**Test Series: April, 2021**

**MOCK TEST PAPER 2**

**FINAL (New) GROUP – I**

**PAPER – 4: CORPORATE AND ECONOMIC LAWS**

**SUGGESTED ANSWERS**

**Division A: Multiple Choice Questions (30 Marks)**

**1. (a)**

**2. (d)**

**3. (d)**

**4. (a)**

**5. (a)**

**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. (b)**

**19. (b)**

**20. (a)**

**Division B: Descriptive Answer (70 Marks)**

**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.

As per the facts, 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 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 requirement, 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 BSD Private Limited 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 getting any compensation by way of salary.

**(B) Right to lodge a caveat (Section 18C)**

As per section 18C of the SARFAESI, 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. Since in the given case 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.

**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)** **(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—

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

(b) 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.

**4.** **(A)** (i) Section 5(1) of the Securities Contracts (Regulations) Act, 1956 states that if the Central Government/ SEBI is of the opinion that the recognition granted to a stock exchange under the provisions of this Act, should, in the interest of the trade or in the public interest, be withdrawn, the Central Government or SEBI may serve on the governing body of the stock exchange, a written notice that the Central Government or SEBI is considering the withdrawal of the recognition for the reasons stated in the notice and after giving an opportunity to the

governing body to be heard in the matter, the Central Government/SEBI may withdraw the recognition granted to the stock exchange.

Thus, Central Government/ SEBI can withdraw the recognition of 'X' Stock Exchange Limited on the grounds that their activities were against the interest of the trade and general public.

(ii) As per section 19 of the Securities Contracts (Regulations) Act, 1956, no person shall organise or assist in organising or be a member of any stock exchange (other than a recognised stock exchange) for the purpose of assisting in, entering into or performing any contracts in securities, except with the approval of Central Government or SEBI.

Hence, no person can be a member of an unrecognised Stock exchange for the purpose of performing any contracts in Securities, except with the approval of Central Government or SEBI.

**(B)** Arbitration is a private method of dispute resolution. Under the Indian law every individual has the right to approach the court for resolution of his/her dispute that may involve infringement of right(s) vested upon that individual. This protection is so stringent that it cannot be contracted away. The Indian Contract Act, 1872 however notes an exception in favour of arbitration.

Arbitration cannot happen without the parties consenting to submit their dispute to arbitration. Consent of the parties therefore is the most fundamental requirement for an arbitration to happen. An arbitration agreement records the consent of the parties that in the event of a dispute between them that matter instead of being taken to court, will be submitted for resolution to arbitration. Arbitration agreement therefore is necessary to start arbitration.

In the instant case, there is no express arbitration agreement entered between the parties (Mr. Ghia & Mr. Bhajiwala) as regards to reference of disputes for arbitration. Further, Mr. Bhajiwala filed a suit against Mr. Ghia in the court but Mr. Ghia contended that the matter of dispute should be settled through Arbitration. Here, since no express arbitration agreement for dispute resolution was made between the parties, Mr. Ghia contention to submit the dispute for arbitration, is not correct. Even the court cannot refer the parties to arbitration unless there's a written consent by parties by way of joint application or memo or an affidavit.

**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. However, there has been violation of section 380 of the Act, so as per section 393 of the Act, 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, 2013.

**(B) In case of Joint Financial Creditors:**

As per the provisions of the Insolvency and Bankruptcy Code, 2016, where the corporate debtor owes financial debts to two or more financial creditors as part of a consortium or agreement, each such financial creditor shall be part of the Committee of Creditors (CoC) and their voting share shall be determined on the basis of the financial debts owed to them. Voting share shall be based on the proportion of financial debt owed to such financial creditor in relation to the financial debt owed by the Corporate debtor. [Section 5(28)].

On the basis of above provision, A, B and C shall be the members of CoC and their voting share in the CoC shall be in proportion of their debt (i.e. in proportion of 50%, 30% and 20% respectively) to the total debt of the Corporate Debtor (loan amount of Rs. 250 crore under consortium arrangement).

**Voting Share in the CoC**

The Interim Insolvency Resolution Professional (IIRP) noted total financial debt (Rs. 500 cr) owed by the OLAF Ltd. Therefore, the voting share of A, B & C in the given case shall be as under:

A = (50% X Rs.250 Crore) / Rs.500 Crore = 25%

B = (30% X Rs.250 Crore) / Rs. 500 Crore = 15%

C = (20% X Rs.250 Crore) / Rs. 500 Crore = 10%

**6. (A)** 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 2/3$^{rd}$)

Total number of directors to retire by rotation = 8*1/3 = 2.6=3 (nearest to 1/3$^{rd}$)

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.

**(B)** Section 44 of the Prevention of Money Laundering 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)** As per explanation to section 29A of the Insolvency and Bankruptcy Code, "Connected person" means—

(i) any person who is the promoter or in the management or control of the resolution applicant; or

(ii) any person who shall be the promoter or in management or control of the business of the corporate debtor during the implementation of the resolution plan; or

(iii) the holding company, subsidiary company, associate company or related party of a person referred to in clauses (i) and (ii).

Thus, if resolution applicant associated with any 'connected person' who is ineligible under section 29A of Insolvency & Bankruptcy Code, will be ineligible as 'resolution applicant' and hence cannot submit a resolution plan.