

PAPER –: BUSINESS LAW, ETHICS AND COMMUNICATION

Ans.1 Small Company: Under Section 2 (85) of the Companies Act, 2013, "small company" means a company, other than a public company:-

- (i) having paid-up share capital not exceeding fifty lakh rupees or such higher amount as may be prescribed which shall not be more than five crore rupees; and
- (ii) having turnover as per its last profit and loss account not exceeding two crore rupees or such higher amount as may be prescribed which shall not be more than twenty crore rupees.

Exceptions: This section shall not apply to:

- (A) a holding company or a subsidiary company;
- (B) a company registered under section 8, or
- (C) a company or body corporate governed by any special Act.

(4 Marks)

Ans.2 Red-herring Prospectus (Section 32 of the Companies Act, 2013): A red-herring prospectus means a prospectus which does not include complete particulars of the price or the quantum of securities offered therein [Explanation to Section 32].

Section 2 (70) of the Companies Act, 2013 defines a prospectus includes a red herring prospectus within its meaning. Hence, a red herring prospectus is a prospectus within the meaning of section 2 (70). Under section 32 (1) a public company proposing to make an offer of securities may issue a red herring prospectus prior to the issue of a prospectus. Therefore, the issue of a red herring prospectus does not absolve a company from issuing a regular prospectus in accordance with the relevant provisions of the Companies Act 2013.

According to section 32 (1) a company proposing to issue a red herring prospectus under sub-section (1) shall file it with the Registrar at least three days prior to the opening of the subscription list and the offer.

Section 32 (3) states that a red herring prospectus shall carry the same obligations as are applicable to a prospectus and any variation between the red herring prospectus and a prospectus shall be highlighted as variations in the prospectus.

Section 32 (4) states that upon the closing of the offer of securities, the prospectus stating therein the total capital raised, whether by way of debt or share capital, and the closing price of the securities and any other details as are not included in the red herring prospectus shall be filed with the Registrar and the Securities and Exchange Board.

On the basis of offers received, company will finalise the issue price and issue size and then close the offer. After closure of offer of securities, a final prospectus will be prepared stating the total capital raised whether by way of debts, or share capital and the closing price of securities and any other details as were not complete in red-herring prospectus. The prospectus will be filled with ROC and also with SEBI in case of listed company.

(4 Marks)

Ans. 3 The Companies Act, 2013 does not prescribe any qualification for membership. Membership entails an agreement enforceable in a court of law. Therefore, the contractual capacity as envisaged by the Indian Contract Act, 1872 should be taken into consideration.

It was held in the case of *Mohori Bibi Vs. Dharmadas Ghose (1930) 30 Cal. 531 (P.O.)* that since minor has no contractual capacity, the agreement with a minor is void. Therefore, a minor or a lunatic cannot enter into an agreement to become a member of the company.

However, it is an established matter of law as evidenced in a number of cases, that in case a minor is bound in a contractual relationship he shall enjoy the benefits under the contract without being liable for anything.

Hence, if the company registers the minor as a member, he will incur no liability for the company as long as he is a minor. Going by practical legal application, companies do not register minor as members at all.

In view of the above, M/s Honest Cycles Ltd may still give membership to Balak through the transfer of 1000 shares, as the shares are fully paid up and no further liability is attached to them in any case.

(4 Marks)

Ans.4 Under the Companies (Prospectus and Allotment of Securities) Rules, 2014 the rate of commission paid or agreed to be paid shall not exceed, in case of shares, five percent (5%) of the price at which the shares are issued or a rate authorised by the articles, whichever is less.

In the given problem, the articles of X Ltd. have prescribed 4% underwriting commission but the directors decided to pay 5% underwriting commission.

Therefore, the decision of the Board of Directors to pay 5% commission to the underwriters is invalid.

(4 Marks)

Ans.5 Irregular allotment: The Companies Act, 2013 does not separately provide for the term "Irregular Allotment" of securities. Hence, one will have to examine the requirements of a proper issue of securities and consider the consequences of non fulfilment of those requirements.

In broad terms, an allotment of shares is deemed to be irregular when it has been made by a company in violation of Sections 23, 26, 39 and 40. Irregular allotment therefore arises in the following instances:

1. Where a company does not issue a prospectus in a public issue as required by section 23; or
2. Where the prospectus issued by the company does not include any of the matters required to be included therein under section 26 (1), or the information given is misleading, faulty and incorrect; or
3. Where the prospectus has not been filed with the Registrar for registration under section 26 (4);
4. The minimum subscription as specified in the prospectus has not been received in terms of section 39; or
5. The minimum amount receivable on application is less than 5% of the nominal value of the securities offered or lower than the amount prescribed by SEBI in this behalf; or

In case of a public issue, approval for listing has not been obtained

from one or more of the recognized stock exchanges under section 40 of the Companies Act, 2013

Effects of irregular allotment: The consequences of an irregular allotment depend on the nature of irregularity. However, the Companies Act, 2013 does not mention (unlike the previous Companies Act) that in case of an irregular allotment the contract is voidable at the option of the allottee.

Under section 26 (9) of the Companies Act, 2013 if a prospectus is issued in contravention of the provisions of section 26, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and every person who is knowingly a party to the issue of such prospectus shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees, or with both.

Similarly, in case the company has not received the minimum subscription amount within 30 days of the date of issue of the prospectus, it must refund the application money received by it within the stipulated time. Any allotment made in violation of this will be void and the defaulting company and officers will be liable to further punishment as provided in section 39 (5).

Under section 40 (5) any default made in respect of getting the approval to listing of securities in one or more recognized stock exchange in case of a public issue, will render the company punishable with a fine which shall not be less than five lakh rupees but which may extend to fifty lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees, or with both.

Hence, under various provisions of the Companies Act, 2013 stringent punishment has been provided for against irregular allotment of securities but the option of going ahead with such allotment even if desired by the allottee is not specifically permitted.

(6 Marks)

Ans.6 Issue of Further Shares: Section 62 (1) (a) of the Companies Act, 2013 provides that 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 the existing equity shareholders of the company as at the date of the offer, in proportion to the capital paid up on those shares.

However, certain exceptions have been provided in the Companies Act, 2013 when such further shares of a company may-be offered to other persons as well. These are as under-

- (a) Under section 62 (1) (b) issue of further shares may be offered to employees under a scheme of employees' stock option subject to a ¹¹special resolution passed by the company and subject to such conditions as may be prescribed.
- (b) Under section 62 (1) (c) such shares may be offered to any persons, if it is authorised by a special resolution, 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.

¹¹Provisions related to further issue of share capital given under section 62(1)(b) for the words "special resolution", the words "ordinary resolution" shall be substituted in case of private companies vide notification G.S.R. 464 (E) dated 5th June 2015.

- (c) if any equity shareholder to whom the shares are offered in terms of section 62 (1) (a) as described above, declines such offer, the Board of Directors may dispose of the shares in such manner as is not disadvantageous to the shareholders or to the company.

Preference Shareholders - whether (Further Issue of Capital)

can be offered to: From the wordings of Section 62 (1) (c), it is quite clear that these shares can be issued to any persons who may be preference shareholders as well provided such issue is authorized by a special resolution of the company and are issued on such conditions as may be prescribed. **(6 Marks)**

Ans.7 Meaning of Sweat Equity Shares:Section 2 (88) of the Companies Act, 2013 defines "sweat equity shares" as those equity shares which are issued by a company to its directors or employees at a discount or for consideration other than cash for providing their know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called.

Conditions to be fulfilled before issue of Sweat Equity Shares:Notwithstanding anything contained in Section 53 (Providing for issue of shares at a discount), a company may under section 54 of the Companies Act, 2013 issue sweat equity shares if the following conditions are fulfilled:

- 1 The shares being issued belong to a class of shares which have already been issued.
2. The issue should be authorised by a special resolution passed by the company in general meeting.
3. The resolution should specify number of shares, current market price, consideration, if any and the class or classes of directors or employees to whom such shares are to be issued.
4. Not less than one year has elapsed at the date of such issue, since the date on which the company had commenced business.
5. Where the equity shares of the company are listed on a recognised stock exchange, the sweat equity shares are issued in accordance with the regulations made by the Securities and Exchange Board in this behalf and if they are not so listed, the sweat equity shares are issued in accordance with such rules as may be prescribed. Under section 54 (2) the rights, limitations, restrictions and provisions as are for the time being applicable to equity shares shall be applicable to the sweat equity shares issued under this section and the holders of such shares shall rank *paripassu* with other equity shareholders.

(5 Marks)

Ans. 8 Distinction between fixed charge and floating charge:

	Fixed charge		Floating charge
1.	It is a legal charge.	1.	It is an equitable charge.
2.	It is a charge on specific, ascertained and existing asset.	2.	It is a charge on present and future assets. No specific assets.
3.	Company cannot deal with the assets except with the consent of the charge holder.	3.	Company is free to use or deal with the assets the way it likes until the charge becomes fixed.
4.	Registration of fixed charge on movable assets is not compulsory.	4.	Registration of all floating charge on all kinds of assets is compulsory by law.
5.	Fixed charge has always priority over floating charge.	5.	Ambulatory and shifting in character.

(4 Marks)**Ans. 9** Period Within which first and the subsequent AGM must be held:

- (a) Under the first proviso to section 96 (1) of the Companies Act, 2013
- (1) A company may hold its first AGM within a period of nine months from the date of closing of its first financial year;
 - (2) Every subsequent annual general meeting must be held within a period of six months from the date of closing of the financial year.
 - (3) However, the third proviso to section 96 (1) empowers the Registrar, for any special reason, to extend the time within which any AGM (other than the first AGM) shall be held, by a period not exceeding 3 months. Hence, the Registrar is not empowered by the Act to extend the time for holding the first annual general meeting of a company even under special circumstances.
- (b) Further Section 168 of the Companies Act, 1956 provides that if default is made in holding a meeting of the company in accordance with Section 166(i.e., section 96 of the Companies Act, 2013), or in complying with any directions of the CLB under sub-section (1) of Section 167, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to `50,000 and in the case of a continuing default, with a further fine which may extent to `2,500 for every day after the first during which such default continues.

[Note: Sections 168 & 167 of the Companies Act, 1956 is still in existence as the corresponding Sections 97 & 99 of the Companies Act, 2013 not notified till 30th April, 2016]

- (ii) ¹⁷**Business to be transacted at an Annual General Meeting:** Under section 102 (2) of the Companies Act, 2013 the following businesses may be transacted at an annual general meeting:

1. Ordinary Business; Viz.
 - (a) The consideration of the financial statements and the report of the Board of Directors and the Auditors;

- (b) The declaration of any dividend;
 - (c) The appointment of directors in place of those retiring; and
 - (d) The appointment of and the fixing of the remuneration of the auditors.
2. Special Business: Any business other than the above mentioned four shall be deemed to be a special business, which may be transacted at any AGM.
(5 Marks)

Ans. 10 The problem as asked in the question is based on the provisions of the Companies Act, 2013 as contained in Section ²⁰101. Accordingly, the notice may be served personally or sent through post to the registered address of the members and, in the absence of any registered office in India, to the address, if there be any within India furnished by him to the company for the purpose of servicing notice to him. Service through post shall be deemed to have effected by correctly addressing, preparing and posting the notice. If, however, a member wants the notice to be served on him under a certificate or by registered post with or without acknowledgement due and has deposited money with the company to defray the incidental

²⁰Vide Notification G.S.R. 464 (E) dated 5th June 2015, in case of private companies section 101 shall apply unless otherwise specified in respective sections or articles of the company provide otherwise.

expenditure thereof, the notice must be served accordingly, otherwise service will not be deemed to have been effected.

Accordingly, the questions as asked may be answered as under:

- (i) The contention of Dinesh shall be tenable, for the reason that the notice was not properly served and meetings held by the company shall be invalid.
- (ii) In view of the provisions of the Companies Act, 2013, the company is not bound to send notice to Dinesh at the address outside India. Therefore, answer in the second case shall differ from the first one.

(4 Marks)

Ans. 11 Quorum: In this case the quorum for holding a general meeting is 7 members to be personally present. For the purpose of quorum, only those members are counted who are entitled to vote on resolution proposed to be passed in the meeting.

Again, only members present in person and not by proxy are to be counted. Hence, proxies whether they are members or not will have to be excluded for the purposes of quorum.

If a company is a member of another company, it may authorize a person by resolution to act as its representative at a meeting of the latter company, then such a person shall be deemed to be a member present in person and counted for the purpose of quorum. Where two or more companies which are members of another company, appoint a single person as their representative then each such company will be counted as quorum at a meeting of the latter company.

Further the President of India or Governor of a State, if he is a member of a company, may appoint such a person as he thinks fit, to act as his representative at any meeting of the company. A person so appointed shall be deemed to be a member of such a company and thus considered as member personally present.

In view of the above there are only three members personally present.

'A' will be included for the purpose of quorum. B & C have to be excluded for the purpose of quorum because they represent the preference shares and since the agenda being the appointment of Managing Director, their rights cannot be said to be directly affected and therefore, they shall not have voting rights. D will have two votes for the purpose of quorum as he represents two companies 'Y Ltd.' and 'Z Ltd.' E, F, G and H are not to be included as they are not members but representing as proxies for the members.

Thus it can be said that the requirements of quorum has not been met and it shall not constitute a valid quorum for the meeting.

(4 Marks)