Paper-13: CORPORATE LAWS AND COMPLIANCE

	Learning objectives	Verbs used	Definition
LEVEL C	KNOWLEDGE What you are expected to know	List	Make a list of
		State	Express, fully or clearly, the details/facts
		Define	Give the exact meaning of
	COMPREHENSION What you are expected to understand	Describe	Communicate the key features of
		Distinguish	Highlight the differences between
		Explain	Make clear or intelligible/ state the meaning or purpose of
		Identity	Recognize, establish or select after consideration
		Illustrate	Use an example to describe or explain something
	APPLICATION How you are expected to apply your knowledge	Apply	Put to practical use
		Calculate	Ascertain or reckon mathematically
		Demonstrate	Prove with certainty or exhibit by practical means
		Prepare	Make or get ready for use
		Reconcile	Make or prove consistent/ compatible
		Solve	Find an answer to
		Tabulate	Arrange in a table
	ANALYSIS How you are expected to analyse the detail of what you have learned	Analyse	Examine in detail the structure of
		Categorise	Place into a defined class or division
		Compare and contrast	Show the similarities and/or differences between
		Construct	Build up or compile
		Prioritise	Place in order of priority or sequence for action
		Produce	Create or bring into existence
	SYNTHESIS How you are expected to utilize the information gathered to reach an optimum conclusion by a process of reasoning	Discuss	Examine in detail by argument
		Interpret	Translate into intelligible or familiar terms
		Decide	To solve or conclude
	EVALUATION How you are expected to use your learning to evaluate, make decisions or recommendations	Advise	Counsel, inform or notify
		Evaluate	Appraise or asses the value of
		Recommend	Propose a course of action

Paper-13: CORPORATE LAWS AND COMPLIANCE

Full Marks: 100 **Time Allowed: 3 Hours**

This paper contains 3 questions. All questions are compulsory, subject to instructions provided against each question. All workings must form part of your answer. Assumptions, if any, must be clearly indicated.

Question 1: Answer all questions **[20 Marks]**

(i) Asha Pvt Ltd Co is having only 5 members. All the members of the company were travelling by car to go to a business meeting. An accident took place and all of them died on the spot. Answer with reasons with reference to Companies Act, 2013 whether the existence of Asha Ltd. has also come to an end. [3]

(ii) Virat Ltd. wants to be a small company. What are the conditions that need to be satisfied? [3]

(iii) When can dividend be held in abeyance? [3]

(iv) Mr. Angad, a former bank executive, was convicted by a court eight years ago for embezzlement of funds and was sentenced to imprisonment for one year. Can Mr. Angad become the director of Sushma Jewelers Ltd., a public company? [3]

(v) Mr. Sundeep, a director states that he will not be able to attend the next Board meeting. Advise whether notice is required to be sent to him. [3]

(vi) Write a note on Smith Report (2003). [3]

(vii) State the elements of Ethics. [2]

Answer

(i) The existence of the company does not come to an end, since the existence of the Company does not depend upon the life of any or all the members of the company. **[Sec 9 of Companies Act, 2013].** The existence of a company can only come to an end only in accordance with the provisions of law, viz. dissolution of the company.
Since one of the characteristics of a company is 'perpetual succession', the existence of the company does not come to an end with the death of the members of Asha Ltd.

(ii) As per **Sec 2(85) of Companies Act, 2013** a company shall be a small company only if it satisfies any one or both of the following conditions:

1. Its paid up share capital does not exceed –
   → ₹ 50 lakhs; or
   → Such higher amount as may be prescribed (not being more than ₹ 5 crores)
2. Its turnover (as per the last profit and loss account)does not exceed –
   → ₹ 2 crores; or
   → Such higher amount as may be prescribed (not being more than ₹ 20 crores)

A company shall not be a small company, if, it is a –

1. Public company; or
2. Holding Company of any company; or
3. Subsidiary company of any company; or
4. Company registered u/s 8 (viz. a non-profit company); or
5. Company or a body corporate governed by any special act.

Hence Virat ltd. cannot be a small company.

(iii) The object of **section 126 of Companies Act, 2013** is to ensure that pending the transfer of shares by the company, the right of the transferee to receive dividend, right shares and bonus shares remains intact. The provisions of Section 126 are as follows-

1. Where a duly signed transfer deed is deposited with the company, but the transfer of shares has not yet been registered, the company shall-
   → Transfer the dividend in relation to such shares to the Unpaid Dividend Account, unless the registered shareholder authorizes the company to pay such dividend to the transferee.
   → Keep in abeyance in relation to such shares any offer of rights shares or bonus shares.
2. Section 126 shall apply not withstanding anything contained in any other provision of the Act.

(iv) A person is disqualified if he is convicted by a Court of any offence (whether involving moral turpitude or otherwise) and sentenced to imprisonment for 6 months or more. However, such disqualification shall remain in force for a period of 5 years only. **[Section 164(1)(d) of Companies Act, 2013]**

In the present case Mr. Angad was convicted 8 years ago. Since the requirement of 164(1)(d) of Companies Act, 2013 are not satisfied, he is, at present, eligible to become a director of Sushma Jewelers Ltd.

(v) As per **section 173(3) of Companies Act, 2013,** a meeting of the Board shall be called by giving not less than 7 days' notice in writing to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means.

Notice is to be sent to a director even if he waives his right to receive the notice [Re. Portuguese Consolidated Copper Mines Ltd. (1889) 42 Ch D 160(CA)]. Thus, the notice of Board meeting must be sent to Mr. Sundeep.

(vi) The Smith Review of Audit Committees, a group appointed by the financial reporting council, reported in January 2003. The review made clear the important role of the audit committee: 'While all directors have a duty to act in the interests of the company, the audit committee has a particular role, acting independently from the executive, to ensure that the interests of shareholders are properly protected in relation to financial reporting and internal control'. The review defined the audit committee's role in terms of a high-level overview-it needs to satisfy itself that there is an appropriate system of controls in place but it does not undertake the monitoring itself .

(vii) Ethics fundamentally comprises of two elements:

- → Firstly, ethics refers to well founded standards of right and wrong that describe what humans ought to do in terms of rights, obligations, benefits to society, etc.
- → Secondly, ethics refers to the study and development of one's ethical standards.

Question 2: Answer any four questions **[60 Marks]**

Question 2(a)

(i) The paid up share capital of Vishnu Private Ltd. is ₹ one crore consisting of 8,00,000 equity shares of ₹ 10 each fully paid up and 2,00,000 cumulative preference shares of ₹ 10 each fully paid up. Priya Pvt. Ltd. and Radha Pvt. Ltd. are holding 3,00,000 equity shares and 1,50,000 equity shares respectively in Vishnu Private Ltd. Priya Pvt. Ltd. and Radha Pvt. Ltd. are the subsidiaries of Parvati Estates Pvt. Ltd. Examine with reference to the provisions of the Companies Act, 2013 whether Vishnu Private Ltd. is a subsidiary of Parvati Estates Pvt. Ltd. Will your answer be different, if Parvati Estates Pvt. Ltd. controls the composition of Board of Directors of Vishnu Private Ltd.?

(ii) Ms. Preeti the secretary of Strong Limited issues a Share certificate in favour of Mr. Akshaye purporting to be signed by the directors and the secretary and the seal of the company affixed to it. In fact the secretary forged the signature of the directors and has affixed the seal without authority. Can Mr. Akshaye hold the company liable for the shares covered by the Share certificate?

(iii) With a view to issue shares to the general public a prospectus containing some false information was issued by a company. Mr. Javed received a copy of the prospectus from the company, but did not apply for allotment of any shares. The allotment of shares to the general public was completed by the company within the stipulated period. A few months later, Mr. Javed bought 2000 shares through the stock exchange at a higher price which later on fell sharply. Javed sold these shares at a heavy loss. Mr. Javed claims damages from the company for the loss suffered on the ground that the prospectus issued by the company contained a false statement. Referring to the provisions of the Companies Act, 2013 examine whether Javed's claim for damages is justified.

(iv) The Board of directors of a company decides to pay 5% of issue price as underwriting commission to the underwriters. On the other hand the articles of association of the company permit only 3% commissions. The Board of directors further decides to pay the

commission out of the proceeds of the share capital. Are the decisions taken by the Board of directors valid under the Companies Act, 2013?

(v) Define "Sweat Equity Shares" as per Companies Act, 2013.

[5+2+2+4+2= 15]

Answer

(i) Total Equity Share Capital of Vishnu Pvt. Ltd. is ₹ 80,00,000.

Equity Share Capital held by Priya Pvt. Ltd. in Vishnu Pvt. Ltd. is ₹ 30,00,000.

Equity Share Capital held by Radha Pvt. Ltd. in Vishnu Pvt. Ltd. is ₹ 15,00,000.

Equity Share Capital held by Parvati Estates Pvt. Ltd. in Vishnu Pvt. Ltd. is ₹45,00,000.
Since for the purpose of determining holding-subsidiary relationship, Equity Share Capital held in Vishnu (Private) Ltd. by its Subsidiaries Priya Pvt. Ltd. (viz. ₹ 30,00,000) and Radha Pvt. Ltd. (viz. ₹ 15,00,000) shall be considered.

Vishnu Pvt. Ltd. is a subsidiary of Parvati Estates Pvt. Ltd. Since Parvati Estates Pvt. Ltd. holds more than one-half of ESC of Vishnu Pvt. Ltd.

Answer would remain same even if Parvati Estates Pvt. Ltd. controls the composition of Board of Directors of Vishnu Pvt. Ltd.

(ii) Mr. Akshaye is not entitled to shares and he cannot hold the company liable for any loss

Since in case of forgery, there is not a defect in consent, but absence of consent and therefore the share certificate issued by way of forgery is invalid. **[Rubben v Great Fingall Consolidated Company]**

(iii) Mr. Javed is not an original allottee of shares **[Sec 35 of Companies Act, 2013]**
→ Since he purchased the shares from the market, and not from the company.

Mr. Javed cannot claim damages from the company
→ Since Mr. Javed is not an original allottee of shares;
→ Since Mr. Javed did not subscribe for shares on the faith of a misleading prospectus **[Peek v Gurney]**

(iv) The company cannot pay underwriting commission of 5%
→ since the rate of underwriting commission cannot be more than 5% of issue price of shares or such lower rate as prescribed under the articles (3% in the present case);
→ since the maximum permissible underwriting commission in this case is 3%.

The company may pay underwriting commission out of the proceeds of the share capital

→ Since Rule 13 of the **Companies (Prospectus and Allotment of Securities) Rules, 2014** expressly permits payment of underwriting commission out of the proceeds of the issue, i.e. out of the proceeds of share capital.)

(v) As per **section 2(88) of Companies Act, 2013**, 'Sweat equity shares' means such equity shares as are issued by a company to its directors or employees –
(a) At a discount; or
(b) For consideration, other than cash,

For providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

Question 2(b)

(i) Srishti Ltd. is authorised by its articles to accept the whole or any part of the amount of remaining unpaid calls from any member although no part of that amount has been called up. 'Arjun', a shareholder of the Srishti Ltd., deposits in advance the remaining amount due on his shares without any calls made by Srishti Ltd.
Referring to the provisions of the Companies Act, 2013 state the rights and liabilities of Mr. Arjun, which will arise on the payment of calls made in advance.

(ii) Mr. 'Vasu', the transferee, acquired 250 equity shares of BHARAT Limited from Mr. 'Sneh', the transferor. But the signature of Mr. 'Sneh', the transferor, on the transfer deed was forged. Mr. 'Vasu' after getting the shares registered by the company is his name, sold 150 equity shares to Mr. 'Anil' on the basis of the share certificate issued by BHARAT Limited. Mr. 'Vasu' and 'Anil' were not aware of the forgery. State the rights of Mr. 'Sneh', 'Vasu', and 'Anil' against the company with reference to the aforesaid shares.

(iii) Rahul had applied for the allotment of 1,000 shares in a company. No allotment of shares was made to him by the company. Later on, without any further application from Rahul, the company transferred 1,000 partly-paid shares to him and placed his name in the Register of Members. Rahul, knowing that his name was placed in the Register of Members, took no steps to get his name removed from the Register of Members. The company later on made final call. Rahul refuses to pay for this call. Referring to the provisions of the Companies Act, 2013 examine whether his (Rahul's) refusal to pay for the call is tenable and whether he can escape himself from the liability as a member of the company.

[6+5+4 = 15]

Answer

(i) Acceptance of calls in advance by Srishti Ltd. is valid ***(Sec.* 50 of the Companies Act, 2013)**
→ Since Srishti Ltd. has express provision in the articles authorising it to accept calls in advance;
→ Since the power to receive calls in advance has been exercised for the benefit of the company.

Rights and liabilities of Arjun:

→ Arjun shall not be entitled to any voting rights in respect of 'calls in advance' until the call becomes presently payable (Sec. 50 of the Companies Act, 2013).
→ The dividend is paid on the nominal value of a share. However, Srishti Ltd. shall pay dividend in proportion to the paid up capital held by each member, if the articles so provide (Sec. 51 of the Companies Act, 2013).
→ Interest on calls in advance shall be paid to Arjun at such rate *as* may be specified in the articles.
→ Arjun becomes *an* unsecured creditor of the company.
→ The amount paid as calls in advance is non-refundable.
→ The liability of Arjun to pay the future calls is extinguished to the extent of calls paid in advance by him.
→ In case of surplus in winding up, *before* repayment of capital to the members, the amount paid *as* calls in advance along with interest shall be repaid to Arjun.

(ii) Rights of Mr. 'Sneh'
He can compel the company to restore his name on the register of members (since a forged transfer is without any legal effect and the true owner continues to be the member of the company).

Liabilities of Mr. 'Vasu'
'Vasu' is liable to compensate the loss caused to the company since he had lodged the forged transfer deed, even though he was not aware of the forgery.

Rights of Mr. 'Anil'
→ The company can refuse to register Mr. 'Anil' as a member.
→ The company is liable to Mr. 'Anil' since the company had issued share certificate to Mr. 'Vasu', and therefore, the company shall be stopped from denying the liability accruing to it from its own default.

(iii) Register of members is a prima-facie evidence of any matters directed or authorised to be inserted therein by the Act **[Sec. 95 of Companies Act, 2013]**.

Rahul is a member by estoppels
→ Since he knowingly permitted entering his name in the register of members.

Rahul is liable to pay the final call
→ Since a member by estoppel is liable to pay the unpaid calls.

<u>**Question 2(c)**</u>

(i) The Board of Directors of Sreeja Company Limited at its meeting declared a dividend on its on its paid-up equity share capital which was later on approved by the company's Annual General meeting. In the meantime the directors at another meeting of the Board decided by passing a resolution to divert the total dividend to be paid to shareholders for purchase of

investments for the company. As a result dividend was paid to shareholders after 45 days. Examining the provisions of the Companies Act, 2013, state:

1. **Whether the act of directors is in violation of the provisions of the act and also the consequences that shall follow for the above act of directors?**
2. **What would be your answer in case the amount of dividend to a shareholder is adjusted by the company against certain dues to the company from the shareholder?**

(ii) Mr. Prem recently acquired 76% of the equity shares of M/s Good-day Company Ltd. in the hope of earning good dividend income. Unfortunately the existing Board of Directors has been avoiding declaration of dividend due to alleged inadequacy of profits. Unconvinced, Mr. Prem seeks permission of the company to allow him to examine the Books of Accounts, which is summarily rejected by the Company. Examine and advise the provisions relating to inspection of Books of Accounts and remedy available under Companies Act, 2013.

(iii) Mr. Ashu was appointed as managing director for life by the articles of association of a private company incorporated on June, 2014. The articles also empowered Mr. Ashu to appoint a successor. Mr. Ashu appointed, by will, Mr. Jay to succeed him after his death. Can Mr. Jay succeed Mr. Ashu as managing director after the death of 'X? Analyze with reference to Companies Act, 2013.

[5+6+4 = 15]

<u>**Answer**</u>

(i) As per **section 127 of the Companies Act, 2013**, the dividend shall be paid within 30 days from the date of declaration of dividend. In case, the dividend warrant is posted by the company within 30 days of declaration of dividend, it is considered to be a sufficient compliance of section 127 of the Companies Act, 2013.

1. In the present case, Sreeja Company Limited has failed to pay the dividend within 30 days of declaration of dividend, and so, this amounts to violation of section 127 of the Companies Act, 2013, attracting the penal provisions of section 127 of the Companies Act, 2013, stated as under:
   (a) Sreeja Company Limited is liable to pay simple interest @ 18% per annum.
   (b) Every director who is knowingly a party to the default, is liable for imprisonment upto 2 years and is also liable for fine of not less than ₹1,000 per day for each day of default.
2. As per section 127, there shall not be a contravention of section 127 where dividend is lawfully adjusted by the company against any sum due to it from the shareholder.

Thus, where the amount of dividend is adjusted by the company against sums due to the company from the shareholders, it shall not amount to a violation of section 127.

(ii) The present problem relates to section **128 of the Companies Act, 2013 read with Rule 4 of the Companies (Accounts) Rules, 2014** and Regulation 89 of Table F contained in Schedule I.

1. As per section 128 read with Rule 4, a director of the company is entitled to inspect the

books of account of the company, but no member of the company is entitled to make inspection of the books of account.

2. Regulation 89 of Table F reads as under:
   (i) The Board shall from time to time determine whether and to what extent and at what times and places and under what conditions or regulations, the accounts and books of the company, or any of them, shall be open to the inspection of members not being directors.
   (ii) No member (not being a director) shall have any right of inspecting any account or book or document of the company except as conferred by law or authorised by the Board or by the company in general meeting.

   In the given case, Mr. Prem has not been authorised to inspect the books of account by the Board or by the members in the general meeting. Thus, Mr. Prem shall not have any right to inspect the books of account even if he holds 76% of the equity shares of the company.

3. Mr. Prem may, by using the majority of voting power held by him and complying with the provisions of the Act, get appointed as a director of M/s Good-day Company Ltd., and then, he shall be entitled (in the capacity of director) to make the inspection of books of account.

(iii) No director shall assign his office to any other person. If he does, the assignment shall be void **[Section 166 of Companies Act, 2013]**.

The articles of a company empowered its managing director to appoint a successor. The managing director appointed, by his will, Mr. Jay to succeed him as a managing director after his death. The Court observed that a director is prohibited from assigning his office. The word 'his' used in section 166 indicates that the prohibition applies only when an office held by a director is assigned to any other person. Where a director dies, the office held by him becomes vacant and therefore. Such office cannot be assigned to any other person. Therefore, appointment of a new person in such office does not amount to an assignment within the meaning of section 166. [Oriental Metal Pressing Pvt. Ltd. v B.K. Thakoor (1961) 31 Comp Cas 143].

The facts of the given case are identical to the facts discussed in the above case. Accordingly, it can be said that appointment of Mr. Jay is valid and it does not amount to an assignment of office by Mr. Ashu.

<u>Question 2(d)</u>

(i) On recommendation of the Board of Directors of Ganga Company Limited, Mr. Ranjan is appointed at the company's Annual General Meeting held on 1st October, 2014 as auditor for period of 10 years. A resolution to this effect was passed unanimously with no vote against the resolution. Explaining the provisions of the Companies Act, 2013 relating to the appointment and re-appointment of auditors:

1. Examine the validity of the above resolution.

2. What shall be your answer in case an audit firm Messrs Ranjan & Associates is appointed

as the company's auditor?

(ii) Mr. Azad is a director of Down Limited which failed to repay matured deposits from 1st April, 2014 onwards and the default continues. But Down Limited is regular in filing annual accounts and annual returns. Mr. Azad is also a director of Hope Limited and Trust Limited.

Answer the following questions with reference to the relevant provisions of the Companies Act, 2013:

1. **Whether Mr. Azad is disqualified and if so, whether he is required to vacate his office of director in Hope Limited and Trust Limited.**
2. **Is it possible for Board of directors of Faith Limited to appoint Mr. Azad as an additional director at the Board meeting to be held on 15th May, 2015? Would your answer be different if Mr. Azad ceased to be a director of Down Limited by resignation on 1st March, 2015?**

State also the auditor's liability with regard to reporting of disqualification under section 164(2).

(iii) Andrew, one of the shareholder of a company, filed a civil suit in a Court for removal of directors Bikash, Shraddha and Elle. Is the suit maintainable? Advice in the light of Companies Act, 2013.

[6+6+3 = 15]

Answer

(i) The present problem relates to section **139(1) and 139(2) of the Companies Act, 2013**.

1. As per section 139(1), when any appointment of auditor is made at any AGM, the auditor so appointed shall hold office till the conclusion of 6th AGM, with the AGM wherein such appointment has been made being counted as the first AGM. At every AGM (viz. 2nd, 3rd, 4th and 5th AGM), the matter relating to appointment of auditor shall be placed before the members for ratification.
2. In case the company is covered under subsection (2) of section 139 (i.e. the concept of rotation of auditors is applicable to the company), then, -
   (a) No individual shall be appointed or reappointed as auditor for more than 1 term of 5 consecutive years.
   (b) In case, the auditor is a firm, no audit firm shall be appointed or reappointed as auditor for more than 2 terms of 5 consecutive years.

The given case is answered as under:

1. The resolution passed in the AGM appointing Mr. Ranjan as an auditor for a period of 10 years is not valid, since such appointment is in contravention of section 139(1) as well as 139(2). It is immaterial that in the AGM, no vote has been cast against the resolution.
2. The answer remains same even where the M/S Ranjan & Associates, an audit firm was appointed as auditor, since section 139(1) as well as 139(2) do not permit appointment for 10 years. Even in case of an audit firm, the term shall be 5 years. However, on completion of one term of 5 years, the audit firm may be reappointed for another term of 5 years.

(ii) As per section 164(2), a director of a company shall be disqualified from being reappointed as a director in that company or appointed as a director in any other company, if the company of which he is already a director fails to repay its deposits or interest thereon on the due date and such failure continues for 1 year or more. Such disqualification shall remain in force for a period of 5 years. As per section 167(1)(a), the office of a director shall become vacant if he incurs any of the disqualifications specified under section 164.

In the given case Down Limited has failed to repay its deposits on the due date (i.e. 1.4.2014) and such default has continued for more than 1 year (i.e. beyond 31.3.2015). Therefore -

- Mr. Azad shall not be eligible to be appointed as a director in any other company or reappointed in Down Limited after 31.3.2015 for a period of 5 years. Accordingly, Faith Limited cannot appoint Mr. Azad as an additional director on 15.5.2015.

- Mr. Azad cannot continue as a director in Down Limited, Hope Limited and Trust Limited. His office of director shall become vacant on expiry of 31.3.2015

If Mr. Azad had ceased to be a director of Down Limited by resignation on 1st March, 2015, he would have escaped the disqualification specified under section 164(2) and accordingly Faith Limited could appoint Mr. Azad as an additional director on 15.5.2015.

As per section 143(3)(g) of the Companies Act, 2013, the auditor of the company shall state in his report as to whether any of the directors of the company are disqualified from being appointed as a director under section 164(2).

(iii) A Civil Court has no jurisdiction to entertain a suit for removal of a director since the matter relates to the internal management of the company which is governed by the Companies Act, 2013 [Khetan Industries Pvt. Ltd. v Manju Ravindra Prasad Khetan (1995) 16 CLA 169 (Bom)]. Section 169 has given to the shareholders necessary powers (subject to adequate safeguards) to remove a director and thus a Civil Court has no jurisdiction to entertain a suit for removal of a director.

<u>Question 2(e)</u>

(i) One of the directors of your company has been prosecuted for non-payment of sales tax by the company. He intends to obtain relief under the Companies Act, 2013. Will he succeed?

(ii) Mr. Harris was appointed as a director of Imperial Woodens Ltd. with effect from 1st April, 2014. Since the company, namely, Imperial Woodens Ltd. wanted to take full advantage of the wisdom and expertise of Mr. Harris, it offered him remuneration payable on monthly basis and made an application to the Central Government for approval for payment of such remuneration. Anticipating the approval of the Central Government, Imperial Woodens Ltd. started paying such remuneration from the date of appointment and continued to do so till 31st March, 2015. The Central Government did not fully approve the remuneration proposed by the company and restricted the same to a lower amount.

On scrutiny of the accounts, it was established that the company, till 31st March, 2015, has paid to Mr. Harris a total sum of ₹ 1.20 lakhs in excess of the remuneration sanctioned by the Central Government.
You are required to State with reference to the provisions of Companies Act, 2013 in respect of recovery and waiver of recovery of the excess remuneration so paid, whether Mr. Harris can keep the excess remuneration so received and under what conditions.

(iii) Mr. Ram goes abroad for four months from 4.1.2015 and an alternate director has been appointed in his place. Advice as to sending of notice as required under section 173 of the Companies Act, 2013.

[6+6+3 = 15]

Answer

(i) The Court may, in its discretion, relieve an officer of the company from liability, if it appears to the Court that -
(a) he is or may be liable for negligence, default, breach of duty, misfeasance or breach of trust;
(b) he has acted honestly and reasonably; and
(c) having regard to all the circumstances of the case, he ought fairly to be excused.

Relief under section 463 of the Companies Act, 2013 cannot be extended in respect of any liability under any Act, other than the Companies Act. The expression 'any proceedings' occurring in section 463 of the Companies Act, 2013 cannot be read out of context and treated in isolation, and must be confined to the Companies Act only.
Accordingly, section 463 of the Companies Act, 2013 applies to all legal proceedings under the Companies Act only. Otherwise the application of section 463 of the Companies Act, 2013 would result in the penal provisions of other Acts being rendered ineffective. Furthermore, if the parliament had intended that section 463 of the Companies Act, 2013 should apply to other Acts also, it would have specifically provided for it. It is a sound rule of construction to confine the provisions of a statute to itself and therefore section 463 of the Companies Act, 2013 cannot be availed in respect of any proceedings under any other Act [Rabindra Chamariaw ROC(1992) 73 Comp Cas 257].
In the present case a director of the company has been prosecuted under the Sales Tax Act. Since the application of section 463 is restricted to Companies Act only, the Court cannot grant any relief to the directors.

(ii) As per section 197, if any director draws any remuneration in excess of the remuneration approved by the Central Government, he shall refund such excess remuneration to the company. Until such excess remuneration is refunded, he shall hold it in trust for the company. The company shall not waive the recovery of any sum refundable to it (i.e. the excess remuneration drawn by the director) unless permitted by the Central Government.

The answer to the given problem is as follows:

(a) Mr. Harris was appointed as a non-executive director. He was paid monthly remuneration awaiting the approval of the Central Government. However, the remuneration sanctioned by the Central Government was lesser than the remuneration actually paid to Mr. Harris. As per section 197, Mr. Harris cannot keep remuneration drawn by him which is in excess of the remuneration sanctioned by the Central Government. Accordingly, he shall refund to the company ₹ 1,20,000. Until such refund is made, he shall hold it in trust for the company. Further, the company cannot waive the recovery of excess remuneration.

(b) However, if on an application made to the Central Government, the Central Government permits the waiver of recovery of such excess remuneration, the company may waive the recovery of excess remuneration, and then Mr. Harris shall have a right to retain the excess remuneration drawn by him.

(iii) As per section 173(3), a meeting of the Board shall be called by giving not less than 7 days' notice in writing to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means. As can be seen, section 173(3) does not specifically state that notice to an alternate director shall be served. However, an alternate director is a director in his own right. He is not a proxy or representative of the original director. The grounds of vacation of office also apply to him as these apply to the original director, i.e. an alternate director shall vacate his office if he does not attend all the Board meetings during a period of 12 months as per the provisions of section 167(1)(b). Therefore, notice to an alternate director is to be given. Thus, notice shall be served to both, the alternate director as well as the original director at their addresses registered with the company.

Question 3: Answer any two questions **[20 Marks]**

Question 3(a)

(i) What is Corporate Citizenship? Is this fundamentally different from Corporate Social Responsibility?

(ii) Discuss the OECD Guidelines for Corporate Governance of State-owned Enterprises.

[5+5 =10]

Answer

(i) A new terminology that has been gaining grounds in the business community today is Corporate Citizenship. Corporate citizenship is defined by the Boston College Centre for Corporate Citizenship, as the business strategy that shapes the values underpinning a company's mission and the choices made each day by its executives, managers and employees as they engage with society.

According to this definition, the four key principles that define the essence of corporate citizenship are:

1. Minimise harm,
2. Maximise benefit,
3. Be accountable and responsive to key stakeholders and

4. Support strong financial results.

Corporate citizenship, sometimes called corporate responsibility, can be defined as the ways in which a company's strategies and operating practices affect its stakeholders, the natural environment, and the societies where the business operates. In this definition, corporate citizenship encompasses the concept of corporate social responsibility (CSR), which involves companies' explicit and mainly discretionary efforts to improve society in some way, but is also directly linked to the company's business model in that it requires companies to pay attention to all their impacts on stakeholders, nature, and society. Corporate citizenship is, in this definition, integrally linked to the social, ecological, political, and economic impacts that derive from the company's business model; how the company actually does business in the societies where it operates; and how it handles its responsibilities to stakeholders and the natural environment.

Thus, corporate citizenship, similar to its CSR concept, is focusing on the membership of the corporation in the political, social and cultural community, with a focus on enhancing social capital. Notwithstanding the different terminologies and nomenclature used, the focus for companies today should be to focus on delivering to the basic essence and promise of the message that embodies these key concepts – CSR and Corporate Citizenship.

Corporate Social Responsibility is not a fad or a passing trend, it is a business imperative that many Indian companies are either beginning to think about or are engaging with in one way or another.

While some of these initiatives may be labeled as corporate citizenship by some organisations, there basic message and purpose is the same.

(ii) According to OECD, a major challenge is to find a balance between the state's responsibility for actively exercising its ownership functions, such as, the nomination and election of the board, while at the same time refraining from imposing undue political interference in the management of the company. Another important challenge is to ensure that there is a level playing field in markets where private sector companies can compete with the state-owned enterprises, and that governments do not distort competition in the way they use their regulatory or supervisory powers.'

According to OECD, the guidelines suggest that the state should exercise its ownership functions through a centralized ownership entity, or effectively co-ordinated entities, which should act independently and in accordance with a publicly disclosed ownership policy. The guidelines also suggest the strict separation of the state's ownership and regulatory functions.

The major recommendations in OECD guidelines are as discussed below:

Ensuring an effective legal and regulatory framework for state-owned enterprises

- There should be a clear separation between the state's ownership function and other state functions that may influence the conditions for state-owned enterprises, particularly with regard to market regulation.
- SOEs should not be exempt from the application of general laws and regulations. Stakeholders including competitors, should have access to efficient redress.
- SOEs should face competitive conditions regarding access to finance. Their relations with state-owned banks, state-owned financial institutions, and other state-owned companies, should be based on purely commercial grounds.

State acting as an owner

The state should act as an informed and active owner, and establish a clear and consistent ownership policy, ensuring that governance of state-owned enterprises is carried out in a transparent and accountable manner with the necessary degree of professionalism and effectiveness.

- The government should develop and issue an ownership policy that defines the overall objectives of state ownership, the state's role in corporate governance of SOEs, and how it will implement its ownership policy.
- The government should not be involved in the day-to-day management of SOEs and allow them full operational autonomy to achieve their defined objectives.
- The state should let SOE boards exercise their responsibilities and respect their independence.
- The state should exercise its ownership rights according to the legal structure of each company. Keeping this in mind, it should ensure that remuneration schemes for SOE board members foster the long-term interest of the company, and can attract and motivate qualified professionals.

Equitable treatment of shareholders

The SOEs should recognize the rights of all shareholders and in accordance with the OECD principles of corporate governance, ensure their equitable treatment and equal access to corporate information.

- SOEs should observe a high degree of transparency towards all shareholders.
- The co-ordinating or ownership entity and SOEs should ensure that all shareholders are treated equally.
- The participation of minority shareholders in shareholder meetings should be facilitated in order to allow them to take part in fundamental corporate decisions, such as board election.

Relations with stakeholders

The state ownership policy should fully recognize the state-owned enterprises' responsibilities towards stakeholders and report their relations with them.

- Listed on large SOEs, as well as SOEs pursuing important public policy objectives, should report on stakeholder relations.

Transparency and disclosure

State-owned enterprises should observe high standards of transparency in accordance with the OECD Principles of Corporate Governance.

- SOEs should develop efficient internal audit procedures and establish an internal audit function that is monitored by and reports directly to the board and to the audit committee or the equivalent company organ.
- SOEs, especially large ones, should be subject to an annual independent external audit based on international standards. The existence of specific state control procedures dots not substitute for an independent external audit.

Responsibilities of the boards of state-owned enterprises

The boards of state-owned enterprises should have the necessary authority, competencies, and objectivity to carry out their function of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.

- The boards of SOEs should be assigned a clear mandate and ultimate responsibility for the company's performance. The board should be fully accountable to the owners, act in the best interest of the company, and treat all shareholders equally.
- SOE boards should carry out their functions of monitoring of management and strategic guidance, subject to the objectives set by the government and the ownership entity. They should have the power to appoint and remove the CEO.
- The boards of SOEs should be so composed that they can exercise objective and independent judgement. Good practice calls for the chair to be separate from the CEO.
- SOE boards should carry out an annual evaluation to appraise their performance.

Question 3(b)

(i) "The development of Corporate Governance in the UK was initially the findings of a trilogy of codes." Explain the same in brief.

(ii) "Family ownership of firms is the prevalent form of ownership in many countries around the globe."
In view of the above statement, explain the concept and need of Ownership structures.

[5+5 =10]

Answer

(i) As in other countries, the development of Corporate Governance in the UK was initially the findings of a trilogy of codes: the Cadbury Report (1992), the Greenbury Report (1995), and the Hampel Report (1998). These are explained as under:

Cadbury Report (1992)

Following various financial scandals and collapses (Coloroll and Polly Peck, to name but two) and a perceived general lack of confidence in the financial reporting of many UK companies, the Financial Reporting Council, the London Stock Exchange, and the accountancy profession established the Committee on the Financial Aspects of Corporate Governance in May 1991. After the Committee was set up, the scandals at BCCI and Maxwell happened, and as a result, the committee interpreted its remit more widely and looked beyond the financial aspects to Corporate Governance as a whole. The Committee was chaired by Sir Adrian Cadbury and, when the Committee reported in December 1992, the report became widely known as 'the Cadbury Report'.

The recommendations covered: the operation of the main board; the establishment, composition, and operation of key board committees; the importance of, and contribution that can be made by, non-executive directors; the reporting and control mechanisms of a business. The Cadbury Report recommended a code of Best Practice with which the boards of all listed companies registered in the UK should comply, and utilized a 'comply or explain' mechanism. This mechanism means that a company should comply with the code but, if it cannot comply with any particular aspect of it, then it should explain why it is unable to do so. This disclosure gives investors detailed information about any instances of non-compliance and enables them to decide whether the company's non-compliance is justified.

Greenbury Report (1995)

The Greenbury committee was set up in response to concern at both the size of directors' remuneration packages and their inconsistent and incomplete disclosure in companies' annual reports. It made, in 1995, comprehensive recommendations regarding disclosure of directors' remuneration packages. There has been much discussion about how much disclosure there should be of directors' remuneration and how useful detailed disclosures might be. Whilst the work of the Greenbury Committee focused on the directors of public limited companies, it hoped that both smaller listed companies and unlisted companies would find its recommendations useful.

Central to the Greenbury report recommendations were strengthening accountability and enhancing the performance of directors. These two aims were to be achieved by (i) the presence of a remuneration committee comprised of independent non-executive directors who would report fully to the shareholders each year about the company's executive remuneration policy, including full disclosure of the elements in the remuneration of individual directors; and (ii) the adoption of performance measures linking rewards to the performance of both the company and individual directors, so that the interests of directors and shareholders were more closely aligned.

Since that time (1995), disclosure of directors' remuneration has become quite prolific in UK company accounts.

Hampel Report (1998)

The Hampel Committee was set up in 1995 to review the implementation of the Cadbury and Greenbury Committee recommendations. The Hampel Committee reported in 1998. The Hampel Report said: 'We endorse the overwhelming majority of the findings of the two earlier committees'. There has been much discussion about the extent to which a company should consider the interests of various stakeholders, such as employees, customers, suppliers, providers of credit, the local community, etc., as well as the interests of its shareholders. The Hampel report stated that the directors as a board are responsible *for relations with* stakeholders; but they are accountable *to* the shareholders'. However, the report does also state that directors can meet their legal duties to shareholders, and can pursue the objective of long-term shareholder value successfully, only by developing and sustaining these stakeholder relationships'.

The Hampel Report, like its precursors, also emphasized the important role that institutional investors have to play in the companies in which they invest (investee companies). It is highly desirable that companies and institutional investors engage in dialogue and that institutional investors make considered use of their shares, in other words, institutional investors should consider carefully the resolutions on which they have a right to vote and reach a decision based on careful thought, rather than engage in 'box ticking'.

(ii) In many countries, family-owned firms are prevalent. Corporate governance is of relevance to family-owned firms, which can encompass a number of business forms including private and publicly quoted companies, for a number of reasons. Family-owned firms may face difficulties in initially finding appropriate independent non-executive directors but the benefits that such directors can bring is worth the time and financial investment that the family-owned firm will need to make.

One advantage of a family-owned firm is that there should be less chance of the type of agency problems. This is because ownership and control rather than being split are still one and the same, and so the problems of information asymmetry and opportunistic behaviour should (in theory, at least) be lessened. As a result of this overlap of ownership and control, one would hope for higher levels of trust and hence less monitoring of management activity should be necessary. However, problems may still occur and especially in terms of potential for minority shareholder oppression, which may be more acute in family-owned firms.

In family business group firms, the concern is that managers may act for the controlling family, but not for shareholders in general. These agency issues are: the use of pyramidal groups to separate ownership from control, the entrenchment of controlling families, and non-arm's-length transactions (aka 'tunneling') between related companies that are detrimental to public investors.

Family Assembly	**Family Council**	**Advisory Board**	**Board Of Directors (Including Outside Directors)**

Possible stages in a family firm's governance

The advantages of a formal governance structure are several. First of all, there is a defined structure with defined channels for decision-making and clear lines of responsibility. Secondly, the board can tackle areas that may be sensitive from a family viewpoint but which nonetheless need to be dealt with - succession planning is a case in point (deciding who would be best to fill key roles in the business should the existing incumbents move on, retire, or die). Succession planning is important too in the context of raising external equity because, once a family business starts to seek external equity investment, then shareholders will usually want to know that succession planning is in place. The third advantage of a formal governance structure is also one in which external shareholders would take a keen interest: the appointment of non-executive directors. It may be that the family firm, depending on its size, appoints just one, or maybe two, non-executive directors. The key point about the non-executive director appointments is that the persons appointed should be indepen-dent; it is this trait that will make their contribution to the family firm a significant one. Of course, the independent non-executive directors should be appointed on the basis of the knowledge and experience that they can bring to the family firm: their business experience, or a particular knowledge or functional specialism of relevance to the firm, which will enable them to 'add value' and contribute to the strategic development of the family firm. Another advantage of family-owned firms may be their ability to be less driven by the short-term demands of the market. Of course, they still ultimately need to be able to make a profit but they may have more flexibility as to when and how they do so.

Cadbury (2000) sums up the three requisites for family firms to manage successfully the impacts of growth: 'They need to be able to recruit and retain the very best people for the business, they need to be able to develop a culture of trust and transparency, and they need to define logical and efficient organisational structures'. A good governance system will help family firms to achieve these requisites.

Question 3(c)

(i) Write short notes on:
- **Whole Life Cycle Costing**
- **Golden Parachute Proposals**

(ii) What are the pros and cons in adopting Corporate Social Responsibility?

[(2.5×2)+5 = 10]

Answer

(i)
- **Whole Life Cycle Costing (WLCC):**

Towards the late 1990s, the concepts of 'whole life costing' (WLC) and 'whole life-cycle costing' (WLCC) emerged. The terms whole life costing and whole life-cycle costing are interchangeable. WLCC is a new term that appears to have been adopted by many building economists involved in the preparation of forecasts for the long-term cost assessments of capital projects.

'Whole life-cycle costing (WLCC) is a dynamic and ongoing process which enables the stochastic assessment of the performance of constructed facilities from feasibility to disposal. The WLCC assessment process takes into account the characteristics of the constructed facility, reusability, sustainability, maintainability and obsolescence as well as the capital, maintenance, operational, finance, residual and disposal costs. The result of this stochastic assessment forms the basis for a series of economic and noneconomic performance indicators relating to the various stakeholders' interests and objectives throughout the life-cycle of a project.'

Currently, the application of WLCC in the construction industry is still hindered significantly by the lack of standard methods and the excuse of lack of sound data upon which to arrive at accurate decisions. As a result, the output from WLCC models is looked on as unreliable.

Combined with WLCC, risk assessment should form a major element in the strategic decision-making process during project procurement and also in value analysis, especially in today's highly uncertain business environment. WLCC decisions are complex and usually comprise an array of significant factors affecting the ultimate cost decisions. WLCC decisions generally have multiple objectives and alternatives, long-term impacts, multiple constituencies in the procurement of construction projects, generally involve multiple disciplines and numerous decision makers, and always involve various degrees of risk and uncertainty. Project cost, design and operational decision parameters are often established very early in the life of a given building project. The existing methods do not adequately quantify the true economic impacts of many quantitative and qualitative parameters.

- **Golden Parachute Proposals:**

The Securities and Exchange Commission's (the "SEC") new disclosure and advisory vote requirements for compensation based on or relating to merger and similar transactions, often referred to as golden parachute arrangements, became effective for proxy statements and other acquisition related filings initially filed on or after April 25, 2011 for Corporate Governance in USA. The SEC adopted the rules to implement Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").

The Dodd-Frank Act requires companies to hold separate shareholder votes on potential "golden parachute" payments when they seek approval for mergers, sales and certain other transactions. In determining the recommendation with respect to a golden parachute proposal, the 2013 Updates include the consideration of any existing change-in-control arrangements maintained with named executive officers, rather than focusing only on the new or extended arrangements. The list of features considered problematic has been refined. Recent amendments that incorporate problematic features will tend to carry more weight in the overall analysis. However, close scrutiny will also be given if multiple legacy problematic features are present.

(ii) Pros & Cons of adopting Corporate Social Responsibility:

Corporate social responsibility refers to a method of running a company that seeks to address not only profitability, but also the environmental and social consequences of the business. While most corporate social responsibility concerns are directed at very large businesses, even small and medium-sized businesses that employ a large number of local residents or participate in environmentally problematic industries can face pressure to adopt corporate social responsibility.

Costs

Cost represents one of the biggest arguments against adopting corporate social responsibility as a policy. Programs to reduce environmental impact often require expensive changes in equipment or ongoing costs without any clear way to recoup those losses. The decision to maintain domestic production facilities or call centers or to buy from domestic producers rather than outsource or move production overseas can drive up costs for a business. Additionally, there is no clear evidence that adhering to a policy of corporate social responsibility generates a significant increase in sales or profit.

Improved Company Reputation

Embracing a policy of corporate social responsibility, paired with genuine action, can serve to build or improve the reputation of a business. If a company's behavior creates a negative backlash that leads to lost profitability -- over environmental issues, for example -- corporate social responsibility becomes a method to repair reputation damage and restore profitability. In other cases, adopting such a policy works as part of a business' essential brand, and consumers often demonstrate more loyalty to brands that can demonstrate a commitment to environmental concerns.

Shareholder Resistance

Some investors do look to acquire stock in socially responsible corporations, but, on the whole, investors purchase stock on the expectations of turning a profit. While some companies, such as Toyota and GE, have profited from corporate social responsibility, companies that adopt such policies often prove as likely to lose money. Given the spotty track record of corporate social responsibility in demonstrating profit increase, investors may resist attempts by executives to move a company in that direction.

Better Customer Relations

One of the hallmarks of corporate social responsibility is staying involved in the communities where the business operates. This community involvement goes a long way toward building trust between customers and the business. If a business builds trust with its customers, they tend to give the business the benefit of the doubt if something goes wrong, rather than assuming malicious intent or raw negligence. Customers also tend to stick with businesses they trust, rather than actively seeking out new companies, which helps keep a business profitable over the long haul.