company to proceed against a director concerned (i.e., against Mr. Giri and Mr. Rajat) who had entered into such contract in contravention of the provisions of this section for recovery of any loss sustained by it as a result of such contract.

Such concerned directors of a company, who had entered into or authorised the contract or arrangement in violation of the provisions of this section shall be liable to a penalty of twenty-five lakh rupees as XYZ Ltd., is a listed company.

2. (A) Mr. B has filed a complaint before the Tribunal on the grounds of oppression and mismanagement of the Company on the following issues:

(i) Running of Company continuously in losses:

As regards obtaining relief from Tribunal, continuous losses cannot, by itself, be regarded as oppression (Ashok Betelnut Co. P. Ltd. vs. M.K. Chandrakanth).

(ii) Non declaration of dividend:

Failure to declare dividends or payment of low dividends also does not amount to oppression. (Thomas Veddon V.J. (v) Kuttanad Robber Co. Ltd).

(iii) Managing the affairs of the Company by a director who has not been formally appointed as a Managing Director:

Where a person without being so appointed, was acting as a Managing Director and was discharging his functions as such, whether with or without the knowledge of the members, a member cannot claim that it was an act of oppression, by filing an application with the Tribunal.

(iv) Payment of Compensation by way of Salary

Mr. B has filed a complaint soliciting the direction for payment of compensation by way of salary to him as like other directors and such other directions as may be deemed suitable by the Tribunal to remove oppression and mismanagement of the Company. But as per decided case laws, shareholders can share the dividend of the Company, if it is declared but cannot seek directions to be compensated. The payment of salary is a question that concerns the Board of Directors and not the Tribunal.

Hence, Mr. B neither may succeed in getting any relief from Tribunal nor get any compensation by way of salary.

(B) Provisions of the Competition Act, 2002 relating to Combination

As per Section 5 of the Competition Act, 2002 (the Act), the acquisition of one or more enterprises by one or more persons or merger or amalgamation of enterprises shall be a combination of such enterprises and persons or enterprises, if any acquisition where the parties to the acquisition, being the acquirer and the enterprise whose control, shares, voting rights or assets have been acquired or being acquired jointly have, in India, the assets of the value of Rs.2000 crore or turnover more than Rs. 6000 crore respectively (limits as enhanced by the Central Government vide Notification No. S.O.675 E dated march 4, 2016).

As per Section 6 of the Act, no person or enterprise shall enter into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and such a combination shall be void.

However, Vide Notification S.O. 2828(E) dated 30th August, 2017, in exercise of the powers conferred by clause (a) of Section 54 of the Competition Act, 2002 , the Central Government in the public interest hereby exempts, all cases of reconstitution, transfer of the whole or any part thereof and amalgamation of nationalized banks, under the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 and the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980, from the application of provisions of Sections 5 and 6 of the Competition Act, 2002 for a period of ten years from the date of publication of this notification in the Official Gazette.

Hence, in the instant case, the merger of some of the nationalized banks into other nationalized banks shall not constitute 'combination' and it shall not be void.

3. (A) Approval of the Regulatory Body in case a Company is regulated under a Special Act:

Prathmikhta Life Insurance Ltd. is a company regulated under a Special Act, the Insurance Act, 1938. It shall obtain approval of the regulatory body, "Insurance Regulatory and Development Authority" (IRDA) constituted or established under that Act and such approval shall be enclosed with the application.

Here in the given case, no approval of the regulatory body i.e., IRDA was obtained, and therefore, the rejection of application of Prathmikhta Life Insurance Limited, is valid.

Procedure for removal of name of the company

As per Section 248(2) of the Companies Act, 2013, a Company (Prathmikhta Life Insurance Ltd.) may, after extinguishing all its liabilities, by a special resolution, or consent of seventy-five per cent of members in terms of paid-up share capital, file an application to the Registrar for removing the name of the Company from the Register of Companies on the ground that the said Company has failed to commence its business within one year of its incorporation (i.e. from 1/4/2020 till 1/4/2021) and the Registrar shall, on receipt of such application, cause a public notice to be issued.

A notice issued shall be published in the prescribed manner and also in the Official Gazette for the information of the general public.

At the expiry of the time mentioned in the notice, the Registrar may, unless contrary is shown by the Company, strike off its name from the Register of Companies, and shall publish notice thereof in the Official Gazette, and on the publication in the Official Gazette of this notice, the Company shall stand dissolved.

Prathmikhta Life Insurance Limited with approval of the IRDA, shall re-submit the application in compliance with stated procedure and can get its name struck off from Register of Companies and get it dissolved without taking recourse to the regular winding up procedure under the Companies Act, 2013.

(B) Right to lodge a caveat (Section 18C of the SARFAESI Act, 2002)

As per section 18C of the SARFAESI Act,2002 where an application or an appeal is expected to be made or has been made under section 17(1) or section 17A or section 18(1) or section 18B, any person claiming a right to appear before the Tribunal or the Court of District Judge or the Appellate Tribunal or the High Court, as the case may be, on the hearing of such application or appeal, may lodge a caveat in respect thereof.

Where a caveat has been lodged, such caveat shall not remain in force after the expiry of the period of ninety days from the date on which it was lodged unless the application or appeal has been made before the expiry of the period.

Here in the given problem, caveat was lodged on 1st January 2021 by Mr. X and an appeal was filed before the appellate Tribunal by Mr. Raman on 15th March, 2021. As per the stated provision caveat shall remain in force for the period of ninety days from the date on which it was lodged. Therefore, the validity period of the enforcement of the caveat in the given case was till 1st of April, 2021 and since the appeal was filed before 1st April, 2021, so the said caveat holds to be good entitling Mr. X to appear on the hearing of an appeal filed by Mr. Raman.

4. (A) (i) In the given case, both the X Inc Ltd. and Y Infrastructure Ltd. in the eyes of law are separate entity. Further section 14 of the IBC, which deals with moratorium, nowhere prohibits initiation of corporate insolvency resolution process on the subsidiary company or its holding company. Further also that a separate CIRP has been initiated against another corporate debtor by another financial creditor, which is altogether separate and have no connection with the CIRP initiated against X Inc Ltd or Y Infrastructure Ltd.

Therefore, in the given case, corporate insolvency resolution process initiated against the X Inc Ltd, which is a holding company, cannot bar the corporate insolvency resolution process initiated against the Y Infrastructure Ltd which is its subsidiary or vice versa.

(ii) **Appointment of IRP:** As per Section16 of the Code where the application for corporate insolvency resolution process is made by an operational creditor and no proposal for an interim resolution professional is made in the said application, the Adjudicating Authority shall make a reference to the Board (IBBI) for the recommendation of an insolvency professional who may act as an interim resolution professional.

The Board (IBBI) shall recommend the name of an insolvency resolution professional to the Adjudicating Authority against whom no disciplinary proceedings are pending, within ten days of the receipt of a reference from the Adjudicating Authority.

Period of appointment of IRP: The term of the Interim Resolution Professional shall continue from his appointment till the date of appointment of the resolution professional by CoC in its first meeting under Section 22 of the Code.

(B) (i) An Indian resident imports machinery from a vendor in UK for installing in his factory. As per FEMA, it does not alter (create) an asset in India for the UK vendor. It does not create any liability to a UK vendor for the Indian importer. Once the payment is made, the Indian resident or the UK vendor neither owns nor owes anything in the other country. Hence it is a Current Account Transaction.

(ii) An Indian resident transfers US$ 1,000 to his NRI brother in New York as “gift”. The funds are sent from resident’s Indian bank account to the NRI brother’s bank account in New York. As per FEMA, once the gift is accepted by the NRI, no one owns or owes anything to anyone in India or USA, the transaction is over. Hence it is a Current Account Transaction.

5. (A) As per Section 379 of the Companies Act, 2013 where not less than fifty per cent of the paid-up share capital, whether equity or preference or partly equity and partly preference, of a foreign company is held by one or more citizens of India or by one or more companies or bodies corporate incorporated in India, or by one or more citizens of India and one or more companies or bodies corporate incorporated in India, whether singly or in the aggregate, such company shall comply with the provisions of this Chapter and such other provisions of this Act as may be prescribed with

regard to the business carried on by it in India as if it were a company incorporated in India.

As per section 393 of the Act, any failure by a company to comply with the provisions of Chapter XXII of the Act shall not affect the validity of any contract, dealing or transaction entered into by the company or its liability to be sued in respect thereof, but the company shall not be entitled to bring any suit, claim any set-off, make any counter-claim or institute any legal proceeding in respect of any such contract, dealing or transaction, until the company has complied with the provisions of this Act applicable to it.

Chapter XXII of the Act comprises of Section 379 to 393.

In the above question, the provisions of the Companies Act, 2013 are applicable on Z Limited because an aggregate of 55% of the paid-up share capital of the company are held by an Indian citizen and Indian company. However, there has been non-compliance of section 380 of the Act by Z Limited.

Therefore, Provisions of the Companies Act, 2013 apply on the company. Since there has been violation of section 380 of the Act, and as per section 39, the validity of any contract entered into by the foreign company shall not be affected, the company may be sued in respect of such contract but shall not be entitled to bring any suit in respect of such contract until it has complied with the relevant provisions related to the companies incorporated outside India under the Companies Act.

(B) **(a)** As per Section 5(4) of the Prevention of Money Laundering Act, 2002, nothing in this section shall prevent the person interested in the enjoyment of the immovable property attached under Section 5(1) from such enjoyment.

"Person interested", in relation to any immovable property, includes all persons claiming or entitled to claim any interest in the property.

Accordingly, an order of attachment under money laundering Act is not said to be illegal merely because a person interested (i.e., third party) had a prior interest in such property and further issuance of an order of attachment under PML Act cannot, by itself, render illegal the prior statutory right of a person interested in attached property.

Therefore, interest created in a property prior to attachment of property, takes priority over attachment.

(b) According to Section 5 of the Prevention of Money Laundering Act, 2002, where the Director or any other officer for the purposes of this section, has reason to believe, on the basis of material in his possession, that—

(i) any person is in possession of any proceeds of crime; and

(ii) such proceeds of crime are likely to be concealed, transferred or dealt with in any manner which may result in frustrating any proceedings relating to confiscation of such proceeds of crime under this Chapter,

he may, by order in writing, provisionally attach such property for a period not exceeding one hundred and eighty days from the date of the order, in such manner as may be prescribed.

Hence, it is necessary that the attached property should qualify as 'proceeds of crime'.

However, mere nexus between the attached property whether it qualify as a proceeds of crime/ not, the party accused of money laundering, is sufficient for the attachment of such property to take place.

6. (A) (i) As per Section 152(6) of the Companies Act, 2013, unless the articles provide for the retirement of all directors at every annual general meeting, not less than two-thirds of the total number of directors of a public company shall be persons whose period of office is liable to determination by retirement of directors by rotation; and save as otherwise expressly provided in this Act, be appointed by the company in general meeting.

The remaining directors in the case of any such company shall, in default of, and subject to any regulations in the articles of the company, also be appointed by the company in general meeting.

Explanation— For the purposes of this sub-section, "total number of directors" shall not include independent directors, whether appointed under this Act or any other law for the time being in force, on the Board of a company.

Any person appointed as a nominee director being nominated by any institution in pursuance of the provisions of any law or any agreement (financial institution that has been created by the Act of Parliament) cannot be considered as a director liable to retire by rotation.

In the above question, **Total number of Directors** = 20 – 6 (Independent Directors) – 3 (Nominee Directors appointed by State Bank of India) = 11

The nominee directors appointed by Finance Limited to represent its interest (a financial institution with whom the company has long-term lease agreement of land) are not deducted from total number of directors because Finance Limited is not the financial institution set up under the Act of Parliament.

Total number of directors who are rotational directors = 11*2/3 = 7.33= 8 (not less than 2/3rd)

Total number of directors who are liable to retire by rotation = 8*1/3 = 2.6=3 (nearest to 1/3rd)

Therefore, the total number of directors who are rotational directors and total number of directors who are liable to retire by rotation are 8 and 3 respectively.

(ii) (a) As per the given facts, KM Limited have a net profit of Rs.50 crore for the financial year 2019-2020. The Board of Directors proposed a dividend @ 10% to the equity shareholders. However, it has not transferred any amount to the reserves of the Company for the financial year 2019-2020.

Dividend declaration without transfer to reserves: As per the First Proviso to Section 123 (1)(b) of the Companies Act, 2013, a Company may, before the declaration of any dividend in any financial year, transfer such percentage of profits for that financial year as it may consider appropriate to the reserves of the Company. Such transfer is not mandatory and the percentage to be transferred to reserves is to be decided at the discretion of the Company.

In the light of the above, KM Limited can declare dividend even without transfer of any amount to reserves.

(b) Declaration of dividend by section 8 company: According to Section 8 (1) of the Companies Act, 2013 a Company having a licence under Section 8 ('Formation of Companies with Charitable Objects', etc.,) is prohibited from paying any dividend to its members. Their profits are intended to be applied only in promoting the objects of the Company.

Therefore, KA Limited cannot declare dividend to its equity shareholders @ 9%.

(B) Section 44 of the Prevention of Money Laundering Act, 2002, states that an offence punishable under section 4 and any scheduled offence connected to the offence under that section shall be triable by the Special Court constituted for the area in which the offence has been committed.

A Special Court while trying the scheduled offence or the offence of money-laundering shall hold trial in accordance with the provisions of the Code of Criminal Procedure, 1973, as it applies to a trial before a Court of Session.

Further , as per clause (c) of section 44 of the PMLA, if the court which has taken cognizance of the scheduled offence is other than the Special Court which has taken cognizance of the complaint of the offence of money-laundering , it shall, on an application by the authority authorised to file a complaint under this Act, commit the case relating to the scheduled offence to the Special Court and the Special Court shall, on receipt of such case proceed to deal with it from the stage at which it is committed.

(C) The rules regarding interpretation of deeds and documents are as follows:

(1) One has to find out what reasonable man, who has taken care to inform himself of the surrounding circumstances of a deed or a document, and of its scope and intendments, would understand by the words used in that deed or document.

(2) It is inexpedient to construe the terms of one deed by reference to the terms of another. Further, it is well established that the same word cannot have two different meanings in the same documents.

(3) The Golden Rule is to ascertain the intention of the parties of the instrument after considering all the words in the documents/deed concerned in their ordinary, natural sense.

(4) The circumstances in which the particular words have been used have also to be taken into account.

(5) It has also to be considered that very many words are used in more than one sense. It may happen that the same word understood in one sense only will give effect to all the clauses in the deed.

(6) It may also happen that there is a conflict between two or more clauses of the same documents. An effect must be made to resolve the conflict by interpreting the clauses so that all the clauses are given effect.