

MOCK TEST PAPER
INTERMEDIATE (NEW): GROUP – I
PAPER – 2: CORPORATE AND OTHER LAWS
SUGGESTED ANSWERS/HINTS

1. (a) Under section 2 (70) of the Companies Act, 2013, “prospectus” means any document described or issued as a prospectus and includes a red herring prospectus referred to in section 32 or shelf prospectus referred to in section 31 or any notice, circular, advertisement or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate.

A prospectus is a document inviting offers from the public. The prospectus and any statement therein has no legal binding either on the company or its directors, promoters or experts to a person who has not purchased securities in response to it.

Since, X purchased shares through the stock exchange (open market) which cannot be said to have bought shares on the basis of prospectus. X cannot bring action for deceit against the directors. Hence, X will not succeed. It was also held in the case of *Peek Vs. Gurney* that the above-mentioned remedy by way of damage will not be available to a person if he has not purchased the shares on the basis of prospectus.

- (b) According to section 123(3) of the Companies Act, 2013, the Board of Directors of a company may declare interim dividend during any financial year out of the surplus in the profit and loss account and out of profits of the financial year in which such interim dividend is sought to be declared.

Further a dividend when declared becomes a debt and a shareholder is entitled to recovery of the same after expiry of 30 days as prescribed under Section 127 of the Companies Act, 2013. Section 2(14A) of the Act defines dividend to include interim dividend. Therefore, dividend once declared becomes a debt and payable within 30 days of declaration.

In the present case, Perfect Limited declared an interim dividend for the second time. After declaration, the Board of Directors decided to revoke the second interim dividend as its financial position was poor.

However, in view of the above, the Board of directors cannot revoke the second interim dividend.

Therefore, decision of the Board to revoke the declared 2nd Interim dividend is invalid.

- (c) According to 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 is not a sub-agent, but an agent of the principal for such part of the business of the agency as is entrusted to him.

Further, as per section 195, in selecting such agent for his principal, an agent is bound to exercise the same amount of discretion as a man of ordinary prudence would exercise in his own case; and, if he does this, he is not responsible to the principal for the acts or negligence of the agent so selected.

Thus, in the present case, Aman is not, but the surveyor is, responsible to Mr. Bhalla.

- (d) As per the provisions of Section 9 of the General Clauses Act, 1897, in any legislation or regulation, it shall be sufficient, for the purpose of excluding the first in a series of days or any other period of time to use the word “from” and for the purpose of including the last in a series of days or any other period of time, to use the word “to”.

Section 127 of the Companies Act, 2013 uses the words, ‘thirty days from’. Thus, in the given situation Excel Ltd. is required to pay declared dividend within 30 days from the date of declaration

i.e. from 01/10/2016 to 30/10/2016. In this series of 30 days, 30/09/2016 will be excluded and last 30th day i.e. 30/10/2016 will be included.

2. (a) (i) Class of companies required to appoint Internal Auditor: Section 138 of the Companies Act, 2013 and the Companies (Accounts) Rules, 2014 prescribes the class of companies required to appoint Internal Auditor. According to it, following class of companies shall be required to appoint an internal auditor or a firm of internal auditors 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; or
 - (c) Outstanding loans or borrowings from banks or public financial institutions exceeding 100 crore rupees or more at any point of time during the preceding financial year; or
 - (d) Outstanding deposits of 25 crore rupees or more at any point of time during the preceding financial year; and
3. Every private company having –
 - (a) Turnover of 200 crore rupees or more during the preceding financial year; or
 - (b) Outstanding loans or borrowings from banks or public financial institutions exceeding 100 crore rupees or more at any point of time during the preceding financial year.

As per the facts given in the question, Natraj Limited is an unlisted public company with the paid up share capital of ₹ 80 cores during the preceding financial year with the turnover of ₹ 110 crores. Since, Natraj Limited fulfills one of the criteria with paid up share capital of more than 50 crore rupees during the preceding financial year, it is mandatory for the Natraj Limited to appoint an internal auditor for the financial year 2017-18.

(ii) Qualifications of Internal Auditor

- (a) Internal Auditor shall either be a chartered accountant or a cost accountant or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the company.

Here, the term “Chartered Accountant” or “Cost Accountant” shall mean a “Chartered Accountant” or a “Cost Accountant”, as the case may be, whether engaged in practice or not.

- (b) The internal auditor may or may not be an employee of the company.

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

As per Section 72 of the Companies Act, 2013-

- (1) every holder of securities of a company may, at any time, nominate, in the prescribed manner, any person to whom his securities shall vest in the event of his death.

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

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

- (c) (i) The problem as asked in the question is based on the provisions of the Negotiable Instruments Act, 1881 as contained in Section 84. The section provides that where a cheque is not presented by the holder for payment within a reasonable time of its issue and the drawer suffers actual damage through the delay because of the failure of the bank, he is discharged from liability to the extent of such damage. In determining what is reasonable time, regard shall be had to the nature of the instrument, the usage of trade and bankers, and the facts of the particular case.

Accordingly, in the given case, the drawer is discharged from the liability to pay the amount of cheque to B. However, B can sue against the bank for the amount of the cheque applying the above provisions.

- (ii) **Person to be called as a holder:** As per section 8 of the Negotiable Instruments Act, 1881 'holder' of a Negotiable Instrument means any person entitled in his own name to the possession of it and to receive or recover the amount due thereon from the parties thereto.

On applying the above provision in the given cases-

- (1) Yes, A can be termed as a holder because he has a right to possession and to receive the amount due in his own name.
- (2) No, X is not a 'holder' because to be called as a 'holder' he must be entitled not only to the possession of the instrument but also to receive the amount mentioned therein.

3. (a) **Issue of Further Shares:** According to Section 62 (1) of the Companies Act, 2013 if at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, such shares should be offered to –

- (i) the existing equity shareholders of the company as at the date of the offer, in proportion to the capital paid up on those shares.
- (ii) employees under a scheme of employees' stock option subject to a special resolution passed by the company and subject to such conditions as may be prescribed.
- (iii) to any persons, if it is authorised by a special resolution, whether or not those persons include the persons referred to in clause (i) or clause (ii), either for cash or for a consideration other than cash, if the price of such shares is determined by the valuation report of a registered valuer subject to such conditions as may be prescribed.

Since, in the given case Dhyan Dairy Ltd. approached Shayam Ltd. for subscribing to the shares of the company for its expansion and Shayam Ltd. is neither an existing equity shareholder of the company nor an employee, Dhyan Dairy Ltd., if it is authorised by a special resolution, may issue shares to Shayam Ltd. either for cash or for a consideration other than cash, subject to the condition that the price of such shares is determined by the valuation report of a registered valuer.

(b) According to section 131 of the Companies Act, 2013,

(1) Preparation of revised financial statement or revised report on the approval of Tribunal:

If it appears to the directors of a company that—

- (a) the financial statement of the company; or
- (b) the report of the Board,

do not comply with the provisions of section 129 or section 134, they may prepare revised financial statement or a revised report in respect of any of the three preceding financial years after obtaining approval of the Tribunal on an application made by the company in such form and manner as may be prescribed and a copy of the order passed by the Tribunal shall be filed with the Registrar:

Tribunal to serve the notice: Provided that the Tribunal shall give notice to the Central Government and the Income tax authorities and shall take into consideration the representations, if any, made by that Government or the authorities before passing any order under this section:

Number of times of revision and recast: provided further that such revised financial statement or report shall not be prepared or filed more than once in a financial year:

Reason for revision to be disclosed: Provided also that the detailed reasons for revision of such financial statement or report shall also be disclosed in the Board's report in the relevant financial year in which such revision is being made.

(2) Where copies of the previous financial statement or report have been sent out to members or delivered to the Registrar or laid before the company in general meeting, the revisions must be confined to—

- (a) the correction in respect of which the previous financial statement or report do not comply with the provisions of section 129 or section 134; and
- (b) the making of any necessary consequential alternation.

(3) **Framing of rules by the Central Government in relation to revised financial statement or director's report:** The Central Government may make rules as to the application of the provisions of this Act in relation to revised financial statement or a revised director's report and such rules may, in particular—

- (a) make different provisions according to which the previous financial statement or report are replaced or are supplemented by a document indicating the corrections to be made;
- (b) make provisions with respect to the functions of the company's auditor in relation to the revised financial statement or report;
- (c) require the directors to take such steps as may be prescribed.

(c) **“Coming into operation of enactment”:** According to section 5 of the General Clauses Act, 1897, where any Central Act has not specifically mentioned a particular date to come into force, it shall be implemented on the day on which it receives the assent of the Governor General in case of a

Central Acts made before the commencement of the Indian Constitution and/or, of the President in case of an Act of Parliament.

Example: The Companies Act, 2013 received assent of President of India on 29th August, 2013 and was notified in official gazette on 30th August, 2013 with the enforcement of section 1 of the Act. Accordingly, the Companies Act, 2013 came into enforcement on the date of its publication in the Official Gazette.

- (d) **Difference between Interpretation and Construction-** Interpretation differs from construction. Interpretation is of finding out the true sense of any form and the construction is the drawing of conclusion respecting subjects that lie beyond the direct expression of the text.

When the legislature uses certain words which have acquired a definite meaning over a period of time, it must be assumed that those words have been used in the same sense.

Thus, where the Court adheres to the plain meaning of the language used by the legislature, it would be 'interpretation' of the words, but where the meaning is not plain, the court has to decide whether the wording was meant to cover the situation before the court. Here the court would be resorting to what is called 'construction', however, the two terms – 'interpretation' and 'construction' – overlap each other and it is rather difficult to state where 'interpretation' leaves off and 'construction' begins.

4. (a) Section 109 of the Companies Act, 2013 provides for the demand of poll before or on the declaration of the result of the voting on any resolution on show of hands. Accordingly law says that:-

Before or on the declaration of the result of the voting on any resolution on show of hands, a poll may be ordered to be taken by the Chairman of the meeting on his own motion, and shall be ordered to be taken by him on a demand made in that behalf:-

- (a) In the case a company having a share capital, by the members present in person or by proxy, where allowed, and having not less than one-tenth of the total voting power or holding shares on which an aggregate sum of not less than five lakh rupees or such higher amount as may be prescribed has been paid-up; and
- (b) in the case of any other company, by any member or members present in person or by proxy, where allowed, and having not less than one tenth of the total voting power.

Withdrawal of the demand: The demand for a poll may be withdrawn at any time by the persons who made the demand.

Hence, on the basis on the above provisions of the Companies Act, 2013:

- (i) The chairman cannot reject the demand for poll subject to provision in the articles of company.
- (ii) The chairman cannot reject the request of the members for withdrawing the demand of the Poll.
- (b) Section 145 of the Companies Act, 2013 provides for auditors to sign audit reports, etc. According to this section:
- (i) The person appointed as an auditor of the company shall sign the auditor's report or sign or certify any other document of the company in accordance with the provisions of sub-section (2) of section 141 (i.e. in case of firm including LLP, only Chartered Accountants are authorised to act and sign).
- (ii) The qualifications, observations or comments on financial transactions or matters, which have any adverse effect on the functioning of the company mentioned in the auditor's report shall be read before the company in general meeting and shall be open to inspection by any member of the company.

- (c) **Natural and grammatical meaning:** Statute are to be first understood in their natural, ordinary, or popular sense and must be construed according to their plain, literal and grammatical meaning. If there is an inconsistency with any express intention or declared purpose of the statute, or it involves any absurdity, repugnanacy, inconsistency, the grammatical sense must then be modified, extended or abridged only to avoid such an inconvenience, but no further. [(State of HP v. Pawan Kumar(2005)]

Example: In a question before the court whether the sale of betel leaves was subject to sales tax. In this matter the Supreme Court held that betel leaves could not be given the dictionary, technical or botanical meaning when the ordinary and natural meaning is clear and unambiguous. Being the word of everyday use it must be understood in its popular sense by which people are conversant with it as also the meaning which the statute dealing with the matter would attribute to it. Therefore, the sale of betel leaves was liable to sale tax. (Ramavtar V. Assistant Sales Tax Officer, AIR 1961 SC 1325).

- (d) According to section 3(18) of the General Clauses Act, 1897, 'Document' shall include any matter written, expressed or described upon any substance by means of letters, figures or marks or by more than one of those means which is intended to be used or which may be used, for the purpose or recording that matter.

Thus,

- (i) Yes, power-of-attorney is a document.
- (ii) Yes, cheque upon a banker is a document.

5. (a) Yes, the Director shall be held liable for the false statements in the prospectus under sections 34 and 35 of the Companies Act, 2013. Whereas section 34 imposes a criminal punishment on every person who authorises the issue of such prospectus, section 35 more particularly includes a director of the company in the imposition of liability for such mis statements.

The only situations when a director will not incur any liability for mis statements in a prospectus are as under:

- (a) No criminal liability under section 34 shall apply to a person if he proves that such statement or omission was immaterial or that he had reasonable grounds to believe, and did up to the time of issue of the prospectus believe, that the statement was true or the inclusion or omission was necessary.
- (b) No civil liability for any mis statement under section 35 shall apply to a person if he proves that:
 - (1) Having consented to become a director of the company, he withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent; or
 - (2) The prospectus was issued without his knowledge or consent, and that on becoming aware of its issue, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent.

Therefore, in the present case the director cannot hide behind the excuse that he had relied on the promoters for making correct statements in the prospectus. He will be liable for mis statements in the prospectus.

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

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

However, the Registrar is empowered under proviso to section 77 (1) to extend the period of 30 days by another 300 days on payment of such additional fee as may be prescribed. Taking advantage of this provision, Mind Limited, should immediately file the particulars of charge with the Registrar and satisfy the Registrar that it had sufficient cause, for not filing the particulars of charge within 30 days of creation of charge.

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

(c) According to the Section 125 of the Indian Contract Act, 1872 the indemnity holder i.e., promisee in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor:

- (1) all damages which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies;
- (2) all costs which he may be compelled to pay in any such suit, if in bringing or defending it, he did not contravene the orders of the promisor, and acted as it would have been prudent for him to act in the absence of any contract of indemnity, or if the promisor authorised him to bring or defend the suit.
- (3) all sums which he may have paid under the terms of any compromise of any such suit, if the compromise was not contrary to the orders of the promisor, and was one which it would have been prudent for the promisee to make in the absence of any contract of indemnity, or if the promisor authorised him to compromise the suit.

Section 125 is by no means exhaustive, which deals only with his rights in the event of his being sued. The indemnity holder has other rights besides those mentioned above. If he has incurred a liability and that liability is absolute he is entitled to call upon his indemnifier to save him from that liability and to pay it off.

(d) The problem is based on the provision of Section 42 of the Negotiable Instruments Act, 1881. In case a bill of exchange is drawn payable to the drawer's order in a fictitious name and is endorsed by the same hand as the drawer's signature, it is not permissible for the acceptor to allege as against the holder in due course that such name is fictitious. Accordingly, in the instant case, Y cannot avoid payment by raising the plea that the drawer (Z) is fictitious. The only condition is that the signature of Z as drawer and as endorser must be in the same handwriting.

6. (a) According to Section 63 of the Companies Act, 2013, a company may issue fully paid-up bonus shares to its members, in any manner whatsoever, out of -

- (i) its free reserves;
- (ii) the securities premium account; or
- (iii) the capital redemption reserve account.

Provided that no issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets.

Conditions for issue of Bonus Shares: No company shall capitalise its profits or reserves for the purpose of issuing fully paid-up bonus shares, unless—

- (i) it is authorised by its Articles;
- (ii) it has, on the recommendation of the Board, been authorised in the general meeting of the company;
- (iii) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;

- (iv) it has not defaulted in respect of payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;
- (v) the partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up;
- (f) it complies with such conditions as may be prescribed.

But the company has to ensure that the bonus shares shall not be issued in lieu of dividend.

Hence, after following the above compliances on issuing bonus shares under the Companies Act, 2013, Shree Ltd. may proceed for a bonus issue of 1 share for every 2 shares held by the existing shareholders.

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

(1) The Central Government on being satisfied that—

- (i) (a) the **omission to file with the Registrar the particulars of any charge** created by a company or any charge subject to which any property has been acquired by a company or any modification of such charge; or
- (b) the **omission to register any charge within the time** required under this Chapter or the omission to give intimation to the Registrar of the payment or the satisfaction of a charge, within the time required under this Chapter; or
- (c) the **omission or mis-statement of any particular** with respect to any such charge or modification or with respect to any memorandum of satisfaction or other entry made in pursuance of section 82 or section 83,
 - was accidental or due to inadvertence or some other sufficient cause or it is not of a nature to prejudice the position of creditors or shareholders of the company; or
- (ii) **on any other grounds**, it is just and equitable to grant relief,
 - it may on the application of the company or any person interested and on such terms and conditions as it may seem to the Central Government just and expedient, direct that the time for the filing of the particulars or for the registration of the charge or for the giving of intimation of payment or satisfaction shall be extended or, as the case may require, that the omission or mis-statement shall be rectified.

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

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

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

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

in the said order.

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

Thus, if the creditor makes any variance (i.e. change in terms) without the consent of the surety, then surety is discharged as to the transactions subsequent to the change. In the instant case Yash is liable as a surety for the loss suffered by the bank due to misappropriation of cash by Shashank during the first nine months but not for misappropriations committed after the reduction in salary.

- (d) According to section 45A of the Negotiable Instruments Act, 1881, where a bill of exchange has been lost before it is overdue,

- the person who was the holder of it may apply
- to the drawer to give him another bill of the same tenor,
- giving security to the drawer, if required,
- to indemnify him against all persons whatever in case the bill alleged to have been lost shall be found again.

If the drawer on request as aforesaid refuses to give such duplicate bill, he may be compelled to do so.