# GUIDELINE ANSWERS

## PROFESSIONAL PROGRAMME

***(New Syllabus)***

**DECEMBER 2021**

**MODULE 3**

THE INSTITUTE OF
Company Secretaries of India
भारतीय कम्पनी सचिव संस्थान
IN PURSUIT OF PROFESSIONAL EXCELLENCE
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(Under the jurisdiction of Ministry of Corporate Affairs)
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These answers have been written by competent persons and the Institute hope that the **GUIDELINE ANSWERS** will assist the students in preparing for the Institute's examinations. It is, however, to be noted that the answers are to be treated as model answers and not as exhaustive and the Institute is not in any way responsible for the correctness or otherwise of the answers compiled and published herein.

In answers to the questions based on case study, the students may write any other alternative answer with valid reasoning.

The Guideline Answers contain the information based on the Laws/Rules applicable at the time of preparation. However, students are expected to be updated with the applicable amendments which are as follows:

| **CS Examinations** | **Applicability of Amendments to Laws** |
|---|---|
| December Session | upto 31 May of that Calender year |
| June Session | upto 30 November of previous Calender Year |

## C O N T E N T S

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**MODULE 3**

**PROFESSIONAL PROGRAMME EXAMINATION**

DECEMBER 2021

# CORPORATE FUNDING & LISTING IN STOCK EXCHANGES

*Time allowed : 3 hours* *Maximum marks : 100*

***NOTE :*** *Answer ALL Questions.*

## PART A

**Question 1**

*(a) Ultra-Information Services Limited, provides IT and ITES services. The Board of Directors of the Company want to go for Initial Public Offer (IPO) to raise funds for expansion of the Company. During the previous year, the Company started a new line of business of providing aeronautical designs to an Australian entity and accordingly changed its name to Ultra Aero Technology Services Limited.*

*As a Company Secretary, advise the Board of Directors about eligibility for an IPO.*

*(b) The Board of Directors of Minto Limited wanted to set up a new production plant at Manesar. In the Board Meeting where the budgets were being discussed, one Director suggested that funds can be raised by issuing warrants to fund the new project.*

*As a Company Secretary, advise the Board of Directors, whether the Company can issue warrants.*

*(c) Explain minimum promoter's contribution to be brought in before public issue open under regulation 14(3 & 4) of SEBI (ICDR) Regulations, 2018.*

*(5 marks each)*

**Answer 1(a)**

The eligibility requirements for initial public offer are provided under Regulation 6(1) of the SEBI (Issue of Capital and Disclosure Requirements) Regulations 2018. The said Regulation inter-alia, provides that an issuer shall be eligible to make an IPO only if, in case the issuer has changed its name within the last one year, at least 50% of the revenue calculated on a restated and consolidated basis, for the preceding one full year has been earned by it from the activity indicated by the new name.

Hence, based on the above it can be concluded that as the Company has changed its name in the previous year, it would be eligible for an IPO, if at least 50% of the revenue calculated on a restated and consolidated basis, for the preceding one full year has been earned from its aeronautical designing business.

Nonetheless, in terms of the Regulation 6(2) of the SEBI (Issue of Capital and Disclosure Requirements) Regulations 2018, an issuer not satisfying the condition stipulated above shall be eligible to make an initial public offer if the issue is made through the book-building process and the issuer undertakes to allot at least 75% of the net offer to qualified institutional buyers and to refund the full subscription money if it fails to do so. Therefore, Ultra Aero Technology Services Limited may also opt for this route if the conditions above are not satisfied.

**Answer 1(b)**

As per Regulation 13 of the SEBI (Issue of Capital and Disclosure Requirements) Regulations 2018, an issuer shall be eligible to issue warrants in an initial public offer subject to the following:

- the tenure of such warrants shall not exceed 18 months from the date of their allotment in the initial public offer;
- a specified security may have one or more warrants attached to it;
- the price or formula for determination of exercise price of the warrants shall be determined upfront and disclosed in the offer document and at least 25 % of the consideration amount based on the exercise price shall also be received upfront;

  However, in case the exercise price of warrants is based on a formula, 25% consideration amount based on the cap price of the price band determined for the linked equity shares or convertible securities shall be received upfront.
- in case the warrant holder does not exercise the option to take equity shares against any of the warrants held by the warrant holder, within 3 months from the date of payment of consideration, such consideration made in respect of such warrants shall be forfeited by the issuer.

  Accordingly, Minto Ltd. can issue warrants after complying with the aforementioned conditions.

**Answer 1(c)**

As per Regulation 14(3) of the SEBI (Issue of Capital and Disclosure Requirements) Regulations 2018, the promoters shall bring full amount of the promoters' contribution including premium at least one day prior to the date of opening of the issue.

In terms of the Regulation 14(4) of the said Regulations where the promoters have to subscribe to equity shares or convertible securities towards minimum promoters' contribution, the amount of promoters' contribution shall be kept in an escrow account with a scheduled commercial bank, which shall be released to the issuer along with the release of the issue proceeds.

However, where the promoters' contribution has already been brought in and utilised, the issuer shall give the cash flow statement disclosing the use of such funds in the offer document.

Further, where the minimum promoters' contribution is more than Rs.100 crore and the initial public offer is for partly paid shares, the promoters shall bring in at least Rs. 100 crore before the date of opening of the issue and the remaining amount may be brought on a pro-rata basis before the calls are made to the public.

Regulation 14(4) of the SEBI (Issue of Capital and Disclosure Requirements) Regulations 2018 further clarified that Promoters' contribution shall be computed on the basis of the post-issue expanded capital:

a) assuming full proposed conversion of convertible securities into equity shares;

b) assuming exercise of all vested options, where any employee stock options are outstanding at the time of initial public offer.

***Attempt all parts of either Q. No. 2 or Q. No. 2A***

**Question 2**

*(a) On the basis of the following information, calculate the operating cycle of Raksha Goods Limited :*

| *Particulars* | *As at April 1, 2019* | *As at March 31, 2020* |
|---|---|---|
| *Inventory* | *₹4,00,000* | *₹3,80,000* |
| *Accounts receivable* | *₹18,00,000* | *₹22,50,000* |

*The sales and cost of goods sold for the year ended March 31, 2020 are ₹2,65,00,000 and ₹1,55,00,000 respectively.*

*(b) Somaskanda Printers Limited approached Support Bank, for working capital facilites. The projected annual turnover of the Company is ₹1,85,00,000. Explain the assessment of working capital requirement as per Nayak Committee and compute the working capital finance which can be extended by the Bank.*

*(c) Alphameter Technologies Limited has outstanding guarantees of ₹92 crore as on March 31, 2019. During the year, Company had given new guarantees of Rs. 8 crore to the Telecom Department for new telephone lines. The income tax assessment proceedings for the Assessment Year (AY) 2014-15 have concluded and the Department has released bank guarantees of ₹21 crore which the company had provided earlier. The Department has demanded an additional guarantee of ₹2 crore towards the interest for the AY 2015 -16, for which the Company had provided guarantee of ₹14 crore in previous years.*

*Compute the bank guarantee limits as on March 31, 2020. (5 marks each)*

***OR (Alternate question to Q. No. 2)***

**Question 2A**

*(i) Bon wants to invest in Angel Funds. Explain how an investment can be made in an Angel Fund and in which type of undertakings an Angel Fund can invest. Can units of Angel Funds be listed on a stock exchange ?*

*(ii) "Venture capital firms, finance both early and later stage investments to maintain a balance between risk and profitability." Explain early stage financing.*

*(iii) Explain the meaning of 'Strategic Investor' as mentioned in the SEBI (Real Estate Investment Trusts) Regulations, 2014. (5 marks each)*

**Answer 2 (a)**

**Calculation of Operating Cycle of Raksha Goods Limited**

Operating cycle = Inventory period + Accounts receivable period

Inventory period = Average inventory/Cost of goods sold * 365

Average Inventory = (₹4,00,000 + ₹3,80,000)/2 = ₹3,90,000

**Inventory period = ₹3,90,000 / ₹1,55,00,000 * 365 = 9.18 days**

Average Accounts receivable = (₹18,00,000 + ₹22,50,000)/2 = ₹20,25,000

**Accounts receivable period = ₹20,25,000 / ₹2,65,00,000 * 365 = 27.89 days**

**Operating cycle = 9.18 + 27.89 days = 37.07 days**

**Answer 2(b)**

As per Nayak Committee, bank credit for working capital purposes for borrowers requiring fund-based limits up to Rs. 5 crores for Small Scale Industries borrowers and Rs. 2 crores in case of other borrowers, may be assessed at minimum of 25% of the projected annual turnover of which should be provided by the borrower (i.e. minimum margin of 5% of the annual turnover to be provided by the borrower) and balance 4/5th (i.e. 20% of the annual turnover) can be extended by way of working capital finance.

The projected turnover or output value may be interpreted as projected gross sales which will include excise duty also.

Since the bank finance is only intended to support the need-based requirement of a borrower, if the available Net Working Capital (net long-term surplus funds) is more than 5% of the turnover the former should be reckoned for assessing the extent of bank finance.

**Computation of Working Capital**

| *Particulars* | *Amount (in ₹)* |
|---|---|
| Projected Sales turnover | 1,85,00,000 |
| Working Capital Limit (25% of annual turnover) | 46,25,000 |
| Permissible Bank Finance | 46,25,000 - 9,25,000=37,00,000 |
| Minimum money from borrower (5% of Projected Sales Turnover) | 9,25,000 |

**Answer 2(c)**

**Computation of Bank guarantee limits as on March 31, 2020**

| *Particulars* | *Amount (in ₹ crores)* | |
|---|---|---|
| Outstanding Bank Guarantee as on 31st March 2019 | 92 | A |
| Bank guarantees including additional guarantee issued during the period (8 cr. + 2 cr.) | 10 | B |
| Bank guarantees released during the year | 21 | C |
| Bank Guarantee Limits as on 31st march 2020 | 81 | D =A+ B-C |

*Notes:*

- ₹ 92 crores have been considered as the opening bank guarantees outstanding as on April 1, 2019

- Additions during the year include ₹ 8 crore and ₹ 2 crore bank Guarantee provided towards the interest with the income-tax department
- ₹ 14 crores have not been considered separately, as it was provided during the earlier years and is included in the opening guarantees as on April 01, 2019

**Answer 2A(i)**

As per SEBI (Alternative Investment Fund) Regulations, 2012 (AIF Regulations), Angel Fund means a sub-category of Venture Capital Fund under Category I Alternative Investment Fund that raises funds from angel investors and invests in accordance with the provisions of Chapter III A of the AIF Regulations.

'Angel Investor' means any person who proposes to invest in an angel fund and satisfies one of the following conditions, namely,

(a) an individual investor who has net tangible assets of at least 2 crore rupees excluding value of his principal residence, and who:
   - has early stage investment experience, or
   - has experience as a serial entrepreneur, or
   - is a senior management professional with at least ten years of experience.

(b) a body corporate with a net worth of at least 10 crore rupees, or

(c) an Alternative Investment Fund registered under SEBI AIF Regulations or a Venture Capital Fund registered under the SEBI (Venture Capital Funds) Regulations, 1996.

As per AIF Regulations, the angel fund may launch schemes subject to filing of a term sheet with SEBI, containing material information regarding the scheme, in the format and time period as may be specified by SEBI.

Angel funds shall only raise funds by way of issue of units to angel investors. An angel fund shall have a corpus of at least Rs.5 crore. Angel funds shall accept, up to a maximum period of five years, an investment of not less than Rs.25 lakh from an angel investor and such funds shall be raised through private placement by issue of information memorandum or placement memorandum, by whatever name called. No scheme of the angel fund shall have more than two hundred angel investors. However, the provisions of the Companies Act, 2013 shall apply to the Angel Fund, if it is formed as a company.

Therefore, Bon may invest in Angel Fund if qualifies for investment as stated above.

Regulation 19F of the AIF Regulations states that the Angel funds shall invest in startups which are not promoted or sponsored by or related to an industrial group whose group turnover exceeds Rs.300 crore.

- Investment by an angel fund in any venture capital undertaking shall not be less than Rs.25 lakh and shall not exceed Rs. 10 crores.
- Investment by an angel fund in the venture capital undertaking shall be locked in for a period of one year.
- Angel Funds shall not invest in associates.

- Angel funds shall not invest more than 25% of the total investments under all its schemes in one venture capital undertaking, the compliance of which shall be ensured by the Angel Fund at the end of its tenure.
- An angel fund may also invest in the securities of companies incorporated outside India subject to such conditions or guidelines that may be stipulated or issued by the Reserve Bank of India and SEBI from time to time.

Regulation 19H of the AIF Regulations prohibits units of Angel Funds from listing. It states that units of Angel Funds shall not be listed on any recognized stock exchange.

**Answer 2A(ii)**

**Early Stages Financing**

- *Seed Capital and R & D Projects* : Venture capitalists are more often interested in providing seed finance i.e., making provision of very small amounts for finance needed to commence a business. Research and Development activities are required to be undertaken before a product is to be launched. External finance is often required by the entrepreneur during the development of the product. The financial risk increases progressively as the research phase moves into the development phase, where a sample of the product is tested before it is finally commercialized. Venture capitalists/ firms/ funds are always ready to undertake risks and make investments in such R & D projects promising higher returns in future.
- *Start Ups* : The riskiest aspect of venture capital is the launch of a new business after the Research and Development activities are over. At this stage, the entrepreneur and his products or services are still not tried and tested keeping in view the various market forces. The finance required usually falls short of his own resources.

  Start-ups may include new industries / businesses set up by the experienced persons in the area in which they have knowledge, specialization and proficiency. Others may result from the research bodies or large corporations, where a venture capitalist joins with an industrially experienced or corporate partner.
- *Second Round Financing* : It refers to the stage when product has already been launched in the market but has not earned enough profits to attract new investors. Additional funds are needed at this stage to meet the growing needs of business. Venture Capital Institutions provide larger funds at this stage than at other early stage financing in the form of debt. The time scale of investment is usually three to seven years.

**Answer 2A(iii)**

Regulation 2(1) (ztb) of the SEBI (Real Estate Investment Trusts) Regulations, 2014 provides the definition of "Strategic Investor".

It means, -

a. an infrastructure finance company registered with the Reserve Bank of India as a Non-Banking Financial Company;

b. a Scheduled Commercial Bank;

c. a multilateral and/or bilateral development financial institution;

d. a systemically important Non-Banking Financial Company registered with the Reserve Bank of India;

e. a foreign portfolio investor,

f. an insurance company registered with the Insurance Regulatory and Development Authority of India;

g. a mutual fund.

who invest, either jointly or severally, not less than 5% of the total offer size of the REIT or such amount as may be specified by the SEBI from time to time, subject to the compliance with the applicable provisions, if any, of the Foreign Exchange Management Act, 1999 and the rules or regulations or guidelines made thereunder.

**Question 3**

*(a) Discuss the concepts "Seed funding" and "Private Equity".*

*(b) Whether 'Letter of Credit' (LC) and 'Letter of Guarantee' (LG) are one and same. Do you agree ? If not, list out the points of differences between them.*

*(c) Outline the reporting requirements under External Commercial Borrowing (ECB) reporting framework.*

*(5 marks each)*

**Answer 3(a)**

**Seed Funding**

Seed funding, taken from the word "seed" is the capital needed to start / expand your business. It often comes from the company founders' personal assets, from friends and family or other investors. The amount of money is usually relatively small because the business is still in the idea or conceptual stage.

This type of funding is often obtained in exchange for an equity stake in the enterprise, although with less formal contractual overhead than standard equity financing.

Lenders often view seed capital as a risky investment by the promoters of a new venture, which represents a meaningful and tangible commitment on their part to making the business a success.This would be a type of Venture Capital Funding and hence covered under the provisions of Angel Funding in the SEBI (Alternative Investment Fund) Regulations, 2012.

**Private Equity**

Private equity is a type of equity (finance) and one of the asset classes that are not publicly traded on a stock exchange. Private equity is essentially a way to invest in some assets that isn't publicly traded, or to invest in a publicly traded asset with the intention of taking it private. Unlike stocks, mutual funds, and bonds, private equity funds usually invest in more illiquid assets, i.e. companies. By purchasing companies, the firms gain access to those assets and revenue sources of the company, which can lead to very high returns on investments.

Another feature of private equity transaction is their extensive use of debt in the form of high-yield bonds. By using debt to finance acquisitions, private equity firms can substantially increase their financial returns.

The private equity consists of institutional investors and accredited investors who can commit large sums of money for long periods of time. Generally, the private equity fund raise money from investors like Angel investors, Institutions with diversified investment portfolio like - pension funds, insurance companies, banks, funds of funds etc.

**Answer 3(b)**

Bank guarantee and a letter of credit are similar in many ways but they are two different things. Letters of credit ensure a transaction proceeds as planned, while bank guarantees reduce the loss if the transaction doesn't go as planned. Therefore, the Letter of Credit (LC) and Letter of Guarantee (LG) are not one and same. There are some differences between the LC and LG which are as under:

**Letter of Credit (LC)**

A letter of credit is a document from a bank that guarantees payment. A Letter of Credit is issued by a bank at the request of its customer (importer / buyer) in favour of the beneficiary (exporter / seller). It is an undertaking/ commitment by the bank, advising/ informing the beneficiary that the documents under a letter of credit would be honoured, if the beneficiary (exporter) submits all the required documents as per the terms and conditions of the letter of credit.

- A letter of credit, sometimes referred to as a documentary credit, acts as a promissory note from a bank.
- It represents an obligation taken on by a bank to make a payment once certain criteria are met. Once these terms are completed and confirmed, the bank will transfer the funds to the beneficiary.
- The letter of credit ensures the payment will be made as long as the services are performed.
- Letters of credit are especially important in international trade due to the distance involved and potentially differing laws in the countries of the businesses involved. In these transactions, it is not always possible for the parties to meet in person.
- The bank issuing the letter of credit holds payment on behalf of the buyer until it receives confirmation that the goods in the transaction have been shipped.
- Letters of credit are used mostly in international trade agreements, whereas bank guarantees are often used in real estate contracts and infrastructure projects.

**Letter of Guarantee (LG) (Bank Guarantees)**

Bank guarantees are part of non-fund based credit facilities provided by the bank to the customers. Bank issue bank guarantee on behalf of his client as a commitment to third party assuring her/ him to honour the claim against the guarantee in the event of the non- performance by the bank's customer. A Bank Guarantee is a legal contract which can be imposed by law. The banker as guarantor assures the third party (beneficiary) to pay him a certain sum of money on behalf of his customer, in case the customer fails to fulfil his commitment to the beneficiary.

- Bank guarantees represent a more significant contractual obligation for banks than letters of credit do.
- A bank guarantee, like a letter of credit, guarantees a sum of money to a beneficiary; however, unlike a letter of credit, the sum is only paid if the opposing party does not fulfil the stipulated obligations under the contract. This can be used to essentially insure a buyer or seller from loss or damage due to non-performance by the other party in a contract.
- Bank guarantees insure both parties in a contractual agreement from credit risk. For instance, a construction company and its cement supplier may enter into a new contract to build a mall.
- Both parties may have to issue bank guarantees to prove their financial stance and capability. In a case where the supplier fails to deliver cement within a specified time, the construction company would notify the bank, which then pays the company the amount specified in the bank guarantee.

**Answer 3(c)**

**Reporting Requirements under External Commercial Borrowings (ECB) Reporting Framework**

Borrowings under ECB Framework are subject to following reporting requirements apart from any other specific reporting required under the framework:

- *Loan Registration Number (LRN)* : Any draw-down in respect of an ECB should happen only after obtaining the LRN from the Reserve Bank. To obtain the LRN, borrowers are required to submit duly certified Form ECB, which also contains terms and conditions of the ECB, in duplicate to the designated AD Category I bank. In turn, the AD Category I bank will forward one copy to the Reserve Bank of India. However, copies of loan agreement for raising ECB are not required to be submitted to the Reserve Bank.
- *Changes in terms and conditions of ECB* : Changes in ECB parameters in consonance with the ECB norms, including reduced repayment by mutual agreement between the lender and borrower, should be reported to the RBI through revised Form ECB at the earliest, in any case not later than 7 days from the changes effected. While submitting revised Form ECB the changes should be specifically mentioned in the communication.
- *Monthly Reporting of actual transactions* : The borrowers are required to report actual ECB transactions through Form ECB 2 Return through the AD Category I bank on monthly basis so as to reach Department of Statistics and Information Management (DSIM) within seven working days from the close of month to which it relates. Changes, if any, in ECB parameters should also be incorporated in Form ECB 2 Return.
- *Late Submission Fee (LSF) for delay in reporting* : Any borrower, who is otherwise in compliance of ECB guidelines, can regularize the delay in reporting of drawdown of ECB proceeds before obtaining LRN or delay in submission of Form ECB 2 returns, by payment of late submission fees.

- *Standard Operating Procedure (SOP) for Untraceable Entities* : The required SOP has to be followed by designated AD Category-I banks in case of untraceable entities who are found to be in contravention of reporting provisions for ECBs by failing to submit prescribed return(s) under the ECB framework, either physically or electronically, for past eight quarters or more.

**Question 4**

*(a) Mono Auto Limited raised ₹100 crores through an IPO with manufacturing of cars as one of its main objects. However due to economic downturn, the Company wants to change its objects to designing and supply of spare parts. Some of the shareholders have voted against this resolution for change in objects. Can the Company give such shareholders an option to exit. If so, what should be the exit price to be offerred ? (3 marks)*

*(b) "The International Finance Corporation (IFC) is an international finanical institution that offers investment, advisory and asset-management services to encourage private sector development in developing countries." Explain the functions of IFC. (3 marks)*

*(c) Dharmadhi Bank wants to issue Perpetual Non-Cumulative Preference Shares. Can a bank issue such instruments ? (3 marks)*

*(d) What are the criteria for listing of Security Receipts ? (3 marks)*

*(e) "The External Commercial Borrowings (ECB) proceeds can be parked abroad." Explain. (3 marks)*

**Answer 4 (a)**

Regulation 59 of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 states that the promoters, or shareholders in control of an issuer, shall provide an exit offer to dissenting shareholders as provided for in the Companies Act, 2013, in case of change in objects or variation in the terms of contract related to objects referred to in the offer document as per conditions and manner is provided in Schedule XX. Further Schedule XX prescribes the procedure and computation of exit price as follows:

The promoters or shareholders in control shall make the exit offer, to the dissenting shareholders, in cases only if a public issue has opened after April 1, 2014; if:

- the proposal for change in objects or variation in terms of a contract, referred to in the offer document is dissented by at least 10 % of the shareholders who voted in the general meeting; and
- the amount to be utilized for the objects for which the offer document was issued is less than 75 % of the amount raised (including the amount earmarked for general corporate purposes as disclosed in the offer document).

The 'exit price payable to the dissenting shareholders shall be the highest of the following:

- the volume-weighted average price paid or payable for acquisitions, whether by the promoters or shareholders having control or by any person acting in concert with them, during the fifty-two weeks immediately preceding the relevant date;

- the highest price paid or payable for any acquisition, whether by the promoters or shareholders having control or by any person acting in concert with them, during the twenty-six weeks immediately preceding the relevant date;
- the volume-weighted average market price of such shares for a period of sixty trading days immediately preceding the relevant date as traded on the recognised stock exchange where the maximum volume of trading in the shares of the issuer are recorded during such period, provided such shares are frequently traded;
- where the shares are not frequently traded, the price determined by the promoters or shareholders having control and the merchant banker considering valuation parameters including book value, comparable trading multiples, and such other parameters as are customary for valuation of shares of such issuers.

Therefore, Mono Auto Limited shall compute the exit price as stated above.

**Answer 4(b)**

The International Finance Corporation (IFC) is a sister organization of the World Bank and member of the World Bank Group and is the largest global development institution focused exclusively on the private sector in developing countries.

**Functions of IFC**

- It provides a wide range of investment and advisory services that help businesses and entrepreneurs in the developing world meet the challenges they face in the marketplace.
- It offers innovative financial products to private sector projects in developing countries. These include loans for IFC's own account (also called A-loans), equity financing, quasi-equity financing, syndicated loans (or B-loans), risk management products, and partial credit guarantees. IFC often provides funding to financial intermediaries that on-lend to clients, especially small and medium enterprises.
- It also provides advisory services that help build businesses. Much of IFC's advisory work is conducted by facilities managed by IFC but funded through partnerships with donor Governments and other multilateral institutions. Other sources of funding include donor country trust funds and IFC's own resources.
- It can provide a mix of financing and advisory services that is tailored to meet the needs of each project. However, the bulk of the funding, as well as leadership and management responsibility, lies with private sector owners and investors.

**Answer 4(c)**

Regulation 3 of the SEBI (Issue and Listing of Non-Convertible Redeemable Preference Shares) Regulations, 2013 (NCRPS Regulations) extends the applicability of Regulations to issue and listing of Perpetual Non-Cumulative Preference Shares and Perpetual Debt Instrument, issued by banks on private placement basis in compliance with Guidelines issued by Reserve Bank of India.

The provisions of Chapter VI of SEBI NCRPS Regulations may, apply to the issuance and listing of Perpetual Non-Cumulative Preference Shares and Innovative Perpetual Debt

Instruments by Banks. No issuer other than a Bank shall issue these instruments. RBI guidelines allow banks to raise capital by issue of non-equity instruments such as Perpetual Non-Cumulative Preference Shares and Innovative Perpetual Debt Instruments. These instruments need to be in compliance with the specified criteria for inclusion in Additional Tier I Capital. A Bank may issue such instruments subject to the prior approval and in compliance with the Guidelines issued by Reserve Bank of India:

- If a bank is incorporated as a company under Companies Act, 1956 / 2013, it shall, in addition, comply with the provisions of Companies Act, 2013 and/or other applicable statues.
- The bank shall comply with the terms and conditions as may be specified by the Board from time to time and shall make adequate disclosures in the offer document regarding the features of these instruments and relevant risk factors and if such instruments are listed, shall comply with the listing requirements.

Accordingly, Dharmadhi Bank can issue perpetual non-convertible preference shares subject to fulfilment of the conditions as stated above.

**Answer 4(d)**

Regulation 38A of the SEBI (Issue and Listing of Securitised Debt Instruments and Security Receipts) Regulations, 2008 provides that an issuer may list its security receipts on a recognized stock exchange subject to the following conditions:

(a) the security receipts have been issued on a private placement basis;

(b) the issuer has issued such security receipts in compliance with the applicable laws;

(c) the offer or invitation to subscribe to security receipts shall be made to such number of persons not exceeding 200 or such other number, in a financial year, as may be prescribed from time to time.

(d) the security receipts proposed to be listed are in dematerialized form;

(e) the disclosures as provided in Regulation 38E of SEBI (issue and Listing of Securitized Debt Instruments and Security Receipts) Regulations, 2008 have been made in the offer document;

(f) the minimum allotment made to the qualified buyers is Rs. 10 lakhs;

(g) such security receipts have been valued prior to listing;

However, such valuation shall not be more than three months old from the date of listing and shall be done by an independent valuer;

(h) the security receipts have been rated by a credit rating agency registered with SEBI.

However, such rating shall not be more than three months old from the date of listing.

Further, the issuer shall comply with the conditions of listing of such security receipts as specified in the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

**Answer 4(e)**

The External Commercial Borrowings (ECB) proceeds are permitted to be parked abroad in a prescribed manner. ECB proceeds meant only for foreign currency expenditure can be parked abroad pending utilization. Till utilisation, these funds can be invested in the following liquid assets:

- deposits or Certificate of Deposit or other products offered by banks rated not less than AA(-) by Standard and Poor/ Fitch IBCA or Aa3 by Moody;
- treasury bills and other monetary instruments of one-year maturity having minimum rating as indicated above; and
- deposits with foreign branches/ subsidiaries of Indian banks abroad.

**PART B**

**Question 5**

*(a) The SEBI (LODR) Regulation, 2015 is applicable on which type of securities ? (5 marks)*

*(b) List out the points of 'Common Obligations for a Listed Entity' prescribed under the SEBI (LODR) Regulations, 2015. (5 marks)*

*(c) Atindra Financial Institutions Group started a new Company for Mutual Fund business. It has sought all the requisite approvals from various regulators. Few of the senior staff were moved from existing group companies to new Mutual Fund Company. The CFO of the new Company is of the view that they also need to appoint a Company Secretary as Compliance Officer.*

*Explain the role of Compliance Officer. (5 marks)*

*(d) Discuss the provisions contained in the SEBI (LODR) Regulations, 2015 relating to dissemination of information to Stock Exchanges on the matter of 'Corporate Insolvency Resolution Process (CIRP)' of a listed company which has become corporate debtor under the Insolvency and Bankruptcy Code, 2016. (5 marks)*

**Answer 5(a)**

**Applicability of the SEBI (LODR) Regulations, 2015 [Regulation 3]**

These regulations shall apply to a listed entity which has listed any of the following designated securities on recognised stock exchange(s):

(a) specified securities listed on main board or SME Exchange or Innovators Growth Platform; Specified securities means 'equity shares' and 'convertible securities as defined under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018.

(b) non-convertible debt securities, non-convertible redeemable preference shares, perpetual debt instrument, perpetual non-cumulative preference shares;

(c) Indian depository receipts;

(d) securitised debt instruments;

(da) security receipts;

(e) units issued by mutual funds;

(f) any other securities as may be specified by the SEBI.

**Answer 5(b)**

Chapter III of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 deals with the Common Obligations for a Listed Entity.

The Listing Regulations has specified the generic obligations or common obligations of listed entity with respect to filing of information, responsibilities of compliance officer, fees etc. and these requirements are applicable to all types of listed securities. The Common Obligations mainly includes: -

- **General Obligations of Compliance - Regulation 5**

  The listed entity shall ensure that key managerial personnel, directors, promoters or any other person dealing with the listed entity, complies with responsibilities or obligations, if any, assigned to them under these regulations.

- **Appointment of Compliance Officer and his/her Obligations – Regulation 6**

  The listed entity shall appoint a qualified Company Secretary as the Compliance Officer. The Compliance Officer is made responsible for certain things.

- **Appointment of Share Transfer Agent (STA) – Regulation 7**

  The listed entity shall appoint a share transfer agent or mange the share transfer facility in house.

- **Co-operation with intermediaries registered with SEBI – Regulation 8**

  It shall co-operate with and submit correct and adequate information to the intermediaries registered with SEBI such as credit rating agencies, registrar to an issue and share transfer agents, debenture trustees etc. within timelines and procedures specified under the Act, respective regulations and circulars issued under the Act.

- **Preservation of Documents - Regulation 9**

  The listed entity shall have a Policy.

  - The policy shall be approved by its Board of Directors.
  - The documents may be kept in electronic mode.

  *Preservation: at least 2 categories of documents as follows:*

  - Documents permanent in nature
  - Documents with preservation > or equal to 8 years after completion of transaction.

- **E-Filing of Information - Regulation 10**

  The listed entity shall file all reports, statements, documents and other information with the recognized stock exchange(s) on the electronic platform as specified by SEBI or the recognized stock exchange(s).

  And put necessary infrastructure in place to comply with this requirement.

- **Scheme of Arrangement - Regulation 11**

  The listed entity shall ensure that any scheme of arrangement/ amalgamation/ merger /reconstruction /reduction of capital etc. to be presented to any Court or Tribunal does not in any way violate, override or limit the provisions of securities laws or requirements of the stock exchange(s).

- **Payment of dividend of interest or redemption or repayment - Regulation 12**

  - o The listed entity shall use Payment facility in electronic mode for payment of dividend, interest, redemption or repayment of amounts, which is approved by the Reserve Bank of India.

  If electronic mode is not possible to be used, then

  - o Issue "Payable at Par" warrants or cheques.
  - o Speed post to be used for “Payable at Par" cheques for more than ₹1,500/-.

- **Grievance Redressal Mechanism - Regulation 13**

  The listed entity shall ensure that adequate steps are taken for expeditious redressal of investors complaints.

  It shall ensure that it is registered with SEBI Complaints Redress System (SCORES) platform or any other platform of SEBI for handing investors complaints electronically as specified by SEBI.

  It shall submit the statement on Investor complaints.

  - o Submit statement to stock Exchange within 21 days from the end of quarter.
  - o The Statement should contain:
    - number of complaints pending at the beginning of the quarter;
    - received during the quarter;
    - resolved/ disposed of during the quarter; and
    - remaining unsolved at the end of the quarter.
    - To be placed before the Board of Directors on quarterly basis.

- **Fees and Other Charges to be paid to the recognised stock exchange(s) – Regulation 14.**

  Payment of all such fees or charges, as applicable including Listing Fee to Stock Exchanges.

**Answer 5(c)**

As per Regulation 6 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 which deals with Compliance Officer and his Obligations, every listed company shall appoint a qualified Company Secretary as the Compliance Officer, who is responsible for:

- Ensuring conformity with the regulatory provisions in letter and spirit.
- Co-ordination with and reporting to SEBI, recognized stock exchange(s) and depositories.
- Monitoring email address of grievance redressal division for the purpose of registering complaint by investors.
- Ensuring correctness, authenticity and comprehensiveness of the information, statements and reports filed by listed entities.

This regulation is not applicable to listing of units of mutual funds.

It may be noted that under this regulation, great responsibility has been cast on the Company Secretary holding the position of Compliance officer in a listed entity.

Further under the Regulation 18(d) of the SEBI (Mutual Funds) Regulations, 1996, the rights and obligations of the trustees of Mutual Fund includes appointment of Compliance Officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions, etc., issued by the SEBI or the Central Government and for redressal of investors grievances.

As mentioned above the Mutual Fund Company though is not required to appoint a Company Secretary as Compliance Officer. However, to ensure compliances, they shall appoint a Compliance officer. Therefore, on voluntary basis Mutual Fund can appoint Company Secretary as Compliance Officer considering the role and responsibilities.

**Answer 5(d)**

Para A.16 of Part A of Schedule III of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 deals with the disclosures relating to Corporate Insolvency Resolution Process (CIRP) matter, which is as under:

The following events in relation to the Corporate Insolvency Resolution Process (CIRP) of a listed corporate debtor under the Insolvency Code shall be disclosed to the Stock Exchanges as a part of material event / information:

(a) Filing of application by the corporate applicant for initiation of CIRP, also specifying the amount of default;

(b) Filing of application by financial creditors for initiation of CIRP against the corporate debtor, also specifying the amount of default;

(c) Admission of application by the Tribunal, along with amount of default or rejection or withdrawal, as applicable;

(d) Public announcement made pursuant to order passed by the Tribunal under section 13 of Insolvency Code;

(e) List of creditors as required to be displayed by the corporate debtor under regulation 13(2)(C) of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016;

(f) Appointment/ Replacement of the Resolution Professional;

(g) Prior or post-facto intimation of the meetings of Committee of Creditors;

(h) Brief particulars of invitation of resolution plans under section 25(2)(h) of Insolvency Code in the Form specified under regulation 36A(5) of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016;

(i) Number of resolution plans received by Resolution Professional;

(j) Filing of resolution plan with the Tribunal;

(k) Approval of resolution plan by the Tribunal or rejection, if applicable;

(l) Specific features and details of the resolution plan as approved by the Adjudicating Authority under the Insolvency Code, not involving commercial secrets;

(m) Any other material information not involving commercial secrets;

(n) Proposed steps to be taken by the incoming investor/acquirer for achieving the Minimum Public Shareholding (MPS);

(o) Quarterly disclosure of the status of achieving the MPS;

(p) The details as to the delisting plans, if any approved in the resolution plan.

**Attempt all parts of either Q. No. 6 or Q. No. 6A**

**Question 6**

*(a) Mr. Jayesh has been recently appointed as Company Secretary of Mahalingam Limited, a company listed on Bombay Stock Exchange (BSE). He wants to draft a dividend distribution policy for the Company. Advise Mr. Jayesh.*

*(b) Outline the provisions of Regulation 30 of SEBI (LODR) Regulations, 2015 regarding the criteria for determination of materiality of events and information.*

*(c) Explain the process of listing GDRs on the Euro MTF.*

*(d) Write a note explaining the provisions contained in SEBI (LODR) Regulations, 2015 in relation to 'Holding of Specified Securities and Shareholding Pattern'.*

*(5 marks each)*

***OR (Alternate question to Q. No. 6)***

**Question 6A**

*(i) Write a note on the periodical compliance calendar (not event based) under SEBI Listing Regulations, 2015. (5 marks)*

*(ii) The Board of Diretors of Sujah Limited are planning to introduce an Employee Stock Option Scheme (ESOS) for select category of employees. The Board has requested the Company Secretary to prepare the required documentation for obtaining in-principle approval from Stock Exchanges. Advise. (5 marks)*

*(iii) ARY & Co. LLP, were the statutory auditors of Ambeaon Limited (a listed company), appointed for period of 5 years. After completion of two years, the auditors resigned as statutory auditors. Soon within a couple of days of auditor's resignation, two independent directors also resigned from the Board. What would be the disclosure obligations on the Company ? (5 marks)*

*(iv) Every website of a listed Company must contain statutory disclosures in terms of listing regulations. In light of this, list out the various information/policies which should be disseminated through the Company's website. (5 marks)*

**Answer 6(a)**

Regulation 43A of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 prescribes the criteria for Dividend Distribution Policy:

- Top 1000 Listed entities based on market capitalization shall formulate a dividend distribution policy.
- Dividend Distribution Policy shall be disclosed on the website of the listed entity and a web-link shall also be provided in their annual reports.
- The dividend distribution policy shall include the following parameters:
    - o the circumstances under which the shareholders of the listed entities may or may not expect dividend;
    - o the financial parameters that shall be considered while declaring dividend;
    - o internal and external factors that shall be considered for declaration of dividend;
    - o policy as to how the retained earnings shall be utilized; and
    - o parameters that shall be adopted with regard to various classes of shares.

  However, If the listed entity proposes to declare dividend on the basis of parameters or proposes to change such additional parameters or the dividend distribution policy contained in any of the parameters, it shall disclose such changes along with the rationale for the same in its annual report and on its website.
- Listed entities other than top 1000 may disclose their dividend distribution policies on a voluntary basis on their websites and provide a web-link in their annual reports.

Mr. Jayesh therefore, would be required to comply with the above mentioned provisions to frame Dividend Distribution Policy.

**Answer 6(b)**

Regulation 30 (4) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 prescribes the criteria for determination of materiality of events / information. Listed entity shall consider the following criteria for determination of materiality of events / information:

- the omission of an event or information, which is likely to result in discontinuity or alteration of event or information already available publicly; or

- the omission of an event or information is likely to result in significant market reaction if the said omission came to light at a later date;
- an event / information may be treated as being material if in the opinion of the Board of Directors of listed entity, the event information is considered material.

The listed entity shall frame a Policy for determination of materiality:

- based on criteria specified in this regulation;
- duly approved by its Board of Directors;
- shall be disclosed on its website.

Regulation 30 (5) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, provides that the board of directors of the listed entity shall authorize one or more Key Managerial Personnel for the purpose of determining materiality of an event or information and for the purpose of making disclosures to stock exchange(s) and the contact details of such personnel shall be also disclosed to the stock exchange(s) and as well as on the listed entity's website.

In case where an event occurs or an information is available with the listed entity, which has not been indicated in Para A or B of Part A of Schedule III of the SEBI (Listing Obligations and Disclosure Requirements), Regulations, 2015, but which may have material effect on it, the listed entity is required to make adequate disclosures in regard thereof.

**Answer 6(c)**

The Luxembourg Stock Exchange (LuxSE) offers a choice of two markets, the main EU-regulated market (called "the BdL market" or the Bourse de Luxembourg market") and an exchange-regulated market (called "the Euro MTF")

When listing on the Euro MTF (Multilateral Trading Facility) market, the Luxembourg Stock Exchange is in charge of prospectus approval and the prospectus is drawn up according to the rules and regulations.

Listing on the Euro MTF will require submission of a prospectus to LuxSE. Once your prospectus has been reviewed and approved, your share or GDR will be listed and admitted to trading.

- **Choose a listing agent (optional)** : It is not mandatory to appoint a listing agent. Either the issuer itself or a company acting on its behalf can submit requests for approval.
- **Listing Requirements** : In order to list on the Euro MTF, a security must fulfil the following criteria, among other things:
  - — Minimum capital of €1,000,000, or equivalent value in other currencies
  - — Minimum public free float of 25%
  - — Securities should be eligible for clearing and settlement
  - — Securities should be freely negotiable and fungible

- **Listing Process** :
  - *File a prospectus* : To begin the listing process, the following documents to be sent to LuxSE:
    - o A copy of the prospectus of issuer;
    - o Application form
    - o Undertaking letter
    - o Articles of association
    - o Existing agreements/conventions
    - o The last three annual financial reports (if published)
  - *Prospectus review* : A first set of comments on a complete draft prospectus will be sent to you within a maximum period of three business days from the date of receipt of the filed application. Additional comments following submission of an updated draft prospectus will be provided within a maximum of two business days after submission.
  - *Final submission* : Listing can take place after receipt of the following items:
    1. Final version of the prospectus
    2. First listing price
- **Fees** : All fees are to be paid to LuxSE and are priced in euros. The fee structure will vary depending on whether or not issuer is a "recently established company", i.e. a company that has not published or registered annual accounts for the three previous financial years.
- **Continuing Obligations** : After listing and admission to trading, issuers must fulfil specific reporting obligations. For example, issuers must file information and scheduled corporate events with LuxSE.
- **LEI Code** : In the context of Markets in Financial Instruments Directive (MiFID II) / Markets in Financial Instruments Regulation (MiFIR) and the Market Abuse Regulation (MAR), the LuxSE is obliged to collect a 'Legal Entity Identifier' or 'LEI' code from any issuer operating on its regulated market (Bourse de Luxembourg) and on its Multilateral Trading Facility (Euro MTF) and communicate it to the relevant supervisory authorities.

**Answer 6(d)**

Regulation 31 of the SEBI (LODR) Regulations 2015 deals with the 'Holding of Specified Securities and Shareholding Pattern'. It provides that-

(1) The listed entity shall submit to the stock exchange(s) a statement showing holding of securities and shareholding pattern separately for each class of securities, in the format specified by the Board from time to time within the following timelines -

(a) one day prior to listing of its securities on the stock exchange(s);

(b) on a quarterly basis, within twenty-one days from the end of each quarter;

(c) within ten days of any capital restructuring of the listed entity resulting in a change exceeding two per cent of the total paid-up share capital:

However, in case of listed entities which have listed their specified securities on SME Exchange, the above statements shall be submitted on a half yearly basis within twenty-one days from the end of each half year.

(2) The listed entity shall ensure that 100% of shareholding of promoter(s) and promoter group is in dematerialized form and the same is maintained on a continuous basis in the manner as specified by the Board.

(3) The listed entity shall comply with circulars or directions issued by the Board from time to time with respect to maintenance of shareholding in dematerialized form.

(4) All entities falling under promoter and promoter group shall be disclosed separately in the shareholding pattern appearing on the website of all stock exchanges having nationwide trading terminals where the specified securities of the entity are listed, in accordance with the formats specified by the Board.

**Answer 6A(i)**

The listed entity shall comply the following periodical compliances under the SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015, other than event based compliances:

| *Regulation Reference* | *Timeline* |
|---|---|
| **Quarterly Compliance** | |
| Regulation 13 (3) - Statement of Grievance Redressal Mechanism | Within 21 days from the end of the quarter. |
| Regulation 27(2)(a) - Corporate Governance Report | Within 21 days from the end of the quarter. |
| Regulation 31 (1) (b) - Shareholding Pattern | Within 21 days from the end of the quarter |
| Regulation 33 (3) (a) - Quarterly Financial Results along with Limited review report/Auditor's report | Within 45 days from the end of the quarter. |
| **Half Yearly Compliance** | |
| Regulation 23 (9) - Disclosures of Related Party Transactions | Within 30 days from the date of publication of its standalone and consolidated financial results |
| **Annual Compliance** | |
| Regulation 7(3) - Share Transfer Agent | Within 30 days from the end of the financial year |

| | |
|---|---|
| Regulation 24A - Secretarial Audit and Secretarial Compliance Report | Within 60 days of the end of the financial year |
| Regulation 33 (3) (d) - Annual Financial Results along with Auditor's Report | Within 60 days from the end of the financial year |
| Regulation 34(1) - Annual Report | Not later than the day of commencement of dispatch to its shareholders. |
| Regulation 40 (10) - Transfer or transmission or transposition of securities | Within 30 days from the end of the financial year |
| Initial Disclosure requirements for large entities | Within 30 days from the beginning of the FY |
| Annual Disclosure requirements for large entities | Within 45 days of the end of the FY |

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**Answer 6A(ii)**

The following are the documentary requirements for prior in-principle under Regulation 28(1) of the SEBI (Listing Obligations and Disclosure Requirements), Regulations, 2015 for ESOS:

- Certified copy of Stock Option/Stock Purchase Scheme/ Stock Appreciation Rights Schemel General Employee Benefits Schemel Retirement Benefit Schemes certified by the Company Secretary.
- Certified copy of statement to be filed with the Stock Exchange as required under Regulation 10(b) SEBI (Share Based Employee Benefits) Regulations, 2014
- Certified true copy of the notice of AGM/EGM for approving the Scheme/for amending the Scheme / for approving grants under Regulation 6 of the SEBI (Share Based Employee Benefits) Regulations, 2014, certified by the company secretary.
- Certified true copy of resolution passed by the shareholders of the Company approving / amending the Scheme.
- Certificate of Auditors on compliance with SEBI (Share Based Employee Benefits) Regulations, 2014.
- Certificate of Merchant Banker on compliance with SEBI (Share Based Employee Benefits) Regulations, 2014.
- List of Promoters as defined under the SEBI (Share Based Employee Benefits) Regulations, 2014.
- Details of employee (wherever applicable) -
    - Who have been granted options / issued shares in excess of 5% of option/ Shares issued in one year.

  - Who have been granted options / issued shares equal to or exceeding 1% of issued capital during any one year
- Copy of latest Annual Report.
- Specimen copy of Share certificate (where shares are issued in physical form)
- Confirmation from the Company.
- Undertakings as required by SEBI under the SEBI (Share Based Employee Benefits) Regulations, 2014.
- Reconciliation statement
- Confirmation whether options lapsed / forfeited will re-issued or not.
- Certified true copy of irrevocable trust deed.
- Certified true copy of Disclosure document (applicable only for ESOS and SARS).
- Processing fees.

**Answer 6A(iii)**

In case of resignation of the auditor of the listed entity, detailed reasons for resignation of auditor, as given by the said auditor, shall be disclosed by the listed entities to the stock exchanges as soon as possible but not later than 24 hours of receipt of such reasons from the auditor.

Therefore, for resignation of ARY & Co., LLP, the Company would be required to make above disclosures. In case of resignation of an independent director of the listed entity, within seven days from the date of resignation, the following disclosures shall be made to the stock exchanges by the listed entities:

- Detailed reasons for the resignation of independent directors as given by the said director shall be disclosed by the listed entities to the stock exchanges.
- The independent director shall, along with the detailed reasons, also provide a confirmation that there is no other material reasons other than those provided.
- The confirmation as provided by the independent director above shall also be disclosed by the listed entities to the stock exchanges along with the detailed reasons.

**Answer 6A(iv)**

The website of a Company assumes great importance as it is medium of information about the Company. The managements are conscious regarding the contents provided in websites of the Companies as it is a true reflection of a company's philosophy, business, history, background etc.

Information dissemination through website assumes significance particularly in respect of listed companies as companies are under obligation to comply with various requirements as far as contents of the website is concerned. Various regulations prescribe certain requirements of disclosure on website. Every website of a listed company must contain statutory disclosures in terms of listing regulations which are enumerated as follows:

**Financial Information**

Each company shall upload unaudited financial results for each quarter of the financial

year and also the audited financial results for the financial year for past 3 years. Annual accounts of the subsidiary companies are also required to be uploaded. Annual reports of the company for past 3 financial years also are required to be uploaded.

**Policies**

Regulation 46 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 states that listed entity shall also maintain functional website. Listed Companies shall disclose certain management policies on the website of the company such as:

- Code of conduct for Board of Directors & Senior Management
- Code of conduct in terms of Insider Trading Regulations
- Code of practices & procedures for fair disclosures of unpublished price sensitive information
- Composition of various committees & Board
- Appointment letters to Independent Directors.
- Familiarization programme for Independent Directors.
- Whistle Blower Policy.
- Policy related to disclosure of material events to the stock exchanges (Materiality Policy).
- Policy on Related Party Transaction.
- Material subsidiary policy.
- Risk Management Policy.
- Archival Policy.
- Policy for disclosure of material information.
- Internal Financial Control.
- Shareholding pattern.
- Dividend Policy (Top 1000 Companies with reference to Market Capitalisation).
- Policy against sexual harassment.

**Other Information**

- Details of unclaimed dividend.
- Scrutinizers Report for the latest financial year.
- Details of compulsory transfer of shares to Investor Education and Protection Fund (IEPF) Suspense Account.

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## MULTIDISCIPLINARY CASE STUDIES

*Time allowed : 3 hours* *Maximum marks : 100*

**NOTE** : *Answer ALL Questions.*

**Question 1**

*Read the following case study carefully and answer the questions given at the end:*

***Brief facts :***

*In the year 1981, the Phosphates Company Limited was incorporated as a joint venture between the Government of India and Rupublic of Nauru with the objective of manufacturing of Di-Ammonium Phosphates.*

*Later on, in the year 1993, the Republic of Nauru disinvested its entire equity stake to the Government of India and the company became a wholly-owned public sector undertaking of the Government of India having its corporate and registered office at Bhubaneswar. (Odisha)*

*Due to deteriorating financial position of certain public sector units, the Government of India on 19.05.1998 decided to temporarily enhance the age of superannuation of all central public sector employees from 58 years to 60 years on the premise that the move may help industries to cut down their losses. Pursuant to the said order dated 19.05.1998, the Company implemented the said order vide order dated 19.11.1998 with retrospective effect from 27.05.1998.*

*Inspite of the enhancement of age of superannuation, the financial performance of the company still did not improve. The Government of India issued an Office Memorandum dated 22.08.2001 to all central public undertakings including the said company intimating its decision to roll back the age of superannuation of all the employees of public sector undertakings from 60 years to 58 years. Before this Memorandum, the Government of India, on 08.06.2000, had also advised the company to review the decision on enhancement of age of superannuation but the company did not take any decision on the said advisory.*

*In the meanwhile, the Government of India, on 28.02.2002, divested its 74% shareholding in the said company in favour of M/s Zuari Maroc Phosphates Ltd. ("Zuari"), thereby, keeping only 26% shareholding in its favour. As per the shareholding agreements, it was provided that all the decisions taken by the Board of directors of the company, prior to the date of the disinvestment, shall be binding on all concerned.*

*In order to revive its financial health, the Board of directors of the Company decided to fill-up the vacancies of Security Guards by engaging an outsourcing agency. As many as 27 Security Guards were employed through outsourcing against vacant posts. In the month of April 2002, some robbers attacked in midnight with arms weapons. Five security guards who were on duty and safeguarding the property were injured. The robbers could not succeed in their nefarions designs. One security guard lost his hand during the firing and another security guard lost his eye. The*

*Union of Security Guards moved an application for regularization of their jobs and also demanded the same pay scale as given to para-military forces under the principle of Equal Pay for Equal Work. The Union also demanded compensation to injured security guards. The Company rejected their claim on the plea that they were contractual labour. As a consequence, the Union filed a petition.*

*Thereafter, on 17.07.2002, the Company, by office order, withdrew the earlier office order dated 19.11.1998 and restored the age of superannuation to 58 years in respect of all the employees in terms of Certified Standing Orders and Service Rules of the Company. Being aggrieved, the Trade Union raised dispute with regard to the above and the Odisha Government also made a reference under Section 12 read with Section 10 of the Industrial Disputes Act, 1947 to the Industrial Tribunal.*

*Questions :*

(a) *Can an employer change the service conditions of the employees by amending, modifying or cancellation of certified Standing Orders ? If so, what is the procedure to be followed by the employer ? Is there any contravention of the provisions of the Industrial Disputes Act, 1947 in the present case ? Give reasons in support of your answer.*

(b) *Can contractual workers, who were security guards in the company, raise the demand for permanent jobs in the company wholly-owned by the government even if no vacancy is advertised for the post ?*

(c) *Can the contractual workers demand compensation from the principal employer due to permanent disablement for an injury caused in the course of employment with the company ? Give reasons in support of your answer.*

(d) *What do you mean by 'Equal Work, Equal Pay' ? Can the employer differentiate the pay scales for same work or work of a similar nature ? Whether the claims of the security guards are sustainable ? Give reasons in support of your answer.*

*(10 marks each)*

**Answer 1(a)**

The present case is similar to the case of *Paradeep Phosphates Limited* vs. *State Of Orissa & Ors, Civil Appeal Nos. 3997-3998 of 2018 (Arising out of Special Leave Petition (C) Nos.35347-35348 of 2016).* In this case the Hon'ble Supreme Court held that the relationship of the employer and employee is of utmost faith and, as a result, it falls under the ambit of fiduciary relationship. In order to regulate such relationship, legislature came up with legislation i.e., the Industrial Disputes Act, 1947(the Act). The purpose of the Act is to protect the interest of employees as they are the weaker sections since time immemorial. In order to safeguard the rights of the employees, certain amendments have been made subsequently in the Statute. In 1956, legislature inserted Section 9A of the Act which makes it obligatory on the part of the employer that he is bound to give advance notice to the employee if he intends to change certain things as envisaged under Section 9A of the Act read with Fourth Schedule.

At the first sight of the provision, prima facie, it appears that the employer is bound to give minimum 21 days' notice to the employee if employer intends to change any material terms of service. Section 9A of the Act is a provision in consonance with the

Constitutional mandate which assures the protection of principles of natural justice i.e., no one shall be condemned unless heard.

Undoubtedly, it is a cardinal principle of law that beneficial laws should be construed liberally. The Industrial Dispute Act, 1947 is one of the welfare legislations which intends to provide and protect the benefits of the employees. Hence, it shall be interpreted in a liberal and broad manner so that maximum benefits could reach to the employees. Any attempt to do strict interpretation would undermine the intention of the legislature. In a catena of cases, this Court has held that the welfare legislation shall be interpreted in a liberal way.

No doubt, the enhancement of the superannuation age was temporary in nature in order to achieve certain objectives and also it is not deniable that yet employees would be governed by the Service Rules and the Certified Standing Orders which were not amended. However, if we allow the plea of the appellant Company then it would defeat the object of legislature because legislature could never have intended that employees would be condemned without giving them right of reasonable hearing, naturally, every employee is under the expectation that before reducing his superannuation age, he would be given a proper chance to be heard. Right to work is a vital right of every employee and in our view, it shall not be taken away without giving reasonable opportunity of being heard otherwise it would be an act of violation of the Constitutional mandate.

Moreover, the contention of the appellant-Company that the object of enhancement of superannuation age was just to save the industries from huge losses, therefore, it does not violate any statutory right of the employees, cannot be sustained in the eyes of law and also it does not give the license to the appellant-Company to act in contravention of law since it is a cannon of law that everyone is expected to act as per the mandate of law.

To sum up, we are of the view that at the very moment when the order of enhancement of superannuation of the employees came into force though temporary in nature, it would amount to privilege to employees since it is a special right granted to them. Hence, any unilateral withdrawal of such privilege amounts to contravention of Section 9A of the Act and such act of the employer is bad in the eyes of law.

In view of above detailed discussion, we are of the considered view that there is no error in the impugned judgment of the High Court, hence, we are not inclined to interfere in it. Accordingly, these appeals are hereby dismissed leaving parties to bear their own cost.

**Answer 1(b)**

The present case is similar to *Chennai Port Trust* vs. *The Chennai Port Trust Industrial Employees Canteen Workers Welfare Association & Ors* the Hon'ble Supreme Court held that the Writ Court (Single Judge) and the Division Bench were right in their reasoning and the conclusion. The Division Bench, in our opinion, rightly relied upon the decision of this Court in *Indian Petrochemicals Corporation Ltd. & Anr.* vs. *Shramik Sena & Ors (1999) 6 SCC 439* and compared the facts of the above case with that of the case at hand and found great similarities in both for granting relief to the members of the respondent (Association).

The Division Bench in Paras 14 and 15 of the impugned judgment took note of 20 factors of this case, which were found identical to the facts involved in Indian Petrochemical's case (supra) wherein this Court had issued a writ of mandamus against the main employer in relation to such employees working in the canteen run for the benefit of the employer.

We find no fault in the aforementioned findings recorded by the Division Bench as, in our view, these findings were recorded on the basis of undisputed facts and documents on record of the case. That apart, these findings were recorded keeping in view the facts involved and law laid down by this Court in the case of Indian Petrochemicals (supra)

Mere perusal of the decision rendered in the case of Indian Petrochemicals (supra) would go to show that in that case also, somewhat similar question, which is the subject matter of this appeal, had arisen at the instance of the employees working in canteen. This Court (Three Judge Bench) elaborately examined the question and took note of the relevant undisputed facts, which had bearing over the question, granted the reliefs to the employees concerned.

In our considered opinion, the approach and the reasoning of the two Courts below (Writ Court and Division Bench) while deciding the writ petition and the appeal arising out of the writ petition keeping in view the law laid down by this Court in the case of Indian Petrochemicals (supra) is just, proper and legal.

In other words, if on the undisputed facts, this Court has granted benefit to the canteen workers in the case of Indian Petrochemicals (supra) then there is no reason that on the same set of undisputed facts arising in this case, the Court should not grant the benefit to the employees/workers in this case. It is more so when no distinguishable facts are pointed out in this case qua Indian Petrochemical's case (supra).

In light of above judgement, it could be held in given question too that contractual workers, who are security guards, are right in raising their demand for permanent jobs.

**Answer 1(c)**

The present case is similar to *Executive Engineer, PWD & Ors* vs. *Commissioner, Workmen's Compensation*. In this case of High Court of Jammu & Kashmir held that there is no substance in the submissions made on behalf of the appellant. Admittedly, Respondent No. 3 was working as a contractor with the appellant and was executing the work allotted to him by none other than the Appellant. It is also not in dispute that Respondent No. 2 was engaged as labourer by Respondent No. 3 for execution of the work of the appellant. From the evidence led by the parties before Respondent No. 1, it is further evident that the job of repairing the compressor rod was assigned to Respondent No. 2 by the Junior Engineer of the Appellant and not by Respondent No. 3.

Viewed from any angle, the Appellant cannot avoid its liability to compensate the Respondent No. 2. The appellant being a principal employer was liable to pay the compensation to the Respondent No. 2 on account of permanent disablement suffered by him during and in the course of his employment with the appellant. Even on facts, the job of repairing the compressor rod was entrusted to Respondent No. 2 by the appellant

That being the position, the plea of the appellant that there was no privity of contract between the Respondent No. 2 and the Appellant is misconceived and is noticed to be

rejected only. Both the pleas raised by the appellant to challenge the award, therefore, fail. Hence, principal employer is liable to pay compensation in the given case too.

**Answer 1(d)**

In Matter of *State Of Punjab And Ors* vs. *Jagjit Singh And Ors*, Hon'ble Supreme Court held that the principle of 'equal pay for equal work', which meant equal pay for everyone irrespective of sex, was deducible from the Preamble and Articles 14, 16 and 39(d) of the Constitution. The principle of 'equal pay for equal work', was held to be applicable to cases of unequal scales of pay, based on no classification or irrational classification, though both sets of employees (engaged on temporary and regular basis, respectively) performed identical duties and responsibilities.

The present case is similar to the case of *DTC Security Staff Union (Regd).* vs. *DTC & Anr*. In this case the Hon'ble Supreme Court of India observed that there is no material to hold that pay scale of Deputy Security Officer and Security Officer in the Corporation was consciously kept at par with that of the Delhi Police keeping in mind aspects with regard to the qualifications, nature of duties etc. Merely because the pay scale may have been and remained the same, it cannot lead to the conclusion of a conscious parity on the principle of equal pay for equal work so as to make it discriminatory and a ground for grant of parity to Assistant Security Officer, Security Havildar and Security Guard also. The Tribunal ought to have refrained from going to the exercise of fixation of pay scales no sooner than that it was brought to its attention that a Commission constituted for the purpose was examining the same. Though the Tribunal examined the pay scales given to similarly situated security personnel in other organisations, and also the next below post principle in the Corporation itself, ignoring the difference in the methods of recruitment and qualifications for appointment in the two organisations, it primarily based its conclusion to grant parity of pay scale to Assistant Security Officer, Security Havaldar and Security Guard merely for the reason that parity of pay scale existed for the posts of Deputy Security Officer and Security Officer with that of the Delhi Police.

It is not in dispute that the pay scale of the employees of the corporation, including the security cadre, have been revised from time to time in accordance with the recommendations of 4th, 5th, 6th Pay Commission and now the 7th Pay Commission. There is no material on record that the appellant at any time filed any objection or raised issues for grant of appropriate pay scale either before the 4th Pay Commission or the successive Commissions. If the award of the Tribunal is to be implemented today, it will create a highly anomalous position in the Corporation, and shall lead to serious complications with regard to the issues of pay scale vis-a-vis recommendations of the Pay Commission and would generate further heartburn and related problems vis-à vis other employees of the Corporation.

The Government of Delhi, which would have had to bear the financial burden, did not concur with the Board of the Corporation to abide by the Award. The vast difference in the nature of general duties performed by personnel of the police force in contradistinction to that of security personnel discharging limited security duties in the confines of the Corporation hardly needs any emphasis. We find no reason to interfere with the order of the Division Bench.

Preamble of The Equal Remuneration Act, 1976, states that it is an Act to provide

for the payment of equal remuneration to men and women workers and for the prevention of discrimination, on the ground of sex, against women in the matter of employment and for matters connected therewith or incidental thereto.

In view of the above, An employer cannot differentiate the pay scales for same work or work of a similar nature on the ground of sex or nomenclature of employment but can do so when there is vast difference in the nature of general duties performed and particularly in light of above judgement, the pay scales of persons employed in public sector undertaking is governed by Pay Commission, can't be objected at later stage by security guards.

**Question 2**

*(a) Lala Karori Mal held 5,35,30,960 equity shares of face value of ₹10 each in Sarvodya Agrotech Ltd., a listed company. The holding amounted to 39.88% of the company. The present market value of the share is ₹368/- per share. He died on 29.03.2020 without filing any nomination. However, he executed a will 3 months prior to his death in favour of Mrs. Jamuna Devi, his wife. Two witnesses duly attested the will in the prescribed manner and same was registered with the Registrar. The shares were held in dematerialization form with Karvy Stock Broker (Depository Participant). Due to violation of various laws, rules and regulations, SEBI banned the depository participant and instructed it to transfer the shares with new Depository Participant within 3 months. Accordingly, Karvy as well as CDSL (Depository) sent the Notice through email as well as courier to all investors.*

*Sampat Kumar, son of late Lala Karori Mal, filed a partition suit in High Court claiming entitlement to one-fourth of the estate of his father including the deceased's shareholdings in the said company. The High Court passed an interim order maintaining status quo concerning shares and other immoveable property.*

*While the suit was pending in the High Court, Sampat Kumar filed Company Petition alleging oppression and mismanagement under sections 241 and 242 of the Companies Act, 2013 against his mother and others. He claimed eligibility to maintain the petition on the ground of being a holder of 0.03% shareholding and claiming entitlement and legitimate expectation to 9.97% shareholding of Sarvodya Agrotech Ltd. by virtue of his being the son of deceased Lala Karori Mal. Mrs. Jamuna Devi challenged the maintainability of the petition on the ground that Sampat Kumar was not the holder of the required number of shares to file the petition.*

***Question :***

*Whether the dispute raised as to the inheritance of the estate of the deceased is a civil dispute or could it be said to be an act of oppression and mismanagement in the affairs of the Company ? Whether such a dispute could be adjudicated in a company petition filed during the pendency of the civil suit ? (6 marks)*

*(b) Hari Vinayak was the Director (Finance) of Engineers Techno India Limited, a BSE Listed Company. After completing 4 years in the company, he resigned from the post of Director (Finance) w.e.f. 20.12.2020 citing some personal reasons.*

*His resignation was accepted in the ensuing meeting of Board of directors held on 20.01.2021. Form DIR 12 was also filed in Registrar of Companies.*

*Godawari Construction Pvt. Ltd. filed a complaint against Hari Vinayak. It was alleged that the accused had issued cheques dated 15.02.2021 and 28.02.2021, which were dishonoured upon presentation. There was, however, no allegation that the cheques were post-dated. Accordingly, summons were issued against Hari Vinayak. On the other hand, Hari Vinayak preferred a miscellaneous writ petition for quashing the same. He took the defence that he had already resigned from the Company on 20.12.2020, which was accepted by the Board of directors on 20.01.2021. The High Court dismissed the petition without considering his contention that he had resigned from the Director of the company prior to the issuance of the cheques. Hari Vinayak then preferred a fresh application under section 482 Cr.P.C. to quash the summons. It was dismissed by the High Court opining that since the earlier miscellaneous application for the same relief had already been dismissed, the second application was not maintainable.*

*Hari Vinayak intends to file a special leave petition against the order of the High Court. Will he succeed ? Give reasons in support of your answer and refer to case law, if any.* *(6 marks)*

**Answer 2(a)**

The facts of the given case are similar to the case of Aruna Oswal vs. Pankaj Oswal & Ors. Civil Appeal No. 9340 of 2019 with connected appeals judgement dated 06/07/2020. In this case Supreme Court observed that respondent as pleaded by him, had nothing to do with the affairs of the company and he is not a registered owner. The rights in estate/ shares, if any, of respondent no.1 are protected in the civil suit. Thus, Supreme Court satisfied that respondent does not represent the body of shareholders holding requisite percentage of shares in the company, necessary in order to maintain such a petition.

It is also not disputed that the High Court in the pending civil suit passed an order maintaining the status quo concerning shareholding and other properties. Because of the status quo order, shares have to be held in the name of Mrs. Jamuna Devi until the suit is finally decided. It would not be appropriate, given the order passed by the civil Court to treat the shareholding in the name of Respondent by NCLT before ownership rights are finally decided in the civil suit, and propriety also demands it. The question of right, title, and interest is essentially adjudication of civil rights between the parties, as to the effect of the nomination decision in a civil suit is going to govern the parties' rights. It would not be appropriate to entertain these parallel proceedings and give waiver as claimed under section 244 of the Companies Act, 2013 (the Act)before the civil suit's decision. Respondent had himself chosen to avail the remedy of civil suit, as such filing of an application under sections 241 and 242 the Act after that is nothing but an afterthought.

Supreme Court refrain to decide the question finally in these proceedings concerning the effect of nomination, as it being a civil dispute, cannot be decided in these proceedings and the decision may jeopardise parties' rights and interest in the civil suit. With regard to the dispute as to right, title, and interest in the securities, the finding of the civil Court is going to be final and conclusive and binding on parties. The decision of such a question

has to be eschewed in instant proceedings. It would not be appropriate, in the facts and circumstances of the case, to grant a waiver to the respondent of the requirement under the proviso to section 244 of the Act, as ordered by the NCLAT. It prima facie does not appear to be a case of oppression and mismanagement. Our attention was drawn by the learned senior counsel appearing for Respondent to certain company transactions. From transactions simpliciter, it cannot be inferred that it is a case of oppression and mismanagement. We are of the opinion that the proceedings before the NCLT filed under sections 241 and 242 of the Act should not be entertained because of the pending civil dispute and considering the minuscule extent of holding of 0.03%, that too, acquired after filing a civil suit in company securities, of respondent no. 1. In the facts and circumstances of the instant case, in order to maintain the proceedings, the respondent should have waited for the decision of the right, title and interest, in the civil suit concerning shares in question. The entitlement of respondent No.1 is under a cloud of pending civil dispute. We deem it appropriate to direct the dropping of the proceedings filed before the NCLT regarding oppression and mismanagement under sections 241 and 242 of the Act with the liberty to file afresh, on all the questions, in case of necessity, if the suit is decreed in favour of respondent No.1 and shareholding of Respondent increases to the extent of 10% required under section 244 of the Act.

Supreme Court reiterate that we have left all the questions to be decided in the pending civil suit. Impugned orders passed by the NCLT as well as NCLAT are set aside, and the appeals are allowed to the aforesaid extent. Supreme Court request that the civil suit be decided as expeditiously as possible, subject to cooperation by Respondent Parties to bear their costs as incurred.

**Answer 2(b)**

The given case is similar to a case decided by Supreme Court in *Anil Khadkiwala* vs. *The State Govt. of NCT of Delhi*.

Facts of the case *Anil Khadkiwala* vs. *The State Govt. of NCT of Delhi* are that the application preferred by the appellant under Section 482 of the Code of Criminal Procedure, 1973 to quash the summons issued in complaint case no.3403/1/2015 was dismissed by the High Court opining that since the earlier Crl. M.C. No.877 of 2005 for the same relief had already been dismissed, the second application was not maintainable. Respondent no.2 filed a complaint against the appellant who was the Director of M/s. ETI Projects Ltd., the Company in question. It was alleged that the accused person had issued cheques dated 15.02.2001 and 28.02.2001, which were dishonoured upon presentation. The appellant had preferred Crl.M.P. No.1459 of 2005 for quashing the same. He took the defence, without any proof that he had already resigned from the Company on 20.12.2000, which was accepted by the Board of Directors on 20.01.2001. The application was dismissed on 18.09.2007 after noticing the plea of resignation, solely on the ground that the cheques were issued under the signature of the appellant. The appellant then preferred a fresh application under Section 482 giving rise to the present proceedings. The High Court noticing the reliance on Form 32 issued by the Registrar of Companies, under the Companies Act, 1956, in proof of resignation by the appellant prior to the issuance of the cheques, issued notice, leading to the impugned order of dismissal subsequently.

In the said case, Hon'ble Supreme Court allowed the Petition. Learned counsel for

the appellant submitted that there was no bar to the maintainability of a second application under Section 482 of the Code of Criminal Procedure, 1973 in the peculiar facts and circumstances of the case, relying on Superintendent and Remembrancer of Legal Affairs, West Bengal vs. Mohan Singh and Ors., AIR 1975 SC 1002. Learned counsel for respondent no.2 relied upon order dated 06.05.2019 of this Court in *Atul Shukla* vs. *The State of Madhya Pradesh and another (Criminal Appeal No.837 of 2019)* to contend that such an application was not maintainable. The cheques being post-dated, the appellant cannot escape its answerability.

We have considered the respective submissions on behalf of the parties and are of the opinion that the appeal deserves to be allowed for the reasons enumerated hereinafter.

The complaint filed by respondent no.2 alleges issuance of the cheques by the appellant as Director on 15.02.2001 and 28.02.2001. The appellant in his reply dated 31.08.2001, to the statutory notice, had denied answerability in view of his resignation on 20.01.2001. This fact does not find mention in the complaint. There is no allegation in the complaint that the cheques were post-dated. Even otherwise, the appellant had taken a specific objection in his earlier application under Section 482 of the Code of Criminal Procedure, 1973 that he had resigned from the Company on 20.01.2001 and it had been accepted. From the tenor of the order of the High Court on the earlier occasion it does not appear that Form 32 issued to the Registrar of Companies was brought on record in support of the resignation. The High Court dismissed the quashing application without considering the contention of the appellant that he had resigned from the post of the Director of the Company prior to the issuance of the cheques. The High Court in the fresh application under Section 482 of the Code of Criminal Procedure, 1973, initially was therefore satisfied to issue notice in the matter after noticing the Form 32 certificate. Naturally there was a difference between the earlier application and the subsequent one, inasmuch as the statutory Form 32 did not fall for consideration by the Court earlier. The factum of resignation is not in dispute between the parties. The subsequent application, strictly speaking, therefore cannot be said to a repeat application squarely on the same facts and circumstances.

The Company, of which the appellant was a Director, is a party respondent in the complaint. The interests of the complainant are therefore adequately protected. In the entirety of the facts and circumstances of the case, we are unable to hold that the second application for quashing of the complaint was not maintainable merely because of the dismissal of the earlier application. The impugned order of the High Court is set aside. The appeal is allowed and the proceeding.

In view of the above mentioned case, Hari Vinayak may succeed in a special leave petition against the order of the High Court.

**Question 3**

(a) *Michael E. Porter's Five Forces Analysis model provides valuable information to support strategic management, especially in addressing relevant issues in the external environment of the business. These issues are based on external factors that represent the degree of competitive revalry in the industry, the bargaining power of customers or buyers, the bargaining power of suppliers, the threat of substitution, and the threat of new entrants.*

*Super Foods Ltd., a fast food company operating in South India, intends to apply the said model to survive and grow. Explain how can the company prioritize the strategic issues related to competition, consumers and substitutes.* *(6 marks)*

*(b) Competition Commission of India received complaints against Karisma Broadcasting Ltd. for abusing its dominant position. Accordingly, Director General started investigations and a raid was carried out. In the course of raid, some documents and property were seized.*

*Karisma Broadcasting Ltd. filed the writ against such search and seizure. The main averments of the writ petition were that the Director General had no power to seize the property. Explain whether the petition filed by the company is maintainable in the court of law. Give reasons in support of your answer and refer to case law, if any.* *(6 marks)*

**Answer 3(a)**

Considering the combination of market conditions, Porter's Five Forces analysis of Super Foods Ltd. establishes the following intensities of the five forces:

1. Competitive rivalry or competition - High
2. Bargaining power of buyers or customers - High
3. Bargaining power of suppliers - Low
4. Threat of substitutes or substitution - High
5. Threat of new entrants or new entry - Moderate

**Competitive Rivalry or Competition with Super Foods Ltd. (High)**

Super Foods Ltd. faces tough competition because the fast food restaurant market is saturated. This element of the Porter's Five Forces analysis model tackles the effects of competing firms in the industry environment. In Super Foods Ltd. case, the strong force of competitive rivalry is based on the following external factors:

- High number of firms - Strong Force
- High aggressiveness of firms - Strong Force
- Low switching costs - Strong Force.

The fast food restaurant industry has many firms of various sizes, such as global chains like Super Foods Ltd. and local mom-and-pop fast food restaurants. This external factor strengthens the force of rivalry in the industry. Also, the Five Forces analysis model considers firm aggressiveness a factor that influences competition. In this business case, most medium and large firms aggressively market their products. This factor increases the intensity of competitive rivalry that Super Foods Ltd. Corporation experiences. In addition, low switching costs make it easy for consumers to transfer to other restaurants, such as Wendy's and Burger King. This external factor adds to the force of competition. Thus, this element of the Five Forces analysis of Super Foods Ltd. shows that competition is among the most significant external forces for consideration in the strategic management of the business.

**Bargaining Power of Super Foods Ltd. Customers/Buyers (Strong Force)**

Super Foods Ltd. must address the power of customers on business performance. This element of the Five Forces analysis deals with the influence and demands of consumers, and how their decisions impact businesses. In Super Foods Ltd. case, the following are the external factors that contribute to the strong bargaining power of buyers:

- Low switching costs – Strong Force
- Large number of providers – Strong Force
- High availability of substitutes – Strong Force

The ease of changing from one restaurant to another (low switching costs) enables consumers to easily impose their demands on Super Foods Ltd.. In the Five Forces analysis model, this external factor strengthens the bargaining power of customers. In relation, because of market saturation, consumers can choose from many fast food restaurants other than Super Foods Ltd.. This condition makes the bargaining power of buyers a strong force in affecting the company's external environment. Moreover, the availability of substitutes is relevant in this external analysis. In this case, the availability of many substitutes adds to the bargaining power of customers. For example, substitutes include food kiosks and outlets, and artisanal bakeries, as well as microwave meals and foods that one could cook at home. Based on this element of Porter's Five Forces analysis, it is crucial to develop strategies to increase customer loyalty, especially in the face of the socio cultural trends.

**Bargaining Power of Super Foods Ltd. Suppliers (Weak Force)**

Suppliers influence Super Foods Ltd. in terms of the company's production capacity based on the availability of raw materials. This element of the Five Forces analysis model shows the impact of suppliers on firms and the fast food restaurant industry environment. In Super Foods Ltd. case, the weak bargaining power of suppliers is based on the following external factors:

- Large number of suppliers – Weak Force
- Low forward vertical integration of suppliers – Weak Force
- High overall supply – Weak Force

The large population of suppliers weakens the effect of individual suppliers on Super Foods Ltd. Corporation. This weakness is partly based on the lack of strong regional and global alliances among suppliers. In relation, most of Super Foods Ltd. suppliers are not vertically integrated. This means that they do not control the distribution network that transports their products to firms like Super Foods Ltd. In Porter's Five Forces analysis model, such low vertical integration weakens the bargaining power of suppliers. Also, the relative abundance of materials like flour and meat reduces individual suppliers' influence on the company. Thus, this element of the Five Forces analysis shows that external factors combine to create the weak supplier power, which is a minimal issue in strategic management.

**Threat of Substitutes or Substitution (Strong Force)**

Substitutes are a significant concern for Super Foods Ltd. Corporation. This element

of Porter's Five Forces analysis model deals with the potential effects of substitutes on firm growth. In Super Foods Ltd. case, the following external factors make the threat of substitution a strong force:

- High substitute availability – Strong Force
- Low switching costs – Strong Force
- High performance-to-cost ratio of substitutes – Strong Force

There are many substitutes to Super Foods Ltd. products, such as products from artisanal food producers and local bakeries. Also, consumers can cook their food at home. In the Five Forces analysis model, this external factor contributes to the strength of the threat of substitution in the fast food service industry. In addition, it is easy to shift from Super Foods Ltd. to substitutes because of the low switching costs. For example, shifting from the company to substitutes typically involves insignificant or minimal disadvantages, such as slightly higher costs per meal in some cases, or additional time consumption for food preparation. Moreover, substitutes are competitive in terms of quality and customer satisfaction (high performance-to-cost ratio). In this element of the Five Forces analysis of Super Foods Ltd. Corporation, external factors make substitutes a major strategic issue that requires approaches like product quality improvement. In relation, the company's efforts include encouraging people to eat in fast food restaurants instead of resorting to substitutes.

**Threat of New Entrants or New Entry (Moderate)**

New entrants can impact Super Foods Ltd. market share and financial performance. This element of the Five Forces analysis refers to the effects of new players on existing firms. In Super Foods Ltd. case, the moderate threat of new entry is based on the following external factors:

- Low switching costs – Strong Force
- Highly variable capital cost – Moderate Force
- High cost of brand development - Weak Force

The low switching costs allow consumers to easily move from Super Foods Ltd. toward new fast food restaurant companies. In Porter's Five Forces analysis model, this external factor strengthens the threat of new entrants. Also, variable capital costs of establishing a new restaurant empowers new businesses to enter the global fast food restaurant industry. For example, small restaurant businesses involve low capital costs compared to major corporations in the market. This external factor leads to the moderate threat of new entry against Super Foods Ltd. On the other hand, it is expensive to build a strong brand in the industry. Many small and medium businesses lack the resources to create a strong brand to match the Super Foods Ltd. brand. Thus, the external factors in this element of the Five Forces analysis shows that the threat of new entrants is considerable but not the most important strategic issue.

**Answer 3 (b)**

Section 41 of the Competition Act, 2002 states that:

(1) The Director General shall, when so directed by the Commission, assist the Commission in investigating into any contravention of the provisions of this Act or any rules or regulations made thereunder.

(2) The Director General shall have all the powers as are conferred upon the Commission under subsection of section 36.

(3) Without prejudice to the provisions of sub-section (2), sections 240 and 240A of the Companies Act, 195), so far as may be, shall apply to an investigation made by the Director General or any other person investigating under his authority, as they apply to an inspector appointed under that Act.

The facts of the present case is similar to the case of *Competition Commission of India* vs. *JCB India Ltd. and Ors, Supreme Court dt 15.01.2019*. In this case, CCI ordered an investigation into an alleged abuse of dominant position by JCB. Pursuant to the same, dawn raid was carried out by the DG in the JCB premises and all incriminating documents, hard drives and laptops found by the inspecting team during the course of the "dawn raid" were seized. A writ petition before the Delhi High Court was filed for setting aside of the search and seizure conducted by the DG. The Single Judge Bench of Delhi High Court, vide order dated 02nd June 2016 stayed the investigation restraining DG from acting on the seized material for any purpose whatsoever till the next date of hearing. CCI filed an SLP in the Supreme Court against the order of the Delhi High Court. The Supreme Court in its judgment dated 15th Janaury 2019 in CCI vs JCB observed that the provisions of Section 240A of the Companies Act, 1956 do not merely relate to an authorization for a search but extend to the authorization of a seizure as well. Unless the seizure were to be authorized, a mere search by itself will not be sufficient for the purposes of investigation. By virtue of Section 240A read with Section 41(3) of the Competition Act, DG was authorised to conduct search and seizures.

The Apex court vacated the stay stating that the blanket restraint which had been imposed by the Delhi High Court on the DG from acting on the seized material for any purpose whatsoever was not warranted. The appeal was allowed and the transferred matters were remitted back to the Delhi High Court to be decided in the writ petitions pending before Delhi High Court.

Therefore, writ petition filed by the Company is not maintainable.

**Question 4**

*(a) A Public Interest Litigation (PIL) was filed in the Supreme Court of India under Article 32 of the Constitution of India by a society registered under the Societies Registration Act, 1860.*

*In the petition, it was mentioned that as per the WHO India guidelines and recommendations, 50% of the victims die in the first 15 minutes due to serious cardiovascular or nervous system injuries and the rest can be saved by providing basic life support during the 'Golden Hour'. Right to life is enshrined under Article 21 which includes right to safety of persons while travelling on the road and the immediate medical assistance as a necessary corollary is required to be provided and also adequate legal protection and prevention from harassment to good Samaritans. The petition further stated that the honourable court issue guidelines and directions including a command for compliance of guidelines and Standard Operating Procedure (SOP) to be issued by the Government of India, Ministry of Road Transport and Highways under Article 32 read with Article 142 of the Constitution of India till such time as the legislature steps into substitute them by proper legislation.*

*Explain whether such types of petitions are maintainable by the Court.*

*(6 marks)*

(b) *On the evening of August 7, 2020, Air India Express Flight 1344 crashed with 190 people on board during a botched landing attempt at Kozhikode Calicut International Airport. Eighteen people were killed in the Air India crash and more than 150 others sustained injuries.*

*The weather was bad and there was low visibility. The pilot circled the airport before asking Air Traffic Controllers to switch runways.*

*ATC granted the request and cleared the flight to land on a tabletop runway with a sudden drop-off at the end. Passengers recalled that the Boeing 737 swayed violently before touching down. They alleged that pilot never gave a warning sign to passengers or indicated that something was wrong.*

*The legal heirs of two passengers Chandran and Lalitha (Wife of Chandran) filed two separate claim applications before the Tribunal. By a common Award, the Tribunal allowed the applications. For the death of both, the Tribunal awarded a total sum of ₹4,36,95,740 to the claimants.*

*The Insurance Company challenged the award before the High Court. The claimants also challenged the award before the High Court for enhancement of compensation amount awarded to them by the Tribunal. By impugned common judgment, the High Court reduced the compensation to ₹ 3,75,00,000.*

*Challenging the said judgement of the High Court, the Insurance Company appealed before the Supreme Court seeking further reduction in the award of compensation. On the other hand, the claimants appealed seeking enhancement in the compensation.*

*Analyse, referring to decided case law, whether the appeal is admissible ?*

*(6 marks)*

**Answer 4(a)**

The present case is similar to case decide by Supreme Court in *Savelife Foundation & Another (Appellant)* vs. *Union of India & Another*.

The facts of the case *Savelife Foundation & Another (Appellant)* vs. *Union of India & Another* are as under:

The petition has been filed under Article 32 of the Constitution of India in public interest for the development of supportive legal framework to protect Samaritans i.e. bystanders and passers-by who render the help to the victims of road accidents. These individuals can play a significant role in order to save lives of the victims by either immediately rushing them to the hospital or providing immediate lifesaving first aid.

The people have the notion that touching the body could lend them liable for police interrogation. Passer-by plays safe and chose to wait for the police to arrive whereas injured gradually bleeds to death. People are reluctant to come forward for help despite, desperate attempts to get help from passer-by, by and large they turn blind eyes to the person in distress. Sometimes those who help are rebuked due to ignorance by the others on touching the scene. In the case of a convoy even when there are several vehicles in the convoy, people wait for the ambulance to arrive and also for the concerned

police help. There are several desisting factors which are required to be taken care of such as fear of legal consequences if once action is ineffective or harmful to victim, fear of involvement in subsequent prolonged investigation and visit to the police station. There is need to evolve the system by promptly providing effective care system with certain ethical and legal principles. It is absolutely necessary that Good Samaritans feel empowered to act without fear of adverse consequence. There is need to provide certain incentives to Good Samaritans. There is also dire need to enact a Good Samaritan Law in the country since there is a felt need of legislation for affording protection to Good Samaritans. The Ministry of Road Transport and Highways has issued a notification containing guidelines on 12.5.2015 for protection of good Samaritans and a further Notification has been issued on 21.1.2016 framing standard operating procedures. It has been mentioned in the affidavit filed by Ministry of Road Transport and Highways, Government of India that in the absence of any statutory backing, it is felt that it will be difficult to enforce these guidelines issued on 12.5.2015 and standard operating procedures as notified on 21.1.2016.

Prayer has been made on the part of the Ministry of Road Transport and Highways of Government of India that the guidelines notified on 12.5.2015 and the standard operating procedure notified on 21.1.2016 may be declared to be enforceable by this Court so that it is binding on all the States and Union Territories until the Union Government enacts a law to this effect.

In this case, Hon'ble Supreme Court allowed the petition.

The Apex Court held that after referring to various judgements and elaborately discussing on the power of the judiciary to lay down laws the Supreme Court held as under:

In view of the aforesaid discussion, it is apparent that guidelines and directions can be issued by this Court including a command for compliance of guidelines and standard operating procedure issued by Government of India, Ministry of Road Transport and Highways, till such time as the legislature steps in to substitute them by proper legislation. This Court can issue such directions under Article 32 read with Article 142 to implement and enforce the guidelines which are necessary for protection of rights under Article 21 read with Article 14 of the Constitution of India so as to provide immediate help to the victims of the accident and at the same time to provide protection to Good Samaritans. The guidelines will have the force of law under Article 141. By virtue of Article 144, it is the duty of all authorities - judicial and civil – in the territory of India to act in aid of this Court by implementing them.

We have carefully gone through the notification dated 12.5.2015. However, as per the guidelines contained in para 13, the 'acknowledgement' if so desired by Good Samaritans, has to be issued as may be prescribed in a standard format by the State Government. In our opinion, till such time the format is prescribed, there should be no vacuum hence we direct that acknowledgement be issued on official letter-pad etc. and in the interregnum period, if so desired by Good Samaritan, mentioning the name of Samaritan, address, time, date, place of occurrence and confirming that the injured person was brought by the said Samaritan.

We have also gone through the notification dated 21.1.2016 with respect to the

examination of Good Samaritan by the Police as contained in para 2(vii) which we modify and be read in the following manner :

"The affidavit of Good Samaritan if filed, shall be treated as complete statement by the Police office while conducting the investigation. In case statement is to be recorded, complete statement shall be recorded in a single examination." Remaining guidelines in the notifications dated 12.5.2015 and 21.1.2016 are approved and it is ordered that guidelines with aforesaid modifications made by us be complied with by the Union Territories and all the functionaries of the State Governments as law laid down by this Court under Article 32 read with Article 142 of the Constitution of India and the same be treated as binding as per the mandate of Article 141.

We also direct that the court should not normally insist on appearance of Good Samaritans as that causes delay, expenses and inconvenience. The concerned court should exercise the power to appoint the Commission for examination of Good Samaritans in accordance with the provisions contained in section 284 of the Code of Criminal Procedure, 1973 suo motu or on an application moved for that purpose, unless for the reasons to be recorded personal presence of Good Samaritan in court is considered necessary.

In view of the above decided case, such type of petitions may be maintained/ entertained by the courts.

**Answer 4(b)**

The given case is similar to the case decided by Supreme Court in the case of *D.M. Oriental Insurance Co. Ltd.* v. *Swapna Nayak & Ors*.

The facts of the case *D.M. Oriental Insurance Co. Ltd.* v. *Swapna Nayak & Ors* are that Mathurananda Nayak, a resident of U.S.A., and his mother Jita Nayak along with two others while coming from Cuttack collided with a truck. As a result of the said accident, Mathurananda Nayak, Jita Nayak along with driver of the car sustained injuries and later succumbed to the injuries on the same day. The legal heirs of Mathurananda Nayak and Jita Naik filed two separate claim applications before the Tribunal. By a common Award the Tribunal allowed the applications. For the death of Mathurananda Naik the Tribunal awarded a total sum of Rs.4,36,95,740/- to the claimants and for the death of Jita Naik awarded a sum of Rs.1,29,500/- with interest at the rate of 7.5% p.a. The Insurance Company challenged the award before the High Court and the claimants also challenged the award before the High Court for enhancement of compensation amount awarded to them by the Tribunal. By impugned common judgment, the High Court reduced the compensation to Rs.3,75,00,000/-. Challenging the said judgment of the High Court, the Insurance Company has filed C.A. No. 3862 of 2013 seeking further reduction in the award of compensation whereas the claimants have filed C.A. Nos. 3863-3864 of 2013 seeking enhancement in the compensation.

The Hon'ble Supreme Court dismissed the application.

The Apex Court held that having heard the learned counsel for the appellant (Insurance Company) and on perusal of the entire record of the case, we have formed an opinion to dismiss both the appeals and, in consequence, are inclined to uphold the order of the High Court which, in our view, does not call for any interference.

On perusal of the decisions cited at the bar and further having regard to the totality of the facts and circumstances of the case and the concurrent findings of two courts and on material issues such as the determination of annual income of the deceased, his age, the number of dependents etc., we do not find any good ground to interfere in the impugned order. In our view, such findings, apart from being concurrent, cannot be said to be, in any way, arbitrary and nor they result in awarding a bonanza or a windfall to the claimants so as to call for further reduction in the compensation awarded by the High Court.

In other words, in our view, what has been eventually awarded to the claimants by the High Court appears to be just and reasonable compensation within the meaning of Section 166 of the Act and there does not appear any good ground for further enhancement under any of the heads including under the head of future prospects as claimed by the claimants in their appeal and nor any case is made out for further reduction by applying the lesser multiplier or to make further deduction in the salary component of the deceased as claimed by the Insurance Company. When we find that under one head, reasonable amount has been awarded and under another head, nothing has been awarded though it should have been so awarded and at the same time, we notice that eventual figure of the award of compensation payable to the claimants appears to be just and reasonable then in such eventuality, we do not consider it proper to interfere in such award in our appellate jurisdiction under Article 136 of the Constitution. In other words, if by applying the tests and guidelines, we find that overall award of compensation is just and fair, then, in our view, such award deserves to be upheld in claimants' favour. We find it to be so in the facts of this case having taken note of all relevant facts and circumstances of the case.

In the light of foregoing discussion, we find no merit in the appeals, i.e., the appeal filed by the Insurance Company seeking further reduction in the compensation and the appeals filed by the claimants seeking enhancement in the compensation and accordingly dismiss the appeals and, in consequence, uphold the order of the High Court calling no interference therein.

In view of the above decided case, the appeal may not be admissible.

**Question 5**

*(a) A company XYZ Ltd. had been mis-reporting its financial statements since more than 10 years which none of the stakeholders noticed for years. When the situation of the Company went from bad to worse and it had no option but to declare it bankrupt, the company issued a press statement that there is a disparity between actual and reported results due to accounting errors. The first question from shareholders of the Company was as to why the auditors had not spotted and corrected the fundamental accounting errors ? The auditors of the Company (one of the largest audit firms in the country) had compromised its independence by charging a huge audit fee and also consultancy income worth several times the audit fee. It had knowingly signed off inaccurate accounts in order to protect the management of the Company. The investigation also found a number of significant internal control deficiencies, external reporting processes, and a disregard of the relevant accounting standards. Based on the above facts, answer the following :*

*(i) Does the case highlight importance of independence of auditors ? Explain*

*provisions under the Companies Act, 2013 which promote independence and rotation of auditors.*

*(ii) NFRA constituted under the Companies Act, 2013 has been vested with powers for action against the auditors. Explain powers and functions of NFRA. (3 + 3 = 6 marks)*

*(b) ABC Ltd. and XYZ Ltd. had executed an agreement. As per the contract, XYZ Ltd. was to provide manufacturing, civil and manpower services at project site of ABC Ltd. There were certain timelines for each activity, on failure of which, there was provision for imposing liquidated damages. As per liquidated damages clause, the specified amount of damages was to be paid by the breaching party (XYZ Ltd.) if it failed to perform specified obligations. The validity of the contract was 5 years.*

*Due to strike by various labour unions and industrial unrest, the project got delayed and ABC Ltd. imposed liquidated damages to the tune of ` 10 Crores. XYZ Ltd. protested the said penalty and raised the dispute as per provisions of the contract. As per Arbitration Clause, the Chairman and Managing Director of ABC Ltd. was the competent authority to appoint the Arbitrator and accordingly he nominated one Roshan as the sole arbitrator. XYZ Ltd. challenged such nomination and cited the judgment of Supreme Court in matter of TRF Ltd. Vs. Energo Engineering Projects Ltd.*

*Whether the appeal of XYZ Ltd. is admissible? Give reasons in support of your answer. (6 marks)*

**Answer 5(a)**

(i) Yes, the given case definitely brings out the importance of independence of auditors which has been re-iterated at various places and through various provisions in the Companies Act, 2013. If the Auditors had exercised independent judgement and not under the influence of the client they would have performed their duties diligently as was expected of them rather than signing inaccurate financial statements.

Some of the Provisions of Companies Act, 2013 which promote independence of Auditors are discussed below:

1. **Eligibility for appointment as Auditor** - Section 141 of the Companies Act 2013 provides that the following cannot be appointed as Auditors –
    1. a body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008;
    2. an officer or employee of the company;
    3. a person who is a partner, or who is in the employment, of an officer or employee of the company;
    4. a person who, or his relative or partner—
        (i) is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company:

Provided that the relative may hold security or interest in the company of face value not exceeding one thousand rupees or such sum as may be prescribed;

(ii) is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of such amount as may be prescribed; or

(iii) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, for such amount as may be prescribed;

5. a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed;

6. a person whose relative is a director or is in the employment of the company as a director or key managerial personnel;

7. a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies;

8. a person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction;

9. any person whose subsidiary or associate company or any other form of entity is engaged as on the date of appointment in consulting and specialized services as provided in Section 144 (auditors not to render certain services).

**2. Rendering of Non - Audit Services by Auditors :** The rendering of following services by Auditor of the Company are prohibited under Section 144:

(i) accounting and book keeping services;

(ii) internal audit;

(iii) design and implementation of any financial information system;

(iv) actuarial services;

(v) investment advisory services;

(vi) investment banking services;

(vii) rendering of outsourced financial services;

(viii) management services; and

(ix) any other kind of services as may be prescribed.

3. **Oversight of Auditors** : To ensure independence and effectiveness of statutory auditors, the audit committee is required to review and monitor the auditor's independence, the audit scope and process, and performance of the audit team and accordingly recommend appointment, remuneration and terms of appointment of auditors of the company.

4. **Appointment and Mandatory presence of Auditors at general meetings of the Company** : In terms of Section 139, the appointment of auditors is done by the members of the Company who are independent of its management. This ensures that the selection of Auditors is done in an impartial manner. Further, the Auditors are mandatorily required to attend all general meetings of the Company which enables the shareholders to raise queries to the auditors concerning the accounts of the Company.

5. **Duty to Report about Fraud** : Section 143(12) imposes duty on the auditors by prescribing that if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government and in case of a fraud involving lesser than the specified amount, the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases.

6. **Mandatory Rotation of Auditors** : Companies Act, 2013 for the first time introduced the concept of mandatory rotation of auditors. Section 139(2) read with Rule 5 of the Companies (Audit and Auditors) Rules, 2014 provides that no listed company or a company belonging to the following classes of companies excluding one person companies and small companies:

   (a) all unlisted public companies having paid up share capital of rupees 10 crore or more;

   (b) all private limited companies having paid up share capital of rupees 50 crore or more;

   (c) all companies having paid up share capital of below threshold limit mentioned in (a) and (b) above, but having public borrowings from financial institutions, banks or public deposits of rupees 50 crore or more shall appoint or re-appoint –

      - An individual as auditor for more than one term of five consecutive years; and

      - an audit firm as auditor for more than two terms of five consecutive years

Also, an individual auditor who has completed his term of five consecutive years shall not be eligible for re-appointment as auditor in the same company for five years from the completion of his term. An audit firm which has completed two terms of five consecutive years shall not be eligible for re-appointment as auditor in the same company for five years from the completion of such term.

Provided further that as on the date of appointment no audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding the financial year, shall be appointed as auditor of the same company for a period of five years.

(ii) The National Financial Reporting Authority (NFRA) is an independent regulator established under Section 132 of the Companies Act, 2013 to oversee the auditing profession. It is similar to the Public Company Accounting Oversight Body set by in the USA by the Sarbanes Oxley Act 2002. NFRA has the investigative and disciplinary powers.

NFRA can:

1) Investigate either suo moto or on the reference made to it by Central Government into the matters of professional or other misconduct, committed by any member or firm of chartered accountants, registered under the Chartered Accountants Act, 1949.

2) Impose penalties of not less than 1 lakh which may extend to five times of the fees received, in case of individuals professionals and of not less than 10 lakhs which may extend to ten times of the fees received, in case of professional firms; if the misconduct is proved.

3) Debarring the member or the firm from engaging himself or itself from practice as the member of the Institute of Chartered Accountant of India for a minimum period of six months which may extend to a period of 10 years. INFRA has also been vested with the same powers as are vested in civil courts under the Code of Civil Procedure, 1908 while trying a suit, relating to:

   - discovery and production of books of account and other documents, as may be specified by the National Financial Reporting Authority;
   - summoning, enforcing the attendance of persons and examination them on oath;
   - issuing commissions for the examination of witnesses or documents;
   - inspection of any books, registers and other documents of any person to whom NFRA has summoned, enforced the attendance and examined on oath;

It is also being provided in section 132 of the Companies Act, 2013 that no other institute or body shall initiate or continue any proceedings in such matters of misconduct where the NFRA has initiated an investigation under this section. However, any person aggrieved by any order of the NFRA may appeal before the Appellate Authority constituted for this purpose.

**Answer 5(b)**

The Supreme Court, by its judgment in *TRF Ltd.* v. *Energo Engineering Projects Ltd., (2017) 8 SCC 377* (rendered on 03.07.2017), held that since a Managing Director of a company which was one of the parties to the arbitration, was himself ineligible to act as arbitrator, such ineligible person could not appoint an arbitrator, and any such appointment would have to be held to be null and void.

The facts of the case referred by XYZ limited do not correspond to TRF Limited and hence same case cannot be relied upon in the given question.

Section 7 of the Arbitration and Conciliation Act, 1996 defines arbitration agreement as under:

(1) In this Part, "arbitration agreement" means an agreement by the parties to submit to arbitration all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not.

(2) An arbitration agreement may be in the form of an arbitration clause in a contract or in the form of a separate agreement.

Section 11 of the Arbitration and Conciliation Act, 1996 provides for appointment of arbitrators.—

(1) A person of any nationality may be an arbitrator, unless otherwise agreed by the parties.

(2) Subject to sub-section (6), the parties are free to agree on a procedure for appointing the arbitrator or arbitrators.

Therefore, arbitrator must be appointed in according to the procedure agreed between the parties.

In the given case, as per the Arbitration clause, the Chairman and Managing Director of ABC Ltd. was the competent authority to appoint the arbitrator and accordingly he nominated one Roshan as the sole arbitrator.

As arbitrator in the question is appointed according to arbitration agreement, therefore, the same cannot be challenged.

**Question 6**

*(a) Paras Pharma Ltd. had accepted deposits since 2002 and regularly paid maturity amounts till 28.02.2013. In 2013, the company started facing liquidity problems and incurred losses.*

*The company filed application before the Company Law Board and obtained relief under section 58 AA read with section 58A (9) of the erstwhile Companies Act, 1956 and get instalments fixed to repay deposits. Whether the said company, which has already got relaxation from CLB under Section 58AA read with Section 58A (9) the erstwhile Companies Act, 1956 and got instalments fixed to repay deposits, can again apply for re-fixing of periods, instalments and rate of interest for repayment of deposits accepted before commencement of the Companies Act, 2013.*

*Give reasons in support of your answer.* *(6 marks)*

*(b) You are the company secretary of a listed food manufacturing company. Your Chairman informs you that he has been asked to meet with two major shareholders of the company. They are institutional investors who together own about 6% of the company's equity shares. Both of them have stated publicly their policy of socially responsible investment and the purpose of the meeting is to discuss*

*social and environmental issues and the company's policy on corporate social responsibility.*

*As a company secretary you are required to write a brief note for the Chairman on the following issues :*

*(i) Role of institutional investors in good corporate governance.*

*(ii) The socially responsible investment principles for institutional investors and the ways in which institutional investors may pursue a socially responsible investment strategy. (6 marks)*

**Answer 6(a)**

The facts of the present case is similar to the case of *M/s Ind-Swift Limited (Appellant)* vs. *Registrar of Companies (Punjab & Chandigarh) (Respondent)*. In this case NCLAT observed that the NCLT considered that the Appellant had at the time of first grant of time got relief of huge extension and that there was no reason to accept the plea for further extension. The NCLT appears to have found that when big relief had already been granted to the Company, further extension was not justified.

Section 76(2) read with Sections 73 and 74 of the Companies Act, 2013 would apply to acceptance of deposits from public by eligible Companies but it saves the Company which had accepted or invited public deposits under the relevant provisions of the Companies Act, 1956 and Rules there under and has been repaying such deposits and interests thereon in accordance with such provisions, then the provisions of Clause (b) of Sub-Section (1) of Section 74 of the Companies Act, 2013 shall be deemed to have been complied with. This is, however, subject to the fact that the Company complies with the requirements under the Companies Act, 2013 and the Rules and continues to repay such deposits and interest due thereon on due dates for the remaining period" as per the terms and conditions.

Considering these provisions, it appears that Section 74(1)(b) the Companies Act, 2013 was attracted and when it appears from record that the Appellant defaulted, the penal provisions would get attracted.

Thus, when once a scheme had been got settled, from Company Law Board, default on the part of the Appellant would attract penal provisions as the earlier scheme itself laid down. Hence, present appeal for further extension is dismissed.

**Answer 6(b)**

(i) Institutional investors are those financial institutions which accept funds from other parties for investment by the institution in its own name but on their clients/ beneficiaries behalf. The different kinds of institutional investors are banks, development financial institutions, insurance companies, mutual funds, foreign institutional investor, provident funds and proposed private fund managers.

They are now significant players in the global economy. Institutional investors are entrusted with funds from the public and most of the household income is with these institutional investors. They are safe keepers of public money and act in a fiduciary capacity. They are obligated to take decisions which best serve the company's' interests and steer the company to function in an ethical manner.

There is a mutual relationship between institutional investors and the good corporate governance of a company. The corporate governance practices followed by a company are very important to determine the number of institutional investors who would like to invest in the firm and the extent to which they would like to invest. Institutional investors, being shareholders with large concentrated shareholding have the power to get involved with good corporate governance practices.

Institutional investors are major contributories of companies in India. The recent government policies have led to an increase in the flow of Foreign Direct Investment and Foreign Institutional Investment in India. Institutional investors are becoming important components of companies. Though institutional investor activism is not prevalent to such a great extent in India, but it is gaining importance. Institutional investors play a proactive role in the corporate governance of companies in the United State and U.K. They monitor the decisions of the Board and help in building effective corporate governance practices in the firm.

Most governance sensitive institutional investors would like to invest in firms which already have their governance mechanisms in place. Institutions with corporate governance mechanisms in place are better to invest in as this would mean decreased monitoring costs. The institutional investors would not have to play a proactive role in monitoring the practices followed by the company.

(ii) The Institutional investors generally follow the given six Principles for Responsible Investment

- Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.
- Principle 2: We will be active owners and incorporate ESG issues into ownership policies and practices.
- Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which they invest.
- Principle 4: We will promote acceptance and implementation of the Principles within the investment industry.
- Principle 5: We will work together to enhance effectiveness in implementing the Principles.
- Principle 6: We will each report on their activities and progress towards implementing the Principles.

Institutional Investors activities may include:

- Monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration.
- Engagement in purposeful dialogue with companies on major issues.
- Decision-making on matters such as allocating assets, awarding investment mandates, designing investment strategies, and buying or selling specific securities.

- They set the tone for stewardship and may influence behavioural changes that lead to better stewardship by asset managers and companies.
- Asset managers, with day-to-day responsibility for managing investments, are well positioned to influence companies' long-term performance through stewardship.

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# BANKING – LAW & PRACTICE

**(Elective Paper 9.1)**

*Time allowed : 3 hours* *Maximum marks : 100*

***NOTE*** : *Answer ALL Questions.*

**Question 1**

*Read the following case study and answer the questions that follow :*

***Execution of Forward Contracts***

*ABC Bank, Kanpur branch is an Authorized Dealer in 'Foreign Exchange' and authorized dealer status given by Reserve Bank of India as ''A Category''. Number of Export/Import oriented units located in SEZ, Kanpur are the clients of ABC Bank, Kanpur Branch. As ABC Bank, Kanpur is only one 'Forex Authorized Branch' located in Kanpur, Exporters and Importers situated within the radius of 60 KM are visiting to the Branch to clarify their doubts with regard to discounting of Export Bills/Import Bills/Letter of Credit etc. from Chief Manager, Foreign Exchange Division of ABC Bank, Kanpur Branch.*

*The Controlling Authority of ABC Bank, Kanpur observed the above situation and instructed the Branch to conduct Exporters/Importers Meet on 9th April, 2020 to mobilize 'Foreign Exchange Business' from Exporters and Importers to the Branch books.*

*Accordingly, ABC Bank, Kanpur Branch followed the instructions of their Controller and invited all the Exporters/Importers surrournding to the Branch and also within a radius of 60 KM. They conducted Meet in a Five Star Hotel in Kanpur in a big way*

*During the Export/Importers Meet number of questions were raised by prospective customers and the same was suitably replied by Senior Staff members of the Bank. Existing and prospective customers were satisfied with the replies given by Bank officials. One clarification sought by 'Number of Customers' is on ''Forward Contract'' Product of International Banking. Most of them are not utilized this Product offered by ABC Bank, Kanpur. Mr. Suresh, Chief Manager of the Branch explain the 'Forward Contracts' Product features offered by the Branch as follows :*

*Forward Contract is the traditional method by which Exporters and Importers were hedging their foreign currency exposure. It affords perfect hedge for foreign currency exposures.*

*The uncertainty about the rate that would prevail on a future date is known as the 'exchange risk'. For the exporter the exchange risk is that the foreign currency in which the transaction is designated may depreciate in future and may bring less than the expected realization in local currency terms.*

*The importer too faces exchange risk when the transaction is designated in a foreign currency. The risk is that the foreign currency may appreciate in value and he may*

*be compelled to pay in local currency an amount higher than that was originally contemplated. Importers generally make arrangements for loans for payment for the imports. If the foreign currency appreciates subsequent to the arrangement of the loan, the importer may find that the resources are not sufficient to meet the importer bill putting him in a difficult situation.*

*Forward contract provides perfect hedge against fluctuations, but it also takes away the opportunity to make profits from favorable movements in exchange rates. Forward contracts impose an obligation on the parties to execute it on the due date irrespective of the spot rate prevailing. On execution, only the rate agreed to in the contract will be applied. If one wants to cancel the contract to take advantage of the better rate in the spot market, the counterparty will levy cancellation charges which will be greater than the benefit obtained in the spot market.*

*By definition, the time and amount of foreign exchange to be delivered are predetermined under a forward contract and the customer is bound by the agreement. So, theoretically, there should not be any variation and on the due date of the forward contract the customer will either deliver or take delivery of the fixed sum of foreign exchange agreed upon. But, in practice, quite often the delivery under a forward contract may take place before or after the due date, or delivery of foreign exchange may not take place at all. The bank generally agrees to these variations provided the customer agrees to bear the loss if any, that the bank may have to sustain on account of the variation.*

*The foreign exchange may be delivered on the due date as per the forward contract. Or, the delivery may take place earlier or later than the due date. Alternatively, the customer may request cancellation of the contract. This request for cancellation may be made on the due date, before the due date or later than the due date. Yet another alternative is that the customer may request postponement of the date of delivery under the forward contract. This request for postponement may be made on the due date, earlier than the due date or after the due date.*

*The various possibilities of forward contracts are summarized in the form of table below :*

| | | |
|---|---|---|
| *Forward Contract* | *Delivery* | *Due Date Delivery* |
| | | *Early Delivery* |
| | | *Late Delivery* |
| | *Cancellation* | *Due Date Delivery* |
| | | *Early Delivery* |
| | | *Late Delivery* |
| | *Extension* | *Due Date Delivery* |
| | | *Early Delivery* |
| | | *Late Delivery* |

*It is clear that a forward contract may end up in any of the following ways :*

*(a) Delivery on the Due Date.*

*(b) Early Delivery.*

*(c) Late Delivery.*

*(d) Cancellation on the Due Date.*

*(e) Early Cancellation.*

*(f) Late Cancellation.*

*(g) Extension on the Due Date.*

*(h) Early Extension.*

*(i) Late Extension.*

***Cancellation** : The Exporter may approach the bank for cancellation when the underlying transaction becomes infructuous, or for any other reason he wishes not to execute the forward contract. If the underlying transaction is likely to take place on a day subsequent to the maturity of the forward contract already booked, he may seek extension in the due date of the contract. Such requests for cancellation or extension can be made by the customer on or before the maturity of the forward contract.*

***Extension** : An exporter finds that he is not able to export on due date but expects to do so in about two months. An importer is unable to pay on due date but is confident of making payment a month later. In both these cases they may approach their bank with which they have entered into forward contracts to postpone the due date of the contract. Such postponement of the date of delivery under a forward contract is known as the extension of forward contract.*

*Based on the above information, read the following case study and answer the questions that follows :*

*On the next day of Exporters/Importers Meet of the Bank, an Import Customer approached ABC Bank, Kanpur Branch and booked a forward contract with the Bank on 10th April for USD 20,000 due 10th June at ₹49.4000. The bank covered its position in the market at 49.2800.*

| ***Particulars*** | ***10th June*** | ***20th June*** |
|---|---|---|
| *Spot* | *USD 1 = 48.8000/8200* | *48.6800/7200* |
| *Spot/June* | *48.9200/9500* | *48.8000/8500* |
| *July* | *49.0500/0900* | *48.9300/9900* |
| *August* | *49.3000/3500* | *49.1800/2500* |
| *September* | *49.6000/6600* | *49.4800/5600* |

*Exchange margin 0.10%.*

*Interest on outlay of funds 12%.*

***Based on the above particulars, please answer the following questions :***

*How will ABC Bank, Kanpur react if the Importer Customer request on 20th June :*

*(i) Calculate the following in case the Contract is Cancelled.*

*(a) The Exchange Difference amount. (5 marks)*

*(b) How much the Swap Loss Amount ? (5 marks)*

*(c) Interest to be charged by the Bank on Outlay of Funds. (5 marks)*

*(d) Charges for Cancellation by the Bank. (5 marks)*

*(ii) Calculate the amount in Execution of the Contract. (6 marks)*

*(iii) What will be exchange rate to extend the contract with due date to fall on 10th August ? (6 marks)*

*(iv) What is Roll Over of a Forward Contract ? How is it done ? (8 marks)*

*(Note : Foreign Exchange Rates are dynamic, the above-mentioned rates are not the current market rates. Use the above rates for calculation purpose.)*

**Answer 1(i)**

**Cancellation:**

**(a) Exchange Difference** : The forward sale contract will be cancelled at the Spot TT purchase rate of the bank for dollar prevailing on the date of cancellation.

| | |
|---|---|
| Dollar / Rupee Market Spot buying rate | ₹48.6800 |
| *Less* : Exchange Margin at 0.10% | (₹0.0487) |
| | ₹48.6313 |
| Rounded off, the rate applicable is | ₹48.6325 |
| Bank Sells Dollar under the Original contract at | ₹49.4000 |
| It buys dollar under the cancellation contract at | ₹48.6325 |
| Exchange difference per dollar payable by customer | ₹0.7675 |

**Exchange difference for USD 20,000 is ₹15,300**

(Though the exchange difference amount works out to Rs.15,350, due to FEDAI rules the amount of Rs. 50 is ignored hence the exchange difference is Rs. 15,300)

**(b) Swap Loss** : On 10th June, the bank does a swap of spot sale of dollar at the market buying rate of ₹48.8000 and forward purchase for June at the market selling rate of ₹48.9500.

| | | |
|---|---|---|
| Bank buys at | | ₹48.9500 |
| It sells at | | ₹48.8000 |
| Swap loss per dollar | 0.1500 | |

**Swap Loss for USD 20,000 is ₹3,000** (20000 x 0.15).

**(c) Interest on Outlay of Funds** : On 10th April, the bank receives delivery under the cover contract at ₹49.2800 and sells spot at ₹48.8000.

| | |
|---|---|
| Bank buys at | ₹49.2800 |
| It sells at | ₹48.8000 |
| Outlay per dollar | ₹0.4800 |
| Outlay for USD 20,000 is | ₹9,600 |

**Interest on Rs. 9,600 at 12% for 10 days is Rs. 32.**

**(d) Charges for Cancellation:**

| | |
|---|---|
| Exchange difference | ₹15,300 |
| Swap Loss | ₹3,000 |
| Interest on outlay of funds | ₹32 |
| **Total Charges for Cancellation** | **₹18,332** |

**Answer 1(ii)**

**Execution of Contract** : Cancellation charges of ₹18,332 as computed above will be recovered. The contract will be executed at the Spot TT selling rate calculated as follows:

| | |
|---|---|
| Dollar / Rupee interbank spot selling rate | ₹48.7200 |
| *Add* : Exchange Margin at 0.10% | ₹0.0487 |
| | ₹48.7687 |
| **Rounding off, the rate applicable is** | **₹48.7675** |

**Answer 1(iii)**

**Extension of Contract** : Cancellation charges of ₹18,332 as computed above will be recovered.

The contract will be extended at the current rate.

| | |
|---|---|
| Dollar / Rupee Market forward selling rate for August | ₹49.2500 |
| *Add* : Exchange Margin at 0.10% | ₹0.0492 |
| | ₹49.2992 |

**The exchange rate applied for the extended contract is ₹49.3000**

**Answer 1(iv)**

In respect of transactions like deferred payment imports / exports, repayment of instalment and interest on foreign currency loans, the customer may require long-term forward cover, i.e., for periods beyond six months.

If suitable cover is available in the market, the banks may book forward contract for long terms.

More often, the cover is made available on roll-over basis.

That is, the initial contract may be made for a period of six months, and, thereafter, as each deferred instalment is delivered, outstanding balance of forward contract may be extended for further periods of six months each.

The rules relating to and charges for cancellation /extension of long-term forward contracts are the same as those for other forward contracts.

**Question 2**

*(a) What is meaning of differentiated banks ? Explain two differentiated banks and their functions in India. (3+2+2 marks)*

*(b) Explain the following statements in brief on the point of reasoning :*

*(i) Normally Banks do not grant advance to Trust Accounts.*

*(ii) "Not Negotiable" Crossing does not mean "Not Transferable".*

*(iii) Nomination facility is provided to all Deposit Accounts.*

*(iv) Banks are entered insurance sector in a Big Way.*

*(v) Bank is giving emphasis on reduction on Non-performing Assets.*

*(1 mark each × 5=5)*

**Answer 2(a)**

**Differentiated Banks** : Differentiated Banks are banking institutions licensed by the RBI to provide specific banking services and products. It is a system refers to the system of different licenses for different sub components of the banking sector such as Limited Banking License, Commercial Banking License etc. A differentiated license will allow a bank to offer products only in select areas such as Small Finance Banks/Payment Banks and banks concentrating on whole-sale and long-term financing.

Main aim for giving license to differentiated banks is to promote financial inclusion and payments. The term differentiated banks indicate that they are different from the usual universal banks. The universal banks like SBI, Canara Bank etc. can give almost all products and services. On the other hand, the differentiated banks can give only selected products like credit, payments, deposit etc., with RBI regulations.

As on date, the differentiated banks are of two types (a) Payment Banks and (b) Small Finance Banks.

**(a) Payment Banks** : A payments bank is like any other bank, but operating on a smaller scale without involving any credit risk. In simple words, it can carry out most banking operations but can't advance loans or issue credit cards. It can accept demand deposits (Increased from Rs.1 lakhs to Rs.2 lakhs from 8th April 2021), offer remittance services, mobile payments/transfers/purchases and other banking services like ATM / debit cards, net banking and third-party fund transfers. The main objective of payments bank is to widen the spread of payment and financial services to small business, low-income households, migrant labour workforce in secured technology-driven environment.

**(b) Small Finance Banks (SFBs)** : SFBs can be promoted by resident individuals/ professionals with 10 years of experience in banking and finance as well as companies and societies owned and controlled by residents. Existing Non-Banking Finance Companies (NBFCs), Micro Finance Institutions (MFIs), and Local Area Banks (LABs) that are owned and controlled by residents are also permitted to convert themselves in to SFBs. Promoter/promoter groups should have a five year successful record of professional experience or of running their businesses are eligible to promote small finance banks. No restriction on operation. At least 50% of loan portfolio should constitute loans up to 25 lakhs. For Forex business, conditions as applicable to category -2 dealers.

Functions of Payment Banks and Small Finance Banks are as follows:

(1) To help in financial inclusion by provision of savings vehicles.

(2) Supply of credit to small business units; small and marginal farmers; micro and small industries and other unorganized sector entities, through high technology-low cost operations.

(3) The small finance banks shall primarily undertake basic banking activities of acceptance of deposits and lending to unserved and underserved sections including small business units, small and marginal farmers, micro and small industries and unorganized sector entities.

**Answer 2(b)(i)**

- Trustees have to act as per the Trust deed and for the sole benefit of the beneficiary of the Trust. Hence normally Banks do not grant advances to a Trust unless the Trust deed permits the Trustees to borrow loan and charge the assets of the Trust.
- The Bank has to ensure that it does not even inadvertently become a party in the misappropriation of funds.

**Answer 2(b)(ii)**

- As per Negotiable Instruments Act, 1881, a Not Negotiable Crossing does not restrict the transferability of any instrument.
- It means the holder does not get a better title than the transferor.

**Answer 2(b)(iii)**

- It is in pursuance of amendments in Section 45ZA to 45ZF of Banking Regulation Act, 1949.
- For easy and prompt settlement of claims of legal heirs of deceased constituents.
- To reduce legal costs to the heirs in getting legal representation.
- To inculcate confidence in the minds of deposits.

**Answer 2(b)(iv)**

- It is a move towards Universal Banking.

- Since insignificant level of population is covered, huge potential exists for insurance business. Brand Equity/Network/Workforce can be optimally utilized for higher profits.
- It enables service under one roof to their customer.
- It enhances earnings of the Bank.

**Answer 2(b)(v)**

- To improve the Interest Income of the Bank as interest on Non-performing Assets (NPAs) cannot be booked as income.
- To reduce the burden of making provisions out of profits earned by the Banks.
- To recycle the funds blocked in Non-performing Assets.
- An effort in meeting the RBI requirement i.e., Provisions and Capital Adequacy Ratio in respect of NPAs.

**Question 3**

*(a) (i) A 5-year 5% Bond has a Basis Point Value (BPV) of 50. How much the bond will gain or lose due to increase in the yield of bond by 2 bps ?*

*(ii) Bond A is a 7-year, 8% Coupon Bond. It has Duration of 4.2 and a Current Yield of 6.6%. If the yield were to suddenly decrease to 6.1% approximately, what will be the percentage price change for this Bond ?*

*(iii) A 10-year 12% Semi-annual Bond @ Market Yield of 8.520% has a price of 116.16 which rises to 117.45 at a Yield of 8.320%. What is the Basis Point Value (BPV) of the bond ? (Book Value of Bond is 1,000.)*

*(1+2+4 marks)*

*(b) M/s Party & Company was sanctioned a Cash Credit Facility of ₹4 lakh from M/s XYZ Bank against pledge of goods and personal guarantee of Mr. A who is not a partner in the firm. The bank subsequently recalled the advance and demanded repayment of the amount both from the borrowing firm and guarantor. As there was no response, the Bank sold the pledged stocks by public auction for ₹2,70,000 and filed a suit against the borrowing firm and the guarantor for the balance amount due in the cash credit account. Mr. A denies his liability on the ground that the pledged stocks were sold without his knowledge or consent and in doing so, the bank has prejudiced his right as guarantor. How will you deal with the situation ?* *(5 marks)*

**Answer 3(a)(i)**

**Increase in yield will affect the bond adversely and the bond will lose.**

Since Basis Point Value (BPV) of the bond is ₹50/-. Increase in yield by 2 bps will result into loss of value of Bond by 50*2=100

**Loss of Value by Rs.100**

**Answer 3(a)(ii)**

Increase in Price of Bond will Decrease Current Yield

Price is Inversely proportionate to Yield

Change in Price = - Modified Duration x Yield Change

= - 4.2 *(-0.5)

**= 2.1**

**Price Increases by 2.1%**

**Answer 3(a)(iii)**

BPV is Change in Price (Market Value) by 1 Basis Point Change in Yield (Market)

Here change in Price is 117.45 - 116.16 = 1.29

And change in Yield is 8.520 -8.320 = 0.20

So, one basis point change in Yield = 0.20 divided by 20 = 0.01 %

So, as we divide price change also by 20 = 1.29 / 20 = 0.0645

That 0.0645 BPV face (Book) value of ₹1,000

**₹64.5 at book value at ₹1,000.**

**Answer 3(b)**

The right of sale conferred by Section 176 of the Contract Act, 1872 arises only if the pawner (pledgor) makes default in payment of the debt or performance of the promise at the stipulated time. Even when no period is fixed for the repayment of debt, or the performance of the promise, the pawnee (pledgee), to entitle him to exercise the power of sale conferred by this section must prove:

1. That he had made demand for the payment of the debt,
2. That the pawner had made a default, and
3. He had given due notice of sale as required by this section.

In the present case the conditions (1 & 2) stand fulfilled. The contention of the guarantor is that the pledged goods were sold without due notice to him and the pawner. In case the right of sale is improperly exercised, the pawner is entitled for damages caused thereby.

Here the pledged stock was sold in a public auction. Therefore, the damages in this case will be difficult to prove.

**Question 4**

*"Commercial Paper is an unsecured Money Market Instrument issued in the form of a Promissory Note introduced in the year 1990 to enable highly rated Corporates to borrow on short-term basis. It also serves as additional Money Market instrument for investment". Explain in detail the latest terms and conditions of Reserve Bank of India in this regard.* *(12 marks)*

**Answer 4**

The Reserve Bank of India (RBI) introduced the Commercial Paper Directions, 2017 Directions on 10 August 2017. The primary purpose of the Directions is to regulate Commercial Papers (CPs) accepted as deposits by non-banking companies. The Directions supersede previous directions such as the Non-Banking Companies (Acceptance of deposits through Commercial Paper) Directions 1989, which had been amended in 1996, 1998, 2000 and further in 2012 (2012 Guidelines).

**Eligible Issuers:**

a. Companies and All India Financial Institutions (AIFIS) subject to following conditions:

   i. The entity has been sanctioned working capital limit by bank/s or Financial Institutes; and

   ii. The account of the company/AIFI is classified as a Standard Asset by the financing bank/institution.

b. Standalone Primary Dealers.

c. Other entities such as co-operative societies/unions, government entities, trusts, limited liability partnerships and any other body corporate having presence in India with a net worth of ₹100 crore or higher with a net worth of ₹100 crore or higher subject to conditions under (a)(i) and (a)(ii) above.

d. Any other entity specifically permitted by the Reserve Bank of India (RBI).

**Eligible Investors** : (individuals, banking companies, other corporate bodies registered/ incorporated in India and unincorporated bodies, Non residents and FIIs (within limits by SEBI)

a. All residents, and non-residents permitted to invest in CPs under Foreign Exchange Management Act (FEMA), 1999 are eligible; however, no person can invest in CPs issued by related parties.

b. Investment by regulated financial sector entities will be subject to such conditions as the concerned regulator may impose.

**Form of the instrument, mode of issuance, rating and documentation procedures**

**Forms**

a) CP shall be issued in the form of a promissory note and held in a dematerialized form through any of the depositories approved by and registered with SEBI.

b) CP shall be issued in minimum denomination of 5 lakh and multiple of 1 lakh.

c) CP may be issued at a discount to face value.

d) No issuer shall have the issue of CP underwritten or co-accepted.

e) Options (call / put) are not permitted on CP.

**Rating Requirement**

a. Eligible issuers shall obtain credit rating for issuance of CPs from at least two CRAs (if the total CP issuance during a calendar year is Rs.1000 crore or more).registered with SEBI and should adopt the lower of the two ratings.

b. The minimum credit rating for a CP shall be 'A3' as per rating symbol and definition prescribed by SEBI.

c. CRAs shall take approval from RBI for the purpose of rating CPs.

**Documentation Procedures**

Issuers, investors and Issuing and Paying Agents (IPAs) shall follow the standard procedures and documentation prescribed by Fixed Income Money Market and Derivatives Association of India (FIMMDA) as 'Operational Guidelines on CPs'.

**Secondary market trading and settlement of CP**

a) All OTC trades in CP shall be reported within 15 minutes of the trade to the Financial Market Trade Reporting and Confirmation Platform (“F-TRAC") of Clearcorp Dealing System (India) Ltd. (CDSL).

b) The settlement cycle for OTC trades in CP shall be T+1.

c) OTC trades in CP shall be settled through the clearing house of the National Stock Exchange (NSE), the Bombay Stock Exchange (BSE), the Metropolitan Stock Exchange of India Limited or any other mechanism approved by RBI.

**Buyback of CP**

a. The buyback of CP, in full or part, shall be at prevailing market price.

b. The buyback offer should be extended to all investors in the CP issue.

c. The buyback offer may not be made before 60 days from the date of issue. (30 days as per FIMMDA rule of 24.2.20)

d. CPs bought back shall stand extinguished.

**Duties and Obligations**

The duties and obligations of the Issuer, Issuing and Paying Agent (IPA), Credit Rating Agency (CRA) and Arrangers are set out below:

**Issuer**

a) Comply with all relevant requirements under these Directions.

b) Appoint an IPA for issuance of CP.

c) Ensure that the proceeds from CP issues should be used to finance only current assets and operating expenses. The end use must be explicitly disclosed in the offer document.

d) Furnish the Board Resolution authorizing the company to borrow through issuance of CP to the IPA.

e) Keep the bank (s) from whom it has outstanding credit facility (ies) informed of its market borrowings, including through CPs, latest by the date of borrowing.

f) Arrange for crediting the CP to the Demat account of the investor with the depository through the IPA.

g) Route all subscriptions/redemptions/payments through the IPA.

h) Make minimum disclosures in the offer document.

i) Submit a certificate from the CEO/CFO to the concerned IPAs on quarterly basis that CP proceeds are used for disclosed purposes, and certifying adherence to other conditions of the offer document.

**Issuing and Paying Agent**

a) Ensure that the borrower is appropriately authorized to borrow through CPs.

b) Verifying all information disclosed in the offer document before issuance.

c) Verify all documents submitted by the issuer are in order and issue a certificate to this effect.

d) Make available the IPA certificate in electronic form on the website of the depositories for the CPs.

e) Verify and hold certified copies of original documents in its custody.

Report the details of issuance of CP and instances of default on the F-TRAC platform by close of business hours, of the day of issuance or default as the case may be.

**Credit Rating Agency**

a) Credit Rating Agency (CRA) must act responsibly in rating CP issuances and continuously monitor the rating assigned to an issue and revisions, if any, to the rating and disseminate to public through their publications and website.

b) Advise the concerned IPA about the ratings of the CP and any subsequent change in the ratings, on the date of rating or change in rating.

**Non-applicability of Certain Other Directions**

Nothing contained in the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998 shall apply to the raising of funds by issuance of CP, by any NBFC in accordance with these directions.

**Question 5**

*(a) (i) What is MUDRA and why MUDRA has been set up ?*

*(ii) What are the roles, responsibilities and offerings of MUDRA ? How MUDRA function ? (3+3 marks)*

*(b) In its 'Statement on Developmental and Regulatory Policies' issued in December 2018, RBI said : "With the digital mode for financial transactions gaining traction in the country, there is an emerging need for a dedicated, cost-free and expeditious grievance redressal mechanism for strengthening consumer*

*confidence in this channel. It has therefore been decided to implement an 'Ombudsman Scheme for Digital Transactions' covering services provided by entities falling under Reserve Bank's regulatory jurisdiction''. Explain in brief how the Ombudsman will deal the Customer Complaints and also explain the process for filing the complaints related to Digital Transactions raised by Bank Customers.* *(6 marks)*

**Answer 5(a)(i)**

MUDRA, which stands for Micro Units Development & Refinance Agency Ltd., is a financial institution set up by Government of India for development and refinancing of micro units' enterprises. It was announced by the Hon'ble Finance Minister while presenting the Union Budget for Financial Year 2016. The purpose of MUDRA is to provide funding to the non-corporate small business sector through various Last Mile Financial Institutions like Banks, NBFCs and MFIs.

The biggest bottleneck to the growth of entrepreneurship in the Non-Corporate Small Business Sector (NCSBS) is lack of financial support to this sector. More than 90% of this sector does not have access to formal sources of finance. Government of India is setting up MUDRA Bank through a statutory enactment for catering to the needs of the NCSBS segment or the informal sector for bringing them in the mainstream.

**Answer 5(a)(ii)**

MUDRA would be responsible for refinancing all Last Mile Financiers such as Non-Banking Finance Companies, Micro Finance Institutions, Societies, Trusts, Section 8 Companies (formerly Section 25), Small Finance Banks and Regional Rural Banks which are in the business of lending to micro / small business entities engaged in manufacturing, trading and services activities as well as Agriculture, Allied activities. MUDRA would also partner with State / Regional level financial intermediaries to provide finance to Last Mile Financier of small / micro business enterprises.

Under the aegis of Pradhan Mantri MUDRA Yojana (PMMY), MUDRA has already created its initial products / schemes. The interventions have been named 'Shishu', 'Kishor' and 'Tarun' to signify the stage of growth / development and funding needs of the beneficiary micro unit / entrepreneur and also to provide a reference point for the next phase of graduation/growth to look forward to. The financial limit for these schemes is:

a. Shishu : Covering loans upto Rs. 50,000.

b. Kishor : Covering loans above Rs. 50,000 and up to Rs. 5 lakhs.

c. Tarun : Covering loans above Rs. 5 lakhs and Rs. 10 lakhs.

As per budget 2019-20 provision has been made for loan up to Rs. 1 lakh to one woman per SHG.

MUDRA's delivery channel is conceived to be through the route of refinance primarily to Banks / NBFCs / MFIs.

At the same time, there is a need to develop and expand the delivery channel at the ground level. In this context, there is already in existence, a large number of 'Last Mile Financiers' in the form of companies, trusts, societies, associations and other networks which are providing informal finance to small businesses.

**Answer 5(b)**

**The Ombudsman will deal the customer complaints as follows:**

The Ombudsman Scheme for Digital Transactions, 2019, launched under Section 18 of the Payment and Settlement Systems Act, 2007, to will provide a cost-free and expeditious complaint-redressal mechanism relating to deficiency in customer services in digital transactions conducted through non-bank entities regulated by Reserve Bank of India (RBI).

The offices of Ombudsman for Digital Transactions function from the existing 21 offices of the Banking Ombudsman and handle complaints of customers from their respective territorial jurisdiction.

The scheme provides for an appellate mechanism under which the complainant/ system participant has the option to appeal against the decision of the Ombudsman before the appellate authority.

The Process for filing the Complaints is:

- Any person who has a grievance on any one or more of the grounds mentioned herein may herself/ himself or through her/his authorized representative (other than an advocate) make a complaint against the branch or office of the system participant with the Ombudsman in the applicable jurisdiction.
- As for a complaint arising out of services with centralized operations, the jurisdiction would be the declared address of the complainant.
- The complaint is made within one year after the complainant has received the reply from the system participant to her / his representation, or if no reply has been received, not later than 1 year and 1 month after the date of representation to the system participant.
- The complaint shall be in writing duly signed and shall be in the complaint form fumishing full details.
- The complaint shall be accompanied by copies of documents to be relied upon.
- E-complaints are accepted.
- Complaints received by RBI/GoI can also be taken up by the Ombudsman.

**Question 6**

*(a) (i) "Payment in due course is one made in accordance with the apparent tenor of the instrument that is according to what appears on the face of the instrument to be intention of the parties". Explain the conditions to qualify before the payment made to the customer by the Bank.*

*(ii) What are the duties of a Collecting Banker ? (3+3 marks)*

*(b) (i) What is the purpose of provisioning in Banks ? What is Provisioning Coverage Ratio (PCR) ?*

*(ii) What is Operational Risk ? Explain the types of Operational Risk as identified by Basel Committee. (3+3 marks)*

**Answer 6 (a) (i)**

To qualify as payment in due course, the payment will have to comply with the following:

- There are sufficient funds in the account.
- Funds are meant for payment of such cheque.
- There is proper demand to make the payment.
- Payment should be made to the person entitled to the payment as well as who is in possession of the instrument.
- It should not be made before the due date.
- It should not be made with the knowledge that it may impair the rights of the holder to receive moneys or under reasonable grounds for believing that the holder in due course is not entitled to receive payment and
- The payment must be made in good faith and without negligence under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment.

**Answer 6(a)(ii)**

The collecting banker is a banker who collects cheques drawn upon other bankers for and on behalf of his customer. He is called the collecting banker as he undertakes the work of collection of Cheques.

**Holder for value** : A collecting banker becomes a holder for value if he has paid the value of the cheque to the customer before the cheque is already collected.

**As an agent** : A collecting banker acts as an agent of the customer on crediting the account of the customer only after realizing the payment from the paying banker (drawee bank).

**Duties and Responsibilities of a Collecting Banker**

- Banker must take at most care while presenting the cheque for collection.
- Collecting banker must present the cheque within reasonable time.
- Serve Notice to /inform customer in case of dishonour of cheque.
- The banker has to credit the proceeds of the cheque to the account of the customer.
- Should undertake the collection of cheque only for customer and not for stranger.
- Must receive the payment as an agent of the customer.
- Cheque must be crossed to get the protection of Section 131 of Negotiable Instruments Act, 1881.

**Answer 6(b)(i)**

One of the leading issues related with the banking sector nowadays is the rising level of NPAs. Higher NPAs worsens the financial health of a bank. To tackle the NPA

or bad assets problem, RBI has designed several mechanisms. An import one among them is the Provisioning norms. Provisioning is a part of the RBI's prudential regulation norm.

Under provisioning, banks have to set aside or provide funds to a prescribed percentage of their bad assets. The percentage of bad asset that has to be provided for is called Provisioning Coverage Ratio (PCR). The provisioning coverage ratio is the percentage of bad assets that the bank has to provide for (keep money) from their own funds-most probably profit. It can also be defined as:

$$\text{PCR} = \frac{\text{Total Provisions}}{\text{Gross NPAs}}$$

For example, if the provisioning coverage ratio is 70% for a particular category of bad loans, banks have to set aside funds equivalent to 70% those bad assets out of their profits (in most cases).

Assets of a bank means loans they have given and investment they have made. If the loans are not coming, there should be provisioning for such bad debts. The assets are classified by the RBI in terms of their duration of non-repayment.

**Provisioning differs with asset quality**

Provisioning coverage ratio differs in terms of the quality of assets. Some assets may be lost forever and they are categorized as loss assets. This implies that such loans will never be repaid. For such assets, bank has to set aside 100% of such loss assets out of its profit. Similarly, there may be substandard assets where the loans are not repaid for a shorter period. In this case, less proportion of those assets can be set aside from profit as per RBI directives.

Now-a-days due to Provisioning requirement, when banks report profits, they pay low dividends. Many banks have substantial NPAs now and they are setting apart a major chunk of their profit to meet the provisioning.

**Answer 6(b)(ii)**

Operational risk has been defined by the Basel Committee on Banking Supervision as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition is based on the underlying causes of operational risk. It seeks to identify why a loss happened and at the broadest level includes the breakdown by four causes: people, processes, systems and external factors.

The Basel Committee has identified the following types of operational risk events as having the potential to result in substantial losses:

- *Internal fraud* : For example, intentional misreporting of positions, employee theft, and insider trading on an employee's own account.
- *External fraud* : For example, robbery, forgery, cheque kiting, and damage from computer hacking.
- *Employment practices and workplace safety* : For example, workers compensation claims, violation of employee health and safety rules, organized labour activities, discrimination claims, and general liability.

- *Clients, products and business practices* : For example, fiduciary breaches, misuse of confidential customer information, improper trading activities on the bank's account, money laundering, and sale of unauthorized products.
- *Damage to physical assets* : For example, terrorism, vandalism, earthquakes, fires and floods.
- *Business disruption and system failures* : For example, hardware and software failures, telecommunication problems, and utility outages.
- *Execution, delivery and process management* : For example: data entry errors, collateral management failures, incomplete legal documentation, and unauthorized access given to client accounts, non-client counterparty mis-performance, and vendor disputes etc.

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# INSURANCE – LAW & PRACTICE

**(Elective Paper 9.2)**

*Time allowed : 3 hours* *Maximum marks : 100*

***NOTE***: *1. Answer ALL Questions.*

*2. Suitable assumptions, if considered necessary, may be made while answering a question. However, such assumptions must be stated clearly.*

**Question 1**

(a) Arvind while taking the Life Insurance Policy had informed in his proposal form to XYZ Insurance Company that he is a smoker. He also submitted special reports of his diabetes and blood pressure, which were asked by the company. The proposal was accepted with extra premium and was informed on 10th January, 2019. He was hospitalised on 17th January, 2019 due to chest congestion and breathlessness. He was under treatment from 17th January. However, he died on 1st October, 2019 due to heart failure. The claim was repudiated on the grounds of suppression of material facts based on certificate of treatment, prescription, letters of doctors and hospital. It was observed that all the diagnosis/treatment commenced after 17th January. All the documents proved that the deceased was not aware of his ailment at the time of taking the proposal.

(b) Bharti was working as a supervisor in postal department. While taking the life insurance policy on 5th January, 2008 she had produced a voter ID card as the age proof and the agent filled up the proposal form. Date of birth mentioned in that voter ID was 01-01-1950 though her actual date of birth was 01-08-1943. However she passed away on 20th December, 2008. The insurer has repudiated the claim based on the allegation of wrong age proof.

(c) Eeswar Prasad purchased a Unit Linked Insurance Policy from ABC Insurance Company on 8th August, 2018. He was under the treatment of High BP prior to the issue of the policy. He did not reveal this information to the insurance company. Within one year of the commencement of the policy, on 1st May, 2019 he died due to Coronary Arterial Disease (CAD). The insurer produced the evidence, which proved that the life assured died due to uncontrolled hypertension, which led to CAD to death. Due to non-disclosure of the material fact the SA claim was repudiated.

(d) Chandra Shekhar, his wife and her brother were travelling in a two-wheeler from Vijayawada to Guntur at night and they met with an accident due to hit and run by a lorry. The wife and her brother died in the accident. The FIR and PIR had concluded that it was breach of law since 3 people were travelling in a 2-wheeler in which only 2 are allowed to travel. Though the life assured was only pillion rider, she was travelling as one of the passengers on the Motor Cycle (as per MVAct only two persons are permitted), which amounts to breach of law. The

*insurer refused to pay the accident benefit sum assured since the accident was caused due to breach of law.*

*(e) Durga Prasad the life assured submitted proposal on 30.03.2005. Policy commenced from 28.04.2005. The life assured died of road accident on 13.05.2005. The insurer refused to pay the accident sum assured since the life assured was under the influence of alcohol at the time of accident. The claimant argued the life assured was not driving the vehicle and hence the double accident benefit claim cannot be rejected. The insurer contended that as per Medico-Legal Manual if the alcohol content is 100 to 300 MG % the person would have some mental confusion, emotional instability, loss of critical judgement, impaired memory, sleeplessness, slowed reaction time, loss of muscular co-ordination etc. As the policy conditions of DAB, if death of the life assured is caused by intentional self-injury, attempted suicide, insanity or immorality or when the life assured is under the influence of intoxicated liquor, drug or narcotic, the insurer is not liable pay the additional sum assured.*

*(i) In all the cited cases (a to e) justify or reject the stand taken by the insurance companies. (8 marks)*

*(ii) With reference to the first two cases (a and b), explain the following :*

*(a) Warranties*

*(b) Representation*

*(c) Misrepresentation*

*(d) Concealments. (8 marks)*

*(iii) Based on the third case (c) discuss the factors that has to be considered while underwriting lives and the difference between medical and non-medical underwriting. (8 marks)*

*(iv) With reference to the fourth case (d), describe the basic principles of motor insurance. (8 marks)*

*(v) Based on the fourth case (d) explain :*

*(a) Third Party Insurance*

*(b) Liability only Policy Coverage*

*(c) Comprehensive Coverage*

*(d) Can Chandra Shekhar claim death benefit from the above coverages ? (8 marks)*

**Answer 1(i)**

(a) From the facts of the case are all evident that the diagnosis and treatment of the said disease chest congestion and breathlessness all started on 17th January, 2019 only. Further as all the documents also proved that the deceased was not aware of his ailment at the time of taking the proposal. The respondent (the insurer) has to be directed to pay the full claim amount as all the documents proved that the deceased was not aware of his ailment at the time of taking the proposal. On 10th January, 2019 proposal submitted the special report of diabetes and blood pressure for which he paid extra premium. The insurer should be given full claim as he was not aware about it.

(b) The proposal would not have been accepted if she had declared her correct age. As a government employee for several numbers of years, she was aware of the importance of the proof of age. She had deliberately understated her age to defraud the insurer, in order to accept the proposal and thereby misled the respondent in taking proper underwriting decision. Hence the decision taken by the insurer in repudiating the claim is just and fair and hence does not require any interference.

(c) The life assured was suffering from Hypertension, which he did not disclose in the proposal form.

Life assured died within 9 months from the date of commencement of the policy. Due to nondisclosure of the material fact the sum assured claim can be repudiated. The decision of the insurer can be upheld since there was suppression of material fact. As ULIP Policy has the provision for investment, the insurer can be ordered to pay the investment portion (Fund Value).

(d) The complaint can be dismissed because 3 persons were riding on two –wheeler and as per law only 2 persons can ride on two-whether as per MV Act, so on the ground that the accident happened and death occurred due to breach of law and the insurer is correct in repudiating the Accident Benefit Sum Assured,

(e) As per the policy conditions, Insurer has the right to reject the claim.

If policyholder's death is due to driving under the influence of alcohol or narcotic substances, the insurer will reject the claim. Death due to any condition that existed while availing the term insurance policy will not be settled by the insurer.

**Answer 1(ii)**

**(a) Warranties :** A warranty is a statement that is considered guaranteed to be true and, once declared, becomes an actual part of the contract. Warranties in insurance contracts can be divided into two types: affirmative or promissory. An affirmative warranty is a statement regarding a fact at the time the contract was made. A promissory warranty is a statement about future facts or about facts that will continue to be true throughout the term of the policy. An untruthful affirmative warranty makes an insurance contract void at its inception. If a promissory warranty becomes true, the insurer may cancel coverage at such time as the warranty becomes untrue.

**(b) Representation :** A representation is a statement that is believed to be true to the best of the other party's knowledge. If the insurer relies on a representation in entering into the insurance contract and if it proves to be false at the time it was made, the insurer may have legal grounds to void the contract.

**(c) Misrepresentation :** Getting into a contract with a person or a company on false grounds by making statements that are not in accordance with the facts is known as misrepresentation. In an insurance policy, misrepresentation on the behalf of the insured gives the insurance company a right to terminate the policy.

**(d) Concealment :** Concealment is the failure to disclose information that one clearly

knows about. In the case of (a) the deceased was not aware of his ailment at the time of taking the proposal, so the question of misrepresentation or concealment does arise against the warranty of the contract.

However, in the case of (b) the life assured was aware of her correct age but she produced a voter ID showing a wrong date of birth so this is a clear case of concealment and misrepresentation.

**Answer 1(iii)**

Factors considered while underwriting lives: Personal health history, family health history, occupation history, personal habits and style, financial status and capacity to pay and country or place risk.

Difference between medical and non-medical underwriting: Each insurance company for each of its products lays down the non-medical criteria based on the age and sum assured. However, in medical underwriting the risk on proposal is measured by sum assured which is beyond the limits of non-medical cases and the life assured has to undergo medical examination. The extent of medical examination depends on the sum assured- higher the sum assured, higher the level of medical check-ups. These medical check-ups are conducted through medical practitioners empanelled with the insurance companies. Even in non medical underwriting grid, if there is an adverse medical history for a client, as per the underwriting guidelines of the company, the insurer/underwriter may treat these cases under medical underwriting.

**Answer 1(iv)**

Motor insurance being a contract like any other contract has to fulfil the requirements of a valid contract as laid down in the Indian Contract Act, 1872 and the complaint can be dismissed on the ground that the accident happened and death occurred due to breach of law and insurer is correct in repudiating the Accident Benefit Sum Assured.

**Basic Principles of Motor Insurance are as follows:**

(i) *Utmost good faith* : The principle of Utmost good faith casts an obligation on the insured to disclose all the material facts. These material facts must be disclosed to the insurer at the time of entering into the contract. All the information given in the proposal form should be true and complete. E.g., the driving history, physical health of the river, type of vehicle etc. If any of the mentioned material facts declared by the insured in the proposal form are found inappropriate by the insurer at the time of claim it may result in the claim being repudiated.

(ii) *Insurable Interest* : In a valid insurance contract it is necessary on the part of the insured to have an insurable interest in the subject matter of insurance. The presence of insurable interest in the subject matter of insurance gives the person the right to insure. The interest should be pecuniary and must be present at inception and throughout the term of the policy. Thus the insured must be either benefited by the safety of the property or must suffer a loss on account of damage to it.

(iii) *Indemnity* : Insurance contracts are contracts of indemnity. Indemnity means making good of the loss by reimbursing the exact monetary loss. It aims at

keeping the insured in the same position he was before the loss occurred and thus prevent him from making profit from insurance policy.

(iv) *Subrogation and Contribution* : Subrogation refers to transfer of insured's right of action against a third party who caused the loss to the insurer. Thus, the insurer who pays the loss can take up the assureds' place and sue the party that caused the loss in order to minimise his loss for which he has already indemnified the assured. Subrogation comes in the picture only in case of damage or loss due to a third party. The insurer derives this right only after the payment of damages to the insured. Contribution ensures that the indemnity provided is proportionately borne by other insurers in case of double insurance. Another such instance is the Insurer paying claims in case of "Lost Vehicle" and subsequently the vehicle is recovered. In such cases, due to subrogation rights, the Insurer becomes the owner of such vehicle and steps in the shoes of the Insured.

**Answer 1(v)**

**(a) Third Party Insurance** : This is liability insurance, under which the insurance company agrees to indemnify the insured person, if he is sued or held legally liable for injuries or damage done to a third party. The insured is one party, the insured company is the second party, and the person (the insured) injures who claims damages against is the insured the third party.

**(b) Liability only Policy Coverage** : This covers third party liability and/or death and property damage.

**(c) Comprehensive coverage** : It is an optional cover. It will include all kinds of risk factors that are associated with vehicle, driver, passengers, third party vehicle, third party driver, third party vehicle passengers and third party property.

(d) Chandra Shekhar cannot claim death benefit from the above coverage as accident was caused due to breach of law.

**Question 2**

*(a) A owns a restaurant, which he had bought three years ago for ₹ 20 lakh. He had bought fire insurance worth ₹16 lakh (which is the written down value of his insured property). His restaurant caught fire and the amount of loss suffered was ₹5 lakh. What is the liability of the insurance company to settle the claim ? On what principles of insurance contract, the settlement of claim takes place in the fire insurance products. Discuss other features of fire insurance policies also. (6 marks)*

*(b) On August 20, 2008 a Span Air MD 87 crashed on take-off at Barajas Airport in Madrid. This crash resulted in 154 deaths and 18 survivors. The Official version of the accident claiming pilot error alone, there may be some additional factors contributed to the plane crash. Aviation insurance offers protection against a wide array of perils, dangers, risks and damages to policyholders. Identify such risks, damages due to aviation. Explain the different aviation insurance policies*

**Answer 2(a)**

Fire Insurance Contracts are contracts of indemnity. Indemnity means making good of the loss by reimbursing the exact monetary loss. It aims at keeping the insured in the same position as he was before the loss occurred and thus prevent him from making profit from the insurance policy.

A has taken insurance worth ₹16 lakh for the property valued at ₹20 lakh.

Average clause will apply so claim would be:

Sum insured/value of insured asset x Actual loss = (16,00,000/20,00,000) 5,00,000 = 4,00,000

Thus the claim payable ₹4,00,000.

Principles of Insurance Contract, the settlement of contract take place:

(i) *Offer and Acceptance* : It is a prerequisite to any contract. The property under fire insurance will be insured after the offer is accepted by the insurance company.

(ii) *Payment of Premium* : An owner must ensure that the premium is paid well in advance so that the risk can be covered. If the payment is made through cheque and it is dishonoured then the coverage of the risk will not exist as per section 64VB of Insurance Act, 1938.

(iii) *Utmost good faith* : The property owner must disclose all the relevant information to the insurance company while insuring their property.

**Features of Fire Insurance Policies**

*Written Agreement* : Fire insurance is a written agreement that take place between insurance company and insured. There is an offer and acceptance of insurance agreement between both the parties. Such agreement is bounded by certain obligations and both parties are required to fulfil these obligation. Insurer agrees to provide guarantee for compensation against fire losses. Insured pays premium to insurer regularly for taking such guarantee for compensation.

*Payment of Premium* : Fire insurance requires payment of premium by insured to insurance companies. Premium is considered as lawful consideration in insurance contract like in any other lawful contract. This premium is paid by insured to insurer for protecting itself and getting compensation against fire losses. Insurance premium is termed as contribution on the part of insured in fire insurance contract.

*Contract of Indemnity* : Fire insurance indemnifies for losses on occurrence of contingency. Insurer under fire insurance contract compensates when some contingency occurs resulting in losses and damages. Insured cannot make profit from insurance policy but can only claim compensation from insurer in case of contingency. If no contingency occurs, insurer is not required to pay any compensation to insured.

*Compensation for Fire Losses* : Under fire insurance contract, insurer compensates insured for fire losses. Fire is the only reason which is taken into account for various losses and damages done. The fire according to this contract must be real and

accidental. Any loss or damages to property arising out of reasons other than fire is not considered under this contract. Insurance companies are not liable to pay for such amount of losses.

*Covers Insured Amount* : Insurer under fire insurance contract are liable to compensate up to insured amount of property. The insured amount is the extent of loss to property which insurer agrees to undertake and compensate at time of entering the insurance contract. Insurer is not liable to pay any amount for amount of losses which exceeds the insured amount.

*No Mis-Representation or Concealment* : There is no misrepresentation or concealment of facts by both insurer and insured. Misrepresentation of facts from both insurer and insured side will make the insurance contract void. Insured is required to disclose full information regarding property to be insured fairly to insurer. This will helps the insurer in calculating the right amount of premium to be charged. Insurer is also required to explain clearly the terms and conditions of insurance contract to insured to avoid any confusion.

*Period of Insurance* : The period of fire insurance policy is equal to or less than one year. Fire insurance cannot exceed one year except if this insurance is issued for residential houses where it can exceed one year. These insurance policies need to be renewed from time to time for carrying it for longer term.

*Claims* : Insured is required to inform the insurer immediately in case of fire accidents for getting their assured compensation. Timely informing about contingencies to insurers will help them in determining the actual amount of losses which take place due to fire accidents.

**Answer 2(b)**

Aviation Insurance offers protection against a wide array of perils, dangers, risks and damage to policyholders. Some of the risks covered by aviation insurance includes turbulent weather, terrorist activities leading to highjacks, mysterious disappearance of flights, auto/technical failure, or plane crash etc.

The different aviation insurance policies, which cover such risks are:

(i) Inflight coverage (when a plane is in mid-air).

(ii) Hull all risk (for flying clubs which operate small planes, private jets of celebrities and covers physical loss/damage of the insured plane).

(iii) Hull/spares war risk (Damage resulted by anti-social activities).

(iv) Loss of license (for aircraft crew members to hold a valid license).

(v) Spare all risk insurance policies (for spares, tools, equipment etc.).

(vi) Aviation personal accident (for crew member injury, disablement or death due to accident).

**Question 3**

*(a) Explain IRDAI's corporate guidelines to insurance companies in addition to the applicable provisions of the Companies Act, 2013/1956.*

*(b) The Bhopal Gas Tragedy, which arose on account of leakage of the methyl isocyanate gas from the Union Carbide Plant in Bhopal on 2nd and 3rd December, 1984 resulting into a liability of US $ 470 million for Union Carbide. This incident led to the enactment of an Insurance Act in 1991. What is that Act ? Explain how that Act imposes no fault liability. (6 marks each)*

**Answer 3(a)**

IRDAI'S Corporate guidelines are applicable to insurance companies in addition to the provisions of the Companies Act, 2013/1956. Wherever there is a conflict, the provisions as per The Insurance Regulatory and Development Authority of India's (IRDAI's) Corporate Governance guidelines shall prevail.

The mandatory committees for an insurance company are investment committee, Audit committee, Risk Management committee, Corporate Social Responsibility committee, With Profit committee and Policyholders Protection committee. The non-mandatory or optional committees are Asset Liability Management committee & Ethics committee.

Auditors, Directors, Actuaries and other key managerial personnel are prohibited from holding positions which are conflicting with each other. Section 48 B and Section 32A of Insurance Act, 1938 provide that a Director of a life Insurance Company shall not be a Director of another life insurance company. However, there are no such prohibitions for non-life or standalone health insurance and Reinsurance companies.

The Financial statements of insurance companies are prepared in accordance with Regulations, 2002.

**Answer 3(b)**

The Bhopal Gas Tragedy incident led to Public Liability Insurance Act in 1991. This Act imposes no fault liability i.e. irrespective of any wrongful act, neglect or default on the owner to pay relief in the event of a death or injury to any person other than workman or damage to property of any person arising out of accident while handling any hazardous substance. No fault liability means the claimant is not required to prove that the death, injury or damage was due to any wrongful act, neglect or default of any person.

**Question 4**

*(a) Is there any insurance policy to cover the liabilities of Directors and Officers of a Company ? If yes, explain the features of such policy.*

*(b) Discuss different types of Marine Fraud. (6 marks each)*

**Answer 4(a)**

There is an insurance policy to cover the liabilities of Directors or Officers of a company. Since they hold positions of trust and responsibility, they may become liable to pay damages, due to acts of omission or commission. It is a type of liability insurance which covers the directors and Officers against the claims made by :

1. Employees
2. Suppliers

3. Competitors
4. Regulators
5. Customers
6. Shareholders
7. Other stakeholders

For wrongful acts committed by them in the supervision and management of the affairs of the company. Besides the company itself may be liable. The policy is designed to provide protection to the company as well as Directors or Officers against their personal civil liability.

**Answer 4(b)**

**Different types of maritime fraud/crimes includes :**

(i) *Scuttling of Ships* : Also known as 'rust bucket' frauds, this involves deliberate sinking of vessels in pursuance of fraud against both cargo and hull interests. With occasional exceptions, these crimes are committed by ship-owners in a situation where a vessel is approaching or has the end of its economic life, taking into account the age of the vessel, its condition and the prevailing freight market. The crime can be aimed at hull insurers alone or against both hull and cargo interests.

(ii) *Documentary Frauds* : This type of fraud involves the sale and purchase of goods of documentary credit terms and some or all of the documents specified by the buyer to be presented by the seller to the bank in order to receive payment, are forged. Bankers pay against documents. The forged documents attempt to cover up the fact that the goods actually do not exist or that they are not of the quality ordered by the buyer. When the unfortunate purchaser of the goods belatedly realizes that no goods are arriving, he starts checking, only to find that the alleged carrying vessels either does not exist or was loading at some other port at the relevant time.

(iii) *Cargo Thefts* : There are several variations in the modus operandi of cargo thefts. In a typical example, the vessel, having loaded a cargo, deviates from its route and puts it into a port of convenience. The cargo may be discharges and sole on the quayside or in a more sophisticated manner. Such an act is often accompanied by c a changed of the vessel's name or a subsequent scuttling in order to hide the evidence of theft. The whole process of investigation is proved difficult as by the time the loss is known the cargo disappears and the actual recovery of goods is unlikely. The owners of these ships are "paper companies" set up a few days prior to the operation.

(iv) *Fraud related to chartering of Vessels* : This is also known as Charter-part fraud". Establishing a chartering company required a modest initial financial commitment and is usually subject to little regulation. In depressed conditions of shipping market, there is no have demand on tonnage and owners anxious to avoid laying up their vessels are tempted to charter them to unknown companies without demanding any substantial financial guarantee for the performance of the charter contract.

**Question 5**

*(a) What is money laundering ? What are the macro-economic consequences of money laundering ? Discuss Anti-Money Laundering guidelines.*

*(b) Describe the salient features of New Pension Scheme (NPS). (6 marks each)*

**Answer 5(a)**

Money laundering is the mechanism of introducing illegal or dirty money in the system and is put through a cycle of transactions so that it comes out washed at the other end and is called legal or clean money.

**The macro economic consequences of money laundering are:**

1. It can pose risks to the soundness of financial institutions and financial system
2. It contaminates legal financial transaction
3. It can increase the volatility of internal capital flows and exchange rates due to huge unanticipated cross border transfers.

**The Anti-Money Laundering guidelines are:**

1. Know your customer at the inception and at regular intervals
2. Risk Profiling of the customer
3. Imparting training to staff
4. Account monitoring and reporting of transactions
5. Effective system controls including internal audit.
6. Reporting of transactions to finance intelligence unit.

**Answer 5(b)**

**National Pension System (NPS)** is based on unique Permanent Retirement Account Number (PRAN) which is allotted to every subscriber. In order to encourage savings, the Government of India has made the scheme reassuring from security point of view and has offered some attractive benefits for. NPS account holders.

**The salient features of New Pension Scheme (NPS) are:**

1. NPS is available to all Indian Citizens aged 18 to 65.
2. The benefits are low cost, simple, flexible, portable, prudentially regulated tax benefits to employees and self-employed.
3. Two types of accounts- Tier-1 and Tier-2 restricted withdrawal accounts and voluntary saving facility accounts.
4. Investment options under PFRDA.
5. Auto choice option for those subscribers who are unwilling/unable to exercise asset allocation.
6. Withdrawal/exit options.

7. In case of death 100% pension lump sum wealth to nominees.
8. Low cost option for planning the retirement.
9. Service Tax/GST as per the existing laws.

**Question 6**

*(a) What is IFRS17 ? Discuss the areas of applicability of IFRS17 in insurance contracts.*

*(b) What do you mean by Takaful Insurance ? Explain the different models of Takaful insurance. (6 marks each)*

**Answer 6(a)**

**International Financial Reporting Standards-17 (IFRS-17)** establishes the principles for recognition, measurement, presentation and disclosure of insurance contracts within the scope of the standard.

The objective of IFRS-17 is to ensure that any entity provides relevant information that faithfully represents these contracts.

The areas of applicability of IFRS-17 in insurance contracts include:

- Insurance contracts including inward reinsurance contracts accepted.
- Reinsurance contracts ceded.
- Investment contracts with discretionary participation features, by an entity which issues insurance contract as well.

**Answer 6(b)**

**Takaful Insurance** - It is specific to Islamic Community. In this Islamic Insurance, members contribute money into a pool system in order to guarantee each other against loss or damage. It is based on Sharia, Islamic religious law. The Takaful compliant model under the Shari'ah Laws does not allow the following 3 things in insurance/ investment activities.

(a) Uncertainty and speculation ('Gharar')

(b) Gambling (Maysir')

(c) In the case of investment or fund management, interest or usury ('Riba')

The different models of Takaful Insurance are:

- *Mudharabah model (profit-sharing)* : the manager (shareholders) are sharing Profit and Losses with the policyholders; used initially in Far East.
- *Tabarru-based* : "donations" (Tabarru) i.e., premiums are accumulated into a fund to meet members' losses. Members are not allowed to take back any contributions or profits from investments.
- *A combination of Tabarru and Mudharabah* : Bahrain, UAE and Middle East countries.

- *Wakala model* : agency fee, received up front from the contributions and transferred to shareholders fund.
- *Al Waqf-based model* : Waqf is a distinct entity and legal person. According to one critic, “except for names and terms, the essence” of both Al Waqf takaful and conventional insurance is the same, and as a consequence this structure “has come under a lot of criticism from Shari’ah scholars”. This model is mainly used in Pakistan and South Africa.

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## INTELLECTUAL PROPERTY RIGHTS – LAWS AND PRACTICES
**(Elective Paper 9.3)**

*Time allowed : 3 hours* *Maximum marks : 100*

***NOTE***: *Answer **ALL** Questions.*

**Question 1**

*The Mayor Inc. is a company incorporated under the laws of United States of America (U.S.A.) consequent to its Research and Development (R&D) activities the company invented and developed its patented drugs to enable its administration to human beings. On successful invention of the patented drug in 1999, the company applied for a patent in U.S.A. Thereafter, on 12 July, 2000 the company applied for an international patent under the Patent Cooperation Treaty (PCT) and on 5th July, 2001 applied in India for grant of the patent to the patented drug in India. On March, 2008 the office of the Controller granted the company's application dated 5th July, 2001. This patent granted in India on 3rd March, 2007 corresponded to the patent granted to this patented drug in over 45 countries of the world.*

*The patented drug is used in the treatment of patients sufferintg from Kidney cancer i.e. Renal Cell Carcinoma (RCC). The aforesaid patented drugs acts more as palliative i.e. relieves patients from the pain and to an extent also slows down the spread of cancer by restricting the speed with which the cancer cells grow.*

*As a consequence of being granted a patent, the company had exclusive right to make, manufacture, use and sell the patented drug either by itself or through its licensee to the exclusion of others for a period of 20 years from the date of its application. Thus, the company had exclusive right to prevent third parties from making/manufacturing, using, selling or importing the patented drug in India without the company's permission/license.*

*The company Mayor Inc. sells this drug under a brand KCWIN which is registered Trademark in India USA, Europe, China, Russia, Japan and New Zealand. Mayor Inc. through its subsidiary Mayor India Ltd. sells the drug in India. The drug was found to be very effective and the doctors worldwide appreciated the result of the drug.*

*M/s. Kipla Pharmaceuticals established in the year 1930, located in Mumbai, Maharashtra, India is a manufacturer of various generic drugs.*

*Owing to the huge demand for the drug, which was nearly about 20 lakh units and the failure of Mayor Inc. to meet the growing demand due to the import restrictions since their manufacturing units is in Washington, Kipla Pharmaceuticals approached Mayor Inc., for technical assistance and license manufacturing of their patented drug KCWIN in India on 20th January, 2012. However, Mayor Inc. declined to grant the license of manufacture for reasons best known to them. As per the records available, Mayor Inc. had supplied only 2 lakh units against the huge demand in*

*India at the rate of ₹2.4 lakhs per month. Kipla on other hand manufacturing the same drug at ₹10,000 per month.*

*In the 2012, the Mayor India came to know that exact copies of their product KCWIN is being manufactured by M/s Kipla Pharmaceuticals. Immediately, thereafter, a Cease and Desist notice was issued by Mayor Inc. to Kipla Pharmaceuticals for infringing the Patent of Mayor Inc. Taking the plea that pharmaceutical companies spend billions of dollars on research. It is estimated that, of every thousand potential drugs screened, only 4-5 reach clinical trials and only one is actually approved for marketing. Pharmaceutical companies patent the drugs that they develop and thereby obtain exclusive marketing rights.*

*Further at the time of expiry of its Patent on KCWIN the The Mayor Inc. came with a minor change in the effectiveness and quality of KCWIN and de-novo applied for Patent before the controller of Patents, who rejected to grant the patent on the ground that it does not result in the enhancement of the known efficacy of that substance or the mere discovery of any new property or new use for a known substance or of the mere use of a known process, machine or apparatus.*

*Based on the above facts, answer the following :*

*(a) The rights of the Mayor Inc. are not absolute. Discuss.*

*(b) Discuss about the matter of dispute between Mayor Inc. Vs. Kipla Pharmaceuticals in the light of provisions of Indian Patent Act, 1970.*

*(c) Discuss in detail the rationale for Intellectual Property Protection to the companies like Mayor Inc. as a Patentee.*

*(d) Critically examine the act of Mayor Inc. to evergreen its pre-existing patent for its pre-patented product and validity of the rejection-order of the controller of patents in the light of provisions of the Patent Act, 1970 and relevant case law.*

*(10 marks each)*

**Answer 1(a)**

The patent right is not an absolute right. It is a fettered right and is subjected to certain specific prescribed constraints. The Patents Act balances well between individual rights of patentee and the interest of general public. A patent does not grant absolute monopoly. The rights of Mayor Inc. (Patentee) are directly subjected to certain conditions under Section 47 of the Patents Act, 1970 that reads as under:

Grant of patents of be subject to certain conditions-- The grant of a patent under this Act shall be subject to the condition that –

(1) any machine, apparatus or other article in respect of which the patent is granted or any article made by using a process in respect of which the patent is granted, may be imported or made by or on behalf of the Government for the purpose merely of its own use;

(2) any process in respect of which the patent is granted may be used by or on behalf of the Government for the purpose merely of its own use;

(3) any machine, apparatus or other article in respect of which the patent is granted or any article made by the use of the process in respect of which the patent is

granted, may be made or used, and any process in respect of which the patent is granted may be used, by any person, for the purpose merely of experiment or research including the imparting of instructions to pupils; and

(4) in the case of a patent in respect of any medicine or drug, the medicine or drug may be imported by the Government for the purpose merely of its own use or for distribution in any dispensary, hospital or other medical institution maintained by or on behalf of the Government or any other dispensary, hospital or other medical institution which the Central Government may, having regard to the public service that such dispensary, hospital or medical institution renders, specify in this behalf by notification in the Official Gazette.

The four exclusive clauses are limitations and conditions. These limitation and conditions may be divided into two kinds. The first two clauses of the above Section are of first kind of the limitations and conditions that are general in character and applicable to the every patent. The last two clauses are of second kind of the limitations and conditions; those are limited to the pharmaceutical patents only.

Section 47 (1), (2), and (4) deal with governmental use, and Section 47 (3) deals with experimentation/research of the granted patents.

Section 47 provides a statutory exemption from patent infringement liability to the government. Section 47 (1) and (2) states that the government may import, make, or have made on its behalf any patented product or product made by a patented process "merely for its own use." Section 47 (4) allows the government to make, use, vend, or even import any medicine or drug, medical equipment, or other equipment for use or distribution in public health centers owned by the government or notified by the government for that purpose. The scope of Section 47 is narrow in comparison with other sections of the Act dealing with the governmental use of a patented invention like Sections 100 and 101. Two landmark cases are determining the scope of Section 47.

In the case *Garware Wall Ropes Ltd.* v. *AI. Chopra and Konkan Railway Corp. Ltd.*, the Bombay High Court, brought out the differences between Sections 47 and 100. The plaintiff (appellant), in this case, Garware Wall Ropes Ltd. (patentee), filed an injunction against the defendant to put an end to the manufacturing and selling of their patented products. The defendant was A.I Chopra, who was making these products and selling them to Konkan Railways under a contract. The defendant contended that since they were manufacturing and selling the patented products only for the Konkan Railways, a Central Government department, and that their contract had been signed on behalf of the President of India, it would fall within the scope of Government use.

The Bombay HC stated that a government agency (third party) could use the patented invention on behalf of the government on the payment of royalty/remuneration to the patentee based on a contract or a license between the patentee and the third party under Section 100. However, under Section 47, the use of the patented invention by the government is restricted merely to its own use only. Therefore, a third party is not allowed to use the patented invention under this section. Further, no royalty fee or other remuneration had to be paid to the patentee by the government when it is using the patented invention for a sovereign purpose. The Bombay HC opined that the government exemption under Section 47 would only be applicable to departments of the government and government servants and agents only.

The Delhi High Court in *Chemtura Corporation* v. *Union of India* provided a different interpretation of Section 47. The defendants, in this case, were the government of India and a consortium of third parties who supplied products based on drawings provided to them by the Railway Ministry on the basis of a contract. The plaintiff contended that Section 47 would not be applicable to the consortium, and it would be liable for infringement as it was not a government agency. The Delhi HC rejected this contention and stated the consortium (third party) was strictly following the instructions and drawings provided by the Ministry and had no autonomy concerning the product. Therefore, it opined that the consortium would fall within the scope of the government exemption. These are the views that can be observed in the two landmark cases concerning the government exemption in Section 47.

Section 47 (3) deals with another instance where a patented invention may be used without attracting liability – for the purpose of research/experimentation and imparting instructions to pupils for educational purposes. Article 47 (3) reads "any machine, apparatus or other article in respect of which the patent is granted or any article made by the use of the process in respect of which the patent is granted, may be made or used, and any process in respect of which the patent is granted may be used, by any person, for the purpose merely of experiment or research including the imparting of instructions to pupils."

**Answer 1(b)**

The matter of dispute between *Mayor Inc.* vs *Kipla pharmaceuticals* is related to grant of Compulsory license under the Indian Patent Act, 1970. Compulsory licenses are sovereign state authorizations which enable a third party to make, use, or sell a patented product without the consent of the patent holder. Provisions pertaining to compulsory licensing are provided for under both the Indian Patent Act, 1970, as well as the international legal agreement between all the member nations of WTO – the TRIPS. In India, Chapter XVI of the Indian Patent Act, 1970 deals with compulsory licensing while the conditions which need to be fulfilled for the grant of a compulsory license are laid down under Sections 84 and 92 of the Act.

In accordance with Section 84(1) of the Indian Patent Act, 1970, after three years from the grant of a patent, any interested person may make an application for a compulsory license on the grounds that the patented invention:

(a) Does not satisfy the reasonable requirements of the public;

(b) Is not available to the public at a reasonably affordable price; and

(c) Is not worked in the territory of India.

In addition to the aforementioned grounds, according to Section 92 of the Act, compulsory licenses can also be issued suomotu by the Controller of Patents pursuant to a notification issued by the Central Government if there is either a "national emergency" or "extreme urgency" or in cases of "public non-commercial use". The said section enables the Government of India to notify to the public of such extreme circumstances, whereupon, any person interested can apply for a compulsory license and the Controller in such case may grant to the applicant a license over the patent on such terms and conditions as he thinks fit. *Natco* v. *Bayer* case On March 9, 2012, the Controller of Patents issued the first compulsory license for patents in India. The compulsory license

was issued to NatcoPharma Ltd. This patent relates to drug Sorafenibtosylate sold under the brand name Nexavar by Bayer. For liver cancer. The Controller granted the compulsory license to Natco to manufacture and sell a generic version of Nexavar . The decision of the Controller was based on section 84 of the Patents Act. The Controller found that the reasonable requirements of the public with respect to the patented invention had not been satisfied, since only 2% of the total kidney and liver cancer patients were able to access the Bayer's drug. The Controller determined that the patented invention was not available to the public at a reasonably affordable price, because Bayer was charging about Rs. 2.8 lakhs for a therapy of one month of the drug.

*Lee Pharma v. AstraZeneca*

The following case illustrates license sought for Saxagliptin® which is used in the treatment of Type-II Diabetes Mellitus On June 29, 2015, Lee Pharma filed an application for compulsory license for patent covering Astra Zeneca's diabetes management drug Saxagliptin®. The application was rejected stating that no prima facie case had been made out on any of the three grounds under section 84 (1) of the Indian Patent Act. Reasonable requirements of the public had not been satisfied: Lee Pharma failed to demonstrate reasonable requirements of the public with respect to Saxagliptin® and further failed to demonstrate the comparative requirements of the drug Saxagliptin® vis-à-vis other drugs. The patented invention was not available to the public at a reasonably affordable price: It was held that all related drugs were in the same price range and that Saxagliptin® being sold at unaffordable price was not justified.The patented invention had not been worked in the territory of India: Lee Pharma also failed to show the exact quantitative requirements of Saxagliptin® in India. Therefore, it could not be concluded whether manufacturing of the drug in India was necessary or not.

*BDR Pharmaceuticals International Pvt Ltd.* v. *Bristol-Myers Squibb Co*

In BDR Pharmaceuticals the controller rejected BDR's application for a compulsory licence (4 March 2013) for the Bristol-Myers Squibb cancer drug SPRYCEL. The controller rejected the compulsory licence application made by BDR by stating that BDR had failed to make a prima facie case for the grant of the compulsory licence. The controller observed that BDR had made no credible attempt to procure a licence from the patent holder and the applicant had also not acquired the ability to work the invention to public advantage. Thus, the request for grant of the compulsory licence was refused.

Under the Indian Patent Act, the reasonable requirements of the public are deemed not to have been satisfied where:

- The patentee refuses to grant a license or licenses on reasonable terms; and
  - o a trade or industry is prejudiced; or
  - o demand for the patented article has not been met to an adequate extent; or
  - o a market for exportation of the patented article manufactured in India is not being supplied or developed; or
  - o the establishment or development of commercial activities in India is prejudiced.
- The patentee imposes a condition on the patented invention;

- Non-working of the patent in the territory of India;
- Working of the patented invention in India on a commercial scale is prevented by the importation from abroad.

Section 146 (2) of the Indian Patent Act requires every patentee and licensee to provide information on the extent to which the patented invention has been worked on a commercial scale in India. Relevant information is submitted by patentees and licensees with Form 27. It is required to be filed every calendar year, within three months of the end of each year.

The information includes the following:

- Whether the invention has been worked;
- If not worked, the reasons for non-working, and steps being taken to work the invention;
- If worked, quantum and value of the patented product;
- If manufactured in India;
- Whether imported from other countries, giving details of the countries concerned;
- Licenses and sub-licenses granted during the year.

**Answer 1(c)**

There are several compelling reasons for Intellectual Property Protection to the companies like Mayor Inc. as a Patentee. First, the progress and well-being of humanity rest on its capacity to create and invent new works in the areas of technology and culture. Second, the legal protection of new creations encourages the commitment of additional resources for further innovation. Third, the promotion and protection of intellectual property spurs economic growth, creates new jobs and industries, and enhances the quality and enjoyment of life. An efficient and equitable intellectual property system can help all countries to realize intellectual property's potential as a catalyst for economic development and social and cultural well-being.

The intellectual property system helps strike a balance between the interests of innovators and the public interest, providing an environment in which creativity and invention can flourish, for the benefit of all. A Patent in simple terms is an invention and therefore requires innovation. It is an exclusive monopoly granted to the inventor for allowing the use of the invention in the open market. A patent can be granted against product, process of doing something or a technical solution to a problem.

When an invention is created the inventor is required to apply for a patent to the patent office as it has various benefits. In order to be patented, an invention must be new i.e. it cannot be an extension of something that already exists. It can neither be obvious to people skilled in the given technical field nor can it be another shuffling of the steps involved in procedure, therefore, it has to involve an inventive step. The most important part is the practicability of the invention, i.e. if it is in theory then it must have the potential to be put to practical use as well.

**SOCIAL CONTRACT THEORY OF JOHN LOCKE**

According to Locke, "every man has a property in his own person", i.e. the fruits of

a man's labour belongs to him. In this scheme intellectual property would seem to follow naturally, since the individual must surely be permitted the fruits of his mental and physical labour.

**PERSONALITY THEORY**

According to Kant and Hegel, if one's artistic expressions are synonymous with one's personality, then they are deserving of protection just as much as the physical person is deserving of protection since in a sense they are a part of that physical person.

**ECONOMIC INCENTIVE RATIONALES**

The incentive theory builds on society's interest in intellectual property works, holding that legal protection for intellectual works serves as an incentive for the production of more intellectual works that will ultimately benefit society.

Economic Theory Economic future of any country primarily depends on the superior corpus of new knowledge and technological development. IPRs help in the successful marketing of knowhow in the competing global market. Progress in technology is a quintessence of industrial development. IP plays a momentous role in furtherance of economic interest of a country. IPR protects the know-how involved in the invention stimulating more technological developments which in turn strengthen the economy of the country. IP accumulates foreign currency and enhances the export of the country as other countries have to procure the IP products from the country of protection. IP thus facilitates competitive advantages in industrial and commercial activity.

*Prospect Development Theory*

A number of years ago, Edmund Kitch proposed a prospect-development theory of the societal benefits of patents. Like the development and commercialization theory, it proposes that the utility of a patent comes after an initial invention is made. Kitch's theory was that having a broad patent on an initial invention enabled the patent holder to orchestrate development of a technological prospect in various dimensions, whereas development of an initial invention that was freely available to all would be chaotic, duplicative, and wasteful. The theory that patents enable orderly development of broad technological prospects differs from the development and commercialization theory in suggesting that a wide range of developments or inventions might become possible if the initial invention is available as an input—through either development or modification in different directions. Many university inventions, particularly research tools, are of this sort. This theory suggests that an important issue defining the benefits and costs of granting patents on broad prospects is what is assumed about the market for patent licenses. If one assumes that, in general, the transaction costs of patent licensing are small, then one may take a relatively relaxed view of the costs of granting a large prospect-controlling patent, even when one believes that potential explorers of the prospect have diverse ideas of what they would do. But if one assumes that transaction costs are high, one is less sanguine about this outcome.

*Disclosure Theory*

The primary issue raised by the disclosure theory is not so much whether strong patents encourage more inventing, but rather how inventors reap the returns from their

inventions. It presumes that secrecy is possible and sufficient to induce invention but that society is better off granting intellectual property rights and getting disclosure in exchange. A patented invention would thus be available for uses that the inventor did not know about or was not in a position to implement. Under this theory, a patent both advertises the presence of an invention and facilitates licensing.

*Invention- inducement theory*

The theory that patents motivate useful invention is the most familiar theory of the benefits of patenting. Indeed, much discussion about the benefits of patents proceeds as though motivating useful invention were the only social purpose served by patents and patents always serve this purpose. In fact, as explained later, the situation can be much more complicated in many cases. All versions of the invention-inducement theory presume either that if there is no patent protection there will be no invention or, more generally, that without a patent system incentives for invention will be too weak to reflect the public interest. In particular, they assume that stronger patent protection will increase the amount of invention. Under what might be called the canonical versions of the invention-inducement theory—versions associated with the models of economists Arrow (1962), Nordhaus (1969), and Scherer (1972)—inventors, as a group, are implicitly assumed to be diverse, working on different and generally noncompeting things. Thus in the absence of redundant efforts that might occur if many groups worked on competing things, stronger patent protection results in a greater number of useful inventions. In most versions of the invention-inducement theory it is assumed, generally implicitly, that the social benefit of a particular invention is strictly its final use value; the social benefit of patent protection stems, therefore, from the additional invention induced by the prospect of a patent. And the social cost of a patent is the restriction on the use associated with the monopoly power lent by a patent.

**Answer 1(d)**

The act of Mayor Inc. to evergreen its pre-existing patent for its pre- patented product is not according to law and the rejection-order of the controller of patents is valid in the light of following provisions of the Patent Act, 1970 and relevant case law mentioned below:

**Section 3(d)** of Indian Patents Act, 1970 says that the mere discovery of a new form of a known substance which does not result in the enhancement of the known efficacy of that substance or the mere discovery of any new property or new use for a known substance or of the mere use of a known process, machine or apparatus unless such known process results in a new product or employs at least one new reactant, is not patentable. This section provides that the new form of the substance shall not be considered as patentable unless it shows enhancement in efficacy. For instance, new use of Aspirin for treatment of the cardio-vascular disease, which was earlier used for analgesic purpose, is not patentable. However, a new and alternative process for preparing Aspirin is patentable. For instance, the paracetamol has antipyretic property. Further discovery of new property of paracetamol as analgesic can not be patented. Similarly, ethyl alcohol is used as solvent but further discovery of its new property as anti knocking, thereby making it usable as fuel, can not be considered patentable.In order to distinguish the invention from the prior art, relevant prior art is also required to be given in the specification. It is always essential to analyze the invention in the light of what is described

and the prior art, in order to identify the contribution to the art and hence determine whether this advancement resides in, or necessarily includes technological features and technical application or is solely intellectual in its content.Section 3(d) of the Indian Patent Act restricts grant of patent for "incremental innovations" in many drugs unless it provides significant therapeutic advantages to existing molecules.

The Supreme Court's judgment in *Novartis A.G* v. *Union of India* [AIR (2013) SC 1311] whereby it dismissed the patent application filed by Novartis for a drug used to treat a type of blood cancer, was a much awaited decision for the patients. Even, in 2006, the Madras Patent Office refused the patent application of Novartis for its drug Glivec stating that the said drug did not exhibit any major changes in therapeutic effectiveness over its pre-existing form, which was already patented outside India. The said decision was based on Section 3(d) of the Indian Patents (Amendment) Act, 2005 which provides a known substance can only be patented if its new forms exhibit “enhanced efficacy”.

The Patent Office did not find any enhanced efficacy in the drug Glivec and, therefore, considered it incapable of patentable under Section 3(d) of 2005 Act.Countries in order to attain development while taking care of the needs of its citizens must go through a paradigm shift, now more than ever. And in order to maximize achievements of developmental goals, health is a parameter of utmost importance; healthy citizens can lead to overall growth of an economy. India is till present categorized as a developing nation owning a naïve Intellectual Property Law regime in contrast to a swiftly germinating population ranked second largest globally. But this disparity does not settle the classic case of commercialism versus larger public good in the form of human rights.

The Indian law since long followed a 'process patenting system which was brought to a stop with TRIPS Agreement of the World Trade Organization (WTO) in 1995 that made 'product' patenting mandatory; thus opening a disputable area in India between the giant pharmaceutical sector and the larger goal of public health. The Apex Court rejected the contention stating that in the case of medicines, efficacy means “therapeutic efficacy” and these properties while they may be beneficial to some patients do not meet this standard.

The Supreme Court also held that patent applicants must prove the increase in therapeutic efficacy based on research data in vivo in animals. The Supreme Court held that the true intention to enact section 3(d) was to prevent the concept of evergreening and thus if the invention does not fulfil the test of Section 3(d), it cannot be granted a patent. The court further specified that this case should not be interpreted to mean that Section 3(d) bars all incremental inventions. It is with regard to the field of medicine especially in cases of life-saving drugs, a great acre and caution needs to be taken so as to protect the right to life of the masses

This section plays an important role to protect public health of teeming millions of our country. This provision is one of the most important safeguards under the Patents Act, 1970 to protect public health. This section contradicts the problem and claim of ever greening 17. This provision does not recognize ever greening and permits entry of generic drugs which in turn makes the price of life saving drug cheaper. It will definitely protect the public health of millions and millions of people in India who live in below poverty line and have a little financial power to purchase medicine.

**Question 2**

*(a) Mr. Lall, was a sculptor of international repute and fame. In 1957, he was approached by the Government of India, to design murals to be installed on the walls of Vigyan Bhavan. Plaintiff accepted the offer and completed the production of his piece of art. The mural was a symbol of India's cultural heritage and was themed on 'science of rural and modern India'. It was installed in the entrance lobby of Vigyan Bhavan in 1962 and stayed installed till 1979 when it was pulled down and kept in a Government store room. He asserted that the pulling down and improper handling of the mural caused immense damage to the mural, which resulted in disappearance of the parts of the mural including the name of its creator. He wants to initiate legal proceedings against Government of India.*

*On the basis of the above facts, advise Mr. Lall as the remedy available to him.*

*(b) What is the purpose of design registration ? What is not a ''design'' as per the provision of the Designs Act, 2000 ? (6 marks each)*

**Answer 2(a)**

In *Amarnath Sehgal* v. *Union of India [2005(30) PTC253(Del))]* brought to the forefront the debate over the moral rights of authors and creators. The main issues for determination before the Court were (a) whether the suit was barred by limitation (b) whether Mr. Sehgal had moral right over the mural even when the copyright vested with the UOI (c) Has UOI infringed moral rights of Mr. Sehgal (d) whether Mr. Sehgal has suffered any damage (e) Relief. Section 57 of the Copyright Act, 1957 provides for what are termed as Author's Special Rights, better known as Moral Rights. Founded on Article 6bis of the Berne Convention, Moral Rights have two key prongs (1) Right to claim authorship of the work (sometimes referred to as Rights of Attribution/Paternity Rights) and (2) Right against distortion, modification or mutilation of one's work if such distortion or mutilation would be prejudicial to the author's honour or reputation (or Integrity Rights).

These moral rights are independent of the author's copyright. They exist even after the assignment of the copyright, either wholly or partially. On the question as to whether the suit was barred by limitation, the Court ruled that the correspondence between UOI and Mr. Sehgal contain the acknowledgement by the former of the right of the latter over the mural and therefore the suit is not barred by limitation. The Court examined at length the national and the international framework for protection of the moral rights of the Author.

The Court was of the opinion that it is a narrow view the derogatory treatment of the creative work would mean deletion to, distortion, mutilation or modification to, or the use of the work in setting which is entirely inappropriate. The broad view is that mutilation is nothing but the destruction of the work as to render it imperfect and is therefore prejudicial to the reputation of the author.

Recognizing the moral rights of the Mr. Sehgal over the Mural, Pradeep Nandrajog J. ruled: *"mural whatever be its form today is too precious to be reduced to scrap and languish in the warehouse of the Government of India. It is only Mr. Sehgal who has the right to recreate his work and therefore has the right to receive the broken down mural. He also has the right to be compensated for the loss of reputation, honor and mental injury due to the offending acts of UOI"*. The Court passed mandatory injunction against

the UOI directing it to return the mural to Mr. Sehgal within two weeks from the date of judgment. Court passed a declaration transferring all the rights over the mural from UOI to Mr. Sehgal and an absolute right to recreate the mural and sell the same. The Court also granted damages to the tune of Rs.5 lacs and cost of suit to Mr. Sehgal against UOI.

The case of Amar Nath Sehgal's mural throws into relief the importance of the Section 57 provision of the Indian Copyright Act, and of the weight it has been accorded by courts in India. It also gives reason to thank the wisdom of those who resolved, all those years ago, that there should be a higher law to protect the soul and essence of artistic expression as much as – or more than – the physical or tangible form of that expression. The Court has given a wide construction to the moral rights of the author under the copyright law.

The Statute only provides for the grant of injunction and damages in cases where any distortion, mutilation, modification or other act in relation to the work if such distortion etc would be prejudicial to his honor or reputation. Court has read into the forgoing provision the *'right of the author to receive the copyrighted work for the purposes of restoration and sell it'. The ratio of the case is establishes the proposition that 'where the owner (not being the author) of the copyright work, treats the work in a manner that is prejudicial to the reputation and honor of the author, the Court may transfer all rights over the work to the author'.*

**Answer 2(b)**

'Design' refers to the unique aspects of shape, figure, blueprints or decorations or composition of lines or hues or combination thereof given to an article, which may be 2 dimensional or 3 dimensional or in both formats, by any manufacturing procedure or mode. The process involved in creation of the design may be manual, mechanical, automated or chemical, separate or all-inclusive, by which the finished article appeal to and can be identified solely by the eye. However, this does not contain any mode or a standard or construction or anything which is in material a mere mechanical device. The Purpose of obtaining the design registration under the Designs Act is to safeguard a novel or an innovative design so created which is to be applied to a specific article under manufacturing process through an Industrial Process or mode. At times, we see that the buying behaviour of the customers towards some articles for consumption is inclined not only by their actual product quality but also by the design of their appearance, e.g., a mobile phone or goggles. The main objective of obtaining a design Registration is to make sure that the particular artisan, creator, craftsman, engineer or the designer of that design having unique appearance is not deprived and deceived of his bonafide reward by some copycats, who might tend to use his design to their goods. The key reasons as to why a business entity needs a Design Registration:

- To get effectual and well-situated legal shield for safeguard of unique designs in India from being imitated or misused.
- To promote and develop creativity and originality.
- It is a mandatorycompliance for all the companies located in the WTO Member nations who have signed the Trade-Related Aspects of Intellectual Property Rights (TRIPs) Agreement.

The important purpose of design Registration is to see that the artisan, creator, originator of a design having aesthetic look is not deprived of his due reward by others applying it to their goods.

As stated in the definition of the design above, design does not include:

(i) Any Trademark, as defined in Section 2(zb) of the Trademarks Act, 1999, or

(ii) Any property mark, as defined in Section 479 of the Indian Penal Code, 1860, or

(iii) Any artistic work, as defined in Section 2(c) of the Copyrights Act, 1957.

(iv) A painting, sculpture, drawing (including a diagram, map, chart or plan), an engraving or a photograph, whether or not any such work possesses artistic quality.

(v) Any work of architecture i.e. any building or structure having an artistic character or design or any mode for such building or structure.

(vii) Any work of artistic craftsmanship.

Colors, verbal elements and sounds are examples of what cannot be protected as a design, since they are not part of the ornamentation of a product. On the other hand, they may seek protection under trademark law.The designs whose appearance respond exclusively to the technical function of the product. It is possible that the technical or functional characteristics of these types of designs can be protected through other intellectual property rights (normally through patents or utility models).Designs that go against public order and certain moral standards. As a general rule, designs that reflect or promote violence or discrimination based on sex, racial or ethnic origin, religion or belief, disability, age or sexual orientation will be denied.

**Question 3**

*(a) Enumerate the criteria for registration of a plant variety and the prerequisites for filing an application form for registration under Plant Varieties Act, 2001.*

*(b) Explain in brief the conditions and procedure for registration of Layout-Design of Integrated Circuits under the Semiconductor Integrated Circuits Layout Design Act, 2000? (6 marks each)*

**Answer 3(a)**

For the registration of a variety under Plant Varieties Act, 2001 following criteria must be fulfilled: Novel: If at the date of filing an application for registration for protection, the propagating or harvested material of such variety has not been sold or otherwise disposed of in India earlier than one year or outside India, in the case of trees or vines earlier than six years, or in any other case earlier than four years, before the date of filing such application.

**Distinct** : A variety is said to be distinct if it is clearly distinguishable by at least one essential characteristic from any other variety whose existence is a matter of common knowledge in any country at the time of filing an application.

**Uniform** : A variety is said to be uniform, if subject to the variation that may be

expected from the particular features of its propagation it is sufficiently uniform in its essential characteristics. Stable: A variety is said to be stable if its essential characteristics remain unchanged after repeated propagation or, in the case of a particular cycle of propagation, at the end of each such cycle.

Application for registration of a varieties can be made by:

1. any person claiming to be the breeder of the varieties.
2. any successor of the breeder of the varieties.
3. any person being the assignee or the breeder of the varieties in respect of the right to make such application.
4. any farmer or group of farmers or community of farmers claiming to be breeder of the varieties.
5. any person authorized to make application on behalf of farmers and
6. any university or publicly funded agricultural institution claiming to be breeder of the varieties.

Application for registration of plant varieties can be made in the office of Registrar, Protection of Plant Varieties and Farmers' Rights Authority (PPV&FRA), New Delhi.

According to Section 18 of Plant Varieties, Act, for registration of a plant variety the following prerequisites has to be completed:

1. Denomination assigned to such variety.
2. Accompanied by an affidavit that variety does not contain any gene or gene sequences involving terminator technology.
3. Complete passport data of parental lines with its geographical location in India and all such information relating to the contribution if any, of any farmer (s), village, community, institution or organization etc. in breeding, evolving or developing the variety
4. Characteristics of variety with description for Novelty, Distinctiveness, Uniformity and Stability.
5. A declaration that the genetic material used for breeding of such variety has been lawfully acquired.
6. A breeder or other person making application for registration shall disclose the use of genetic material conserved by any tribal or rural families for improvement of such variety.

**The PPV& FR Act, 2001 provides for exclusion of following verities from registration under the Act:**

- Where prevention of commercial exploitation of that variety is necessary to protect public order or public morality or human, animal and plant life and health or to avoid serious prejudice to the environment.
- Which involve any technology which is injurious to the life or health of human

beings, animals or plants such as varieties developed by terminator technology and genetic restriction use technology.

- Whose species or genera are not listed in the notification issued by the Central Government.

**Answer 3(b)**

**Layout Designs (topographies) of Integrated Circuits** is a subject in the field of protection of Intellectual Property. Integrated circuits which are commonly known as 'chips' or 'micro-chips are the electronic circuits in which all the components (transistors, diodes and resistors) have been assembled in a certain order on the surface of a thin semiconductor material (usually silicon). In compliance with the TRIPS Agreement, India has enacted the Semiconductor Integrated Circuits Layout- Designs Act, 2000 in order to provide protection to layout designs of integrated circuits. The Act defines "Layout Design" to mean a layout of transistors and other circuitry elements and includes lead wires connecting such elements and expressed in any manner in a semiconductor integrated circuit.

**Conditions and Procedure for Registration Acceptance of Application**

Any person who wants to register his layout-design is required to apply in writing to the Registrar Semiconductor Integrated Circuits Layout-Design Registry in the concerned modifications, as he may consider necessary. territorial jurisdiction, as per the procedure prescribed in the SICLD Act, 2000. The Registrar after scrutiny may refuse the application or may accept it absolutely or with amendments or modifications, as he may consider necessary. Layout designs are registered if they are "(i) Original, (ii) inherently distinctive, (iii) capable of being distinguishable from any other registered layout-design and (iv) if they have not been commercially exploited for more than two years before date of application for registration".

Thus, it is observed that the act requires distinction rather than novelty for the purpose of registration. A layout-design is a combination of elements and interconnection that are commonly known amongst creator of layout-designs and manufacturers of semi-conductor integrated circuits. The layout-designs and thereby only considered original if the combination is a result of the creators own intellectual abilities and efforts.

The SICLD Act, 2000 prohibits the registration of certain Layout designs. Layout design which is not original is prohibited. Similarly, the registration of layout design which has been commercially exploited anywhere in India or a convention country has been prohibited. Layout design which is not inherently distinctive or which is not inherently capable of being distinguishable from any other registered layout-design also cannot be registered. The Act however, provides that a layout-design which has been commercially exploited for not more than two years from the date on which an application for its registration has been filed either in India or a convention country shall be considered as not having been commercially exploited.

According to SICLD Act, 2000, layout-design is to be considered as original if it is the result of its creator's intellectual efforts and is not commonly known to the creators of layout-designs and manufacturers of semiconductor integrated circuits at the time of its creation. The Act further provides that a layout-design consisting of such combination of elements and interconnections that are commonly known among creators of layout-

designs and manufacturers of semiconductor integrated circuits shall be considered as original if such combination taken as a whole is the result of its creator's intellectual efforts. Furthermore, this Act provides that where an original layout-design has been created in execution of a commission or a contract of employment, the right of registration to such layout-design shall belong, in the absence of any contractual provision to the contrary, to the person who commissioned the work or to the employer.

As per provisions of SICLD Act, 2000, the Registrar has the power to withdraw the acceptance of an application for registration (before registration of layout design) if it comes to his knowledge that the layout-design is prohibited of registration under the provisions of this Act.The Registrar may however, provide the opportunity of being heard to the applicant if he so desires, before the withdrawal of the acceptance.

According to the SICLD Act, 2000, Registrar shall register the layout-design in the register, if the application has not been opposed within the prescribed time limit or the application has been opposed and the opposition has been decided for the applicant. The date of making the application is considered to be the date of registration of layout-design. After registration, the Registrar issues certificate of registration sealed with the seal of the Semiconductor Integrated Circuits Layout-Design Registry. Registration gives exclusive rights to the creator of layout-design for 10 years.

It enables him to exploit the creation commercially and in the case of infringement, get reliefs permitted under the Act. Once the layout design is registered, the original registration and all subsequent assignments and transmissions of layout-design are admissible as a prima facie evidence of its validity.

It cannot be held invalid on the ground that it was not a registerable layout design except upon evidence of originality and if such evidence was not submitted to the Registrar before. The Act confer all the powers of a civil court to the Registrar for the purposes of receiving evidence, administering oaths, enforcing the attendance of witnesses compelling the discovery and production of documents and issuing commissions for examination the of witnesses. It can also refer disputes to the Appellate Board.

**Question 4**

(a) *Central Book Company is a registered partnership firm carrying on the business of publishing law books. The said company is involved in the printing and publishing of various books relating to the field of law. One of the well-known publications is the law report known as Law in India. It publishes all reportable judgements along with non-reportable judgments of the Supreme Court of India. After the initial procurement of the judgements, orders and proceeding for publication the appellants make copyediting wherein the judgements, orders and record of proceedings procured, which is the raw source, are copy-edited by a team of assistant staff and various inputs are put in the judgements and orders to make them user friendly. The appellants also prepare the head notes comprising of two portions, the short note consisting of catch/lead words written in bold; and the long note, which is comprised of a brief discussion of the facts and the relevant extracts from the judgements and orders of the Court.*

*Another company named as Spectrum Business Support Ltd. came out with a software called Grand Jurix published on CD-ROMs. In CD all the modules of Central Book Company have been lifted verbatim. A suit of Copyright*

*infringement was filed by Central Book Company against the Spectrum Business Support Ltd. The defence of the Spectrum Business Support Ltd. was that the Judgments published in the Law in India is nothing but merely a derivative work based upon the judgments of the court, which lacks originality and therefore no Copyright can be claimed by the Central Book Company.*

*On the basis of the above facts discuss the concept of originality under Copyright law as laid down by various judicial pronouncement.* *(6 marks)*

*(b) How the right of persons with disability are protected under Copyright Act, 1957?* *(6 marks)*

**Answer 4(a)**

Originality is the basic yardstick used by the copyright regimes in the world to evaluate the availability copyright protection to a particular work. Section 13(1) of the Indian Copyright Act 1957 states that copyright subsists in "original literary, dramatic, musical and artistic works." However, the Act fails to give any definition or test to determine originality of a work.

This leaves the court with the duty to decide the amount originality required for a work to claim copyright protection. India strongly followed the doctrine of 'sweat of the brow' for a considerably long time. In *Eastern Book Company 1. D.B. Modak*, JAIR 2008 Supreme Court 809,810] the Supreme Court discarded the 'Sweat of the Brow' doctrine and shifted to a 'Modicum of creativity' approach as followed in the US. The dispute is relating to copyrightability of judgements. The notion of "flavour of minimum requirement of creativity" was introduced in this case. The Court granted copyright protection to the additions and contributions made by the editors of SCC. At the same the Court also held that the orders and judgments of the Courts are in public domain and everybody has a right to use and publish them and therefore no copyright can be claimed on the same. The Court further referred the principle of a minimal degree of creativity, i.e., there should be a minimum degree of creativity in derivative work to show that the copy-edited version of the Judgement is not an original work.

It can be concluded from this case that the jurisdiction of Copyright protection under the Copyright Act, 1957, finds itself in fair play. At the point when an individual produces something with his ability and work, it provides possession to him, for his/her production and the other individual would not be allowed to make a benefit out of the expertise and work of the primary creator, who had initially produced. It is for this reason that the Copyright Act of 1957, gives the authors absolute privilege of the floor in terms of exclusive rights for their originally produced work, also considered as non-tangible prerogatives in various legislation.

This Act puts a check on the exploitation of the original owner against the use of his work without his consent. Lastly, the Court did not allow the Respondents to sell their CD ROMS with the text of judgements of the Supreme Court Cases along with their own headnotes, footnotes, and other inputs. The Judgement of the High Court was modified to the extent that in addition to the interim relief, the above-mentioned additional relief to the appellants was also granted by the Apex Court.

The concept of “originality” has undergone a paradigm shift from the “sweat of the brow” doctrine to the “modicum of creativity” standard put forth in *Feist Publication Inc.*

v. *Rural Telephone Service* by the United States Supreme Court. The doctrine of "sweat of the brow" provides copyright protection on basis of the labour, skill and investment of capital put in by the creator instead of the originality. In Feist's case, the US Supreme Court totally negated this doctrine and held that in order to be original a work must not only have been the product of independent creation, but it must also exhibit a "modicum of creativity".

The Supreme Court prompted 'creative originality' and laid down the new test to protect the creation on basis of the minimal creativity. This doctrine stipulates that originality subsists in a work where a sufficient amount of intellectual creativity and judgment has gone into the creation of that work. The standard of creativity need not be high but a minimum level of creativity should be there for copyright protection.

**Answer 4(b)**

The Amendment of the Copyright Act in 2012 largely aimed at making Copyright Act, 1957 complaint with the WIPO Copyright Treaty (WCT), the WIPO Performers and Phonograms Treaty (WPPT) and most of the international treaties and conventions in field of copyrights. Of the numerous changes brought about in the new Indian copyright regime, exceptions and limitations for persons with disabilities were incorporated in the following provisions:

**Section 52(1)(zb) of the Copyright Act** : An author of the copyrighted work is granted with exclusive rights of use, reproduction, etc. but there a few exceptions wherein a copyrighted work can be used, copied or reproduced without obtaining the consent from the copyright owner. This section basically deals with such exceptions to copyright infringement and empowers individuals, educational establishments and non-profit organizations to reproduce all types of copyright-protected content in accessible formats for the benefit of disabled persons. To this extent, the Act provides that it would not be a copyright infringement if any individual or any organization working for the benefit of the persons with disabilities and on a non-profit basis creates accessible format copies or distributes them to persons with disabilities.

**Section 31B of the Copyright Act** : Any person or an organisation working for the benefit of disabled persons on a profit basis or for business can undertake conversion and distribution by applying for a license from the Copyright Board in accordance with the procedure laid down in this section.

These provisions in the Indian Copyright Act are inclusive and accommodating for print disabled persons. It gives greater access to creative work and the right to convert the work i.e copyrightable work in any accessible formats through any organisation or themselves without the need to purchase a license.

The Marrakesh Treaty is mainly to facilitate access to copyrighted works of authors for visually disabled, visually impaired or print disabled persons. A conference by the World Intellectual Property Organisation, (WIPO) along with the support of the US delegation in Morocco adopted the Marrakesh Treaty. There are eighty-eight signatories and has been ratified by thirty-three countries.

India has made practical efforts in recent times to accommodate the print disabled person by ratifying the Marrakesh Treaty to Facilitate Access to Published Works by

Visually Impaired, 2013. Through this treaty it has been made mandatory for member countries to enforce exceptions or limitations as need be in their Copyright laws regarding the right to reproduce copyrightable work in accessible formats and also other laws to make education, research more accessible. Digital technology has the potential to transform the lives of sensory-disabled people. For example, the synthesizers that convert text-to-speech allow the words displayed/typed on the screen to be read out loud and the images so displayed to be described orally. This allows the blind people to understand the text by hearing. Also, software that allows a computer to respond to the commands given orally, instead of written commands by keyboard or a mouse helps the visually impaired people to operate the computer with ease. Screen readers which decode the electronic text into Braille are also available.

Awkwardly, DRMs restrict the above activities. For instance, e-books from Adobe have the inbuilt capacity to be read out loud by a computer, but the owners of rights use technological protection methods to turn off this application by Adobe. These measures block the access for blind people, even when they have authentically purchased the original work. Such things override the exceptions provided by copyright law even when no legal barriers exist, and create technological barriers. International IP agreements and national laws in some countries prohibit users from evading or bypassing measures for protection for legitimate access purposes.

**Question 5**

*(a) Jane a microbiologist, wanted to pursue his dream of having his own distilleries, with support of family and friends, he struck out on his own to establish a microbrewery, Smokey Mountain Brews, in a college town. Over the past decade, his business flourished not only with established customers, but also with regional restaurants.*

*Transporting beer, including his signature brew, Smokey Mountain Ale, to surrounding localities, including the city of Asheville, North Karnataka, has been time-consuming and expensive. So, two years ago, Jane began planning to open a second brewery in Asheville, a city nationally-known for its microbrews, and those plans are in the final stages. The facility is ready to go, equipment in place, and an assistant brew master hired. He wants to protect his Intellectual Property Rights before moving further in this regard. Advise him the best ways to protect his Intellectual Property Rights.*

*Give justification for your advice.* *(6 marks)*

*(b) "Registering a Geographical Indication is a catalyst to getting scattered individuals together. GIs are meant to benefit a community of local producers and act as an appellation or indicator of the geographical origin of the product". Comment.* *(6 marks)*

**Answer 5(a)**

The best way to protect his Intellectual Property Right is to maintain the information as a trade secret. Though, there is no specific legislation in India to protect trade secrets and confidential information. Nevertheless, Indian courts have upheld trade secret protection.

The Delhi High Court in *American Express Bank Ltd.* v. *PriyaPuri*, [(2006) HI LLJ 540 (Del)] defined trade secret as formulae, technical know-how or a method of business adopted by an employer which is unknown to others and such information has reasonable impact on organizational expansion and economic interests. Indian courts have approached trade secrets protection on the basis of principles of equity, action of breach of confidence and contractual obligations. On the issue of trade secrets the Learned Judge observes, It is also to be added that a trade secret is some protected and confidential information which the employee has acquired in the course of his employment and which should not reach others in the interest of the employer. However, routine day-to-day affairs of employer which are in the knowledge of many and are commonly known to others cannot be called trade secrets.

In this case, the central issues were with respect to breach of confidentiality and disclosure of trade secrets. The defendant was given the responsibility of supervising the Wealth Management Division of the plaintiff (the employers) and was required to act in accordance with the code of conduct for all employees. The defendant was not allowed to engage in activities, which conflicted with the plaintiff's interest. Additionally, during the defendant's course of employment, all confidential information, like customer records and information, was to be protected from the society and the competitors.

The defendant gave her resignation letter to the Director of the Wealth Management Department. It was soon discovered that the defendant was in the process of joining the competitor firm. It was also found that the defendant had taken advantage of her position and had acquired a comprehensive list of all customer information and investment related data. The plaintiff, being a reputed bank, filed a suit for injunction against the defendant restricting her not to release any confidential information and trade secrets related to the transactions as they have a duty of confidentiality to their customers. It was contended by the plaintiff's that even though the confidential information is not in any document, it existed in the mind of the defendant.

Hence, this existent, intangible threat was sufficient enough to prevent her from disclosing it. On the other hand, the defendant asserted that customer details like their phone numbers and addresses cannot come under the ambit of confidential information or trade secrets. The reason being that the same were common knowledge and could be easily accessed as they were in the public domain. However, the court held that "trade secrets are acquired over a period of time and are the formulae, technical know-how or a peculiar mode or method of business adopted by an employer which is unknown to others…." Here the defendant had acquired all the information and data during her course of employment. Trade secrets do not cover the knowledge which is attained through daily operations of the business. The court further stated that the defendant couldn't be prohibited from changing her job as it helps in overall development.

Article 1(2) of the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS Agreement), states that intellectual property shall include protection of undisclosed information. Article 39 of the TRIPS Agreement states that in the course of ensuring effective protection against unfair competition as provided in Article 10bis of the Paris Convention, with respect to information which is (a) a secret not generally known or readily accessible, (b) has commercial value by virtue of secrecy, and (c) has been subjected to reasonable steps for ensuring its secrecy.

**Answer 5(b)**

The Geographical Indication of Goods (Registration & Protection) Act, 1999 has been made to secure the interests of producers of unique products drawing specific quality from that particular region, and to protect consumers from deception. The term GI refers to any indication that identifies goods as originating from a particular place, where a given quality, reputation or particular characteristic of the goods is essentially attributable to its geographical origin. *Examples* : Columbian Coffee, Darjeeling tea, Champagne wine and Bordeaux cheese. Registered GI with distinctive signs helps artisans, weavers and others from onslaught of corporate competition using the name of geographical origin. GI secures consumers from the confusion of counterfeits and artisans from undue competition. Unique quality arising out of that place coupled with the skill of artisans fetches the premium price. While patents and copyrights belong to individuals, the GI is a collective right of community protected either by their group or state, helping artists and artisans to survive. In collective right, the knowledge or intellect is in public domain, and rights are held in perpetuity. In case of GIs the right-holders' rights are circumscribed, i.e., they cannot assign these rights to others but can prevent makers from other areas from selling their makes projecting that those are produced in that particular geographical areas. These rights are required to be retained in specified territory so that the artisans in that area enjoy the exclusive commercial benefits.

Every region has something unique and exclusive to offer and the G.I. tag honours and recognises these distinctive identity markers of these products and methods of production. There are plenty good reasons to opt for one such as maximization of the export value and safeguarding cultural heritage, amongst others:

- *Branding* : The regional specificity becomes a brand in itself acting as a marketing tactic. It also helps in the elimination of intermediaries leading to higher profits for the producers of the heritage art and goods.
- *Proof of quality* : A GI tag is a guarantee of premium quality of the product coming from its association to a certain region and the history of that product in that territory, especially as it is recognized by the national government of the country of origin (and in some cases, multiple governments all over the world). This in turn increases the possible income in the market both from the premium quality and the heritage attached to it.
- *Authenticity* : A similar superior quality can be imitated by the means of the power loom and other industrial methods, which acts as a threat to the uniqueness of the handcrafted material but the presence of a GI tag preserves the essence derived from centuries of practice and honing the craft by giving the product a market edge over the imitations.
- *Cultural protection* : The products that receive a GI tag are rooted in the heritage of the place whether they are natural or manufactured goods, and the tag helps preserve the traditional methods of production helping protect the local culture and heritage. Many crafts that had been dying from the lack of patronage have been revived post being awarded the tag from the awareness and publicity created resultantly.
- *Economic boost* : The economic value of a product with a GI tag attached is

higher than a regular product due to the promise of quality attached to it and it also helps boost the demand of the product in the market.

Registrations for GIs are not necessary, however the organizations or companies who register their geographical indications obtain numerous benefits of the registration including:

- Registered geographical indications have the exclusive right to exploit or use the GIs' products in the course of trade.
- The authorized users are allowed to issue infringements
- It confers legal protection to Geographical Indications in India
- Prevents unauthorized use of a Registered Geographical Indication by others

**Question 6**

*Abbott Laboratories, Chicago, USA based pharmaceutical company was founded in the year 1888. The Company marketed the medicinal preparation of the drug Camylofin Dihydrochloride with Paracetamol as EASYJET. The word EASYJET is stated to be an invented mark having no dictionary meaning. It is also not derived from any principal ingredient/formulation of the drug. Medicinal preparations with the mark EASYJET are extremely popular and widely distributed all over India. It is stated that the said mark was used by the laboratories predecessor for decades and now the plaintiff by way of extensive use has acquired a considerable reputation as a quality pharmaceutical product. The said trademark EASYJET has acquired valuable goodwill and reputation which extends throughout India. The company's trademark is said to be recognised and associated extensively with the company.*

*Another company the sole proprietorship named as Birani Hosiery carrying its business from Chennai, Tamil Nadu. The said company also filed an application for registration of the mark EASYJET in class 25 which is meant for hosiery products. Abbott in July 2012 through market enquiries came to know about the unauthorised use of the mark EASYJET by the defendants.*

*Abott Laboratories filed an opposition proceeding before Registrar of Trade Mark against the Birani Hosiery stating that mark used by the applicant is identical. The contention of the Birani is that the mark applied for registeration, falls in another class and therefore is eligible for registration.*

*On the basis of the above facts :*

*(a) Discuss the fate of the opposition proceedings. Give reasonable grounds for your decision.*

*(b) What elements can be used as trademarks ? How is the scope of protection of trademark rights determined ?* *(6 marks each)*

**Answer 6(a)**

Descriptive trademarks are generally prohibited from being registered under Section 9 (1) (b) of the Indian Trade Marks Act, 1999 with the exception to the rule being that the mark in question has acquired distinctiveness or secondary meaning by virtue of long-

standing use and the resultingrecognition. Illustrations of marks which are clearly descriptive but registered due to acquired distinctiveness are:

A descriptive mark, over a sustained period of extensive and uninterrupted usage and substantial promotion may acquire the status of a 'well-known' mark under the scope of Section 2 (1) (zg) of the Act and as such, would be considered capable of registration. Some marks which were held as 'well-known by Indian courts are WHIRLPOOL, PEPSI. Thus, the default position in India is that a mark which is descriptive cannot be registered unless it has acquired distinctiveness or it has acquired a secondary meaning.

In *ITC Limited* v. *Nestle India Limited* 2017 (70) PTC 66 (Del) The Court observed that when a word was only descriptive of character of goods, no protection can be claimed for use of such word, but if a word is known for its distinctiveness secondary meaning, such word is entitled to get protection. The evidence for the descriptive mark should be filed at the earliest. After the trademark has been sustainably used, the position established through large sales, publicity and possibly time evidence should be filed to avoid cancellation.

Indian courts have consistently maintained that such marks are registrable only if they have acquired distinctiveness or a secondary meaning. The Supreme Court in *Godfrey Philips India Limited* v. *Girnar Food & Beverages (P) Ltd (2005)*, examining whether the expression Super Cup (for a tea brand) was protectable as a trademark, held that a descriptive trademark may be entitled to protection if it has assumed a secondary meaning and is identified with a particular product or as being from a particular source.

While reiterating this position, Indian courts have sought to construe this protection narrowly, i.e. limiting it to a particular category of products or services. In *Cadila Healthcare Ltd.* v. *Gujarat Co-operative Milk Marketing Federation Limited and Ors (2009)*, a division bench of Delhi High Court held that the mark Sugar Free being highly descriptive could not be protected beyond the goods for which it had been used and with which it was connected. The court agreed with the trial court that the proprietor of the mark was not entitled to restrain any descriptive “non-trademark use” of the expression “sugar free”.

Similarly, in *Marico Limited* v. *Agro Tech Foods Limited (2010)*, Delhi High Court held that the appellant, owner of the registered marks Losorb and Lo-Sorb, could not assert a monopoly over the term “low absorb” for edible oil products. Further, the court held that a descriptive mark may acquire a secondary meaning if the mark is used by one person undisturbed for a long period.

Although via several decided cases, it has been shown that a common descriptive word can acquire a secondary distinctive meaning by use in relation to the goods. However it can be extremely difficult to establish that such word has become distinctive in fact and has acquired a secondary meaning different from its natural meaning. The difficulty becomes even greater when the mark is not only descriptive but also contains the name of the product such as Diabolo for a top or shredded wheat etc. This difficulty may sometime be overcome if the alleged trademark is in fact a description of goods but the public identifies it as a fancy word and not a descriptive word.

The onus is on the applicant to show that the word which is primarily descriptive of quality of goods has become descriptive. The onus must be discharged by the applicant

in respect of every article to which the trademark is applied and not just for one of the many products to which the mark is applied. When the case is on the border line, the registrar will usually refuse to grant the registration, however, he will not try to discover reasons for refusing the registration. However, the trader should get a fair opportunity for establishing his right to the statutory protection.

In determining whether a mark has acquired a distinctive character because of long and continuous use, the competent authority must make an overall assessment of the evidence that the mark has come to identify the product concerned as originating from a particular source. In assessing the distinctive character of a mark in respect of which registration has been applied, the following should be taken into account:

- The market share held by the mark.
- How intensive, geographically, widespread and long, standing use of the mark has been.
- The amount invested by the undertaking in promoting the market.
- The proportion of the relevant class of persons who identify the goods to be coming from a particular undertaking
- Statements from various trade and commerce associations.

**Answer 6(b)**

A trademark helps identify the origin of a product through human senses. People receive messages through the eye, the ear, the nose, etc., but predominantly through the eyes. In reality, trademarks that can be seen are the most common form of trademark. The TRIPS Agreement provides that member countries may require, as a condition of registration, that signs be visually perceptible. Elements that may be used in a visually perceptible trademark include words, letters, numerals, figurative elements and colors. Of course, a trademark may comprise two or more of these elements. For example, Microsoft's corporate trademark contains a word and a device.

Section 2(1)(zb) of the Trademarks Act, 1999 states:

Trade Mark means a mark capable of being represented graphically and which is capable of distinguishing the goods or services of one person from those of others and may include shape of goods, their packaging and combination of colours."

A trade mark is visual symbol used in relation to any goods or services to indicate some kind of trade connection between the goods or services and the person using the mark. In order to bring it within the scope of the statutory definition, a trade mark should satisfy the following essential requirements; It must be a mark that is a device, brand, heading, label, ticket, name or an abbreviation of a name, signature, word, letter or numeral shape of goods, packing or combination of colors or any combination thereof. It must be capable of being represented graphically. It must be capable of distinguishing the goods or services of one person from those of others.

It must be used or proposed to be used in relation to goods or services. The use must be of a printed or other visual representation of the mark. In relation to services, it must be the use of the mark or availability or performance of services. The use must be

for the purpose of indicating the connection in the course of trade between the goods or services, and some person having the right to use the mark either as proprietor or by way of permitted user as the case may be. It is not necessary that the person using the mark should reveal his identity.

Section 9 & 11 of the said Trade Marks Act provides the guidelines as to the conditions for a mark to be get protection.

*Registration of Trademark*

Any person claiming to be the owner of the trademark or supposed to used the trademark by him in future for this he may apply in writing to the appropriate registrar in a prescribed manner. The application must contain the name of the goods, mark and services, class of goods and the services in which it falls, name and address of the applicant and duration of use of the mark. Here the person means an association of firms, partnership firm, a company, trust, state government or the central government.

*Conditions of registration*

The central government by mentioning in the official gazette appoint a person to be known as the controller, general of patents, designs and trademark who shall be the registrar of the trademark. The central government may appoint other officers also if they think that they are appropriate, for the purpose of discharging, under the superintendence and direction of the registrar, the registrar may authorize them to discharge. The registrar has the power to transfer or withdraw the cases by in writing with reasons mentioned. Under Section 6 of the Act, discussed the maintenance of a registered trademark. At head office wherein particulars of registered trademarks and other prescribed, particulars, except notice of the trust, shall be recorded. The copy of the register is to be kept at each branch office. It gives for the preservation of records in computer or diskettes or in any other electronic form.

*Absolute grounds for refusal of registration*

Absolute grounds for the refusal of registration is defined in Section 9 of the Act. The trademarks which can be lacking any distinctive characteristics or which consists exclusively of marks or signals, which can be used in trade to indicate the kind, fine, quantity, supposed grounds, values, geographical origin. And also a time of production of goods or rendering of the offerings or different characteristics of the goods or offerings which consists solely of marks or indications which have come to be average in the present language. That marks are not entitled to registration. Except it is confirmed that the mark has in fact acquired a new character as a result of use before the date of application.

It gives that a mark shall not be registered as trademarks if:

1. It frauds the public or causes confusion.
2. There is any matter to hurt religious susceptibility.
3. There is an obscene or scandalous matter.
4. Its use is prohibited. It provides that if a mark contains exclusively of (a) the shape of goods which form the nature of goods or, (b) the shape of good which

is needed to obtain a technical result or, (c) the shape of goods which gives substantial value of goods then it shall not be registered as trademark.

*Test of similarity*

For the conclusion, if one mark is deceptively similar to another the essential features of the two are to be considered. They should not be placed side by side to find out if there are any differences in the design and if they are of such a character to prevent one design from being mistaken for the other. It would be enough if the disputed mark has such an overall similarity to the registered mark as it likely to deceive a person usually dealing with one to accept the other if offered to him. Apart from the structural, visual, and phonetic similarity or dissimilarity, the query needs to be viewed from the factor of view of man typical intelligence and imperfect collection secondly. It's regarded as an entire thirdly it is the query of his impressions. In *Mohd. Iqbal* v. *Mohd. Wasim* it was held that "it is common knowledge that 'bidis' are being used by persons belonging to the poorer and illiterate or semi-literate class. Their level of knowledge is not high. It cannot be expected of them that they would comprehend and understand the fine differences between the two labels, which may be detected on comparing the two labels are common. In view of the above, there appears to be a deceptive similarity between the two labels".

**Relative grounds for refusal of registration**

Under Section 11 of the Act, it gives relative grounds for the refusal of registration of a trademark. A trademark cannot be registered if because of (i) its identity with an earlier trademark and similarity of goods or services, (ii) its similarity to an earlier trade mark and the similarity of the goods and there is a probability of confusion. It also gives that a trademark cannot be registered which is identical or similar to an earlier trademark. And also which is to be registered for goods and services which are not similar to those for which earlier trademark is registered in the name of a different proprietor if, or to the extent, the earlier trademark is well known in India. It further gives that a trademark is cannot be registered if, or to the extent that, its use in India is liable to be prevented by virtue of any law.

**Procedure and Duration of registration**

The registrar on the application made by the proprietor of the trademark in the prescribed manner within the given period of time with the adequate payment of fees. Registration of a trademark shall be of ten years and renewal of the registered trademark is also for a period of ten years from the date of expiration of the original registration or of the last renewal of registration. The registrar shall send the notice before the expiration of last registration in the prescribed manner to the registered proprietor.

The notice mentions the date of expiration and payment of fees and upon which a renewal of registration may be obtained if at the expiration of the time given in that behalf those conditions have not duly complied with the registrar may remove the trademark from the register. But the registrar shall not remove the trademark from the register if implication made within the prescribed form and the prescribed rate is paid within six months from the expiration of the final registration of the trademark and shall renew the registration of the trademark for an interval of ten years.

If the trademark is removed from the register for non-payment of the prescribed fee,

the registrar shall after six months and within one year from the expiration of the last registration of the trademark renew the registration, And also on receipt of implication in the prescribed form and on payment of the prescribed fee the registrar restores the trademark to the register and renew the registration of the trademark, for a period of ten years from the expiration of the last registration.

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# FORENSIC AUDIT
**(Elective Paper 9.4)**

*Time allowed : 3 hours* *Maximum marks : 100*

***NOTE***: *1. Answer ALL Questions.*

*2. Suitable assumptions, if considered necessary, may be made while answering a question. However, such assumptions must be stated clearly.*

**Question 1**

Bhuvana group of Companies, is a very famous conglomerate engaged in exporting cotton bales, cotton and synthetic yarn, etc. Over last few years, Bhu Ltd, the flagship company of the group has been very active in acquisition of businesses. Also, the Company has many subsidiaries and associates which are into export of agro based products, engineering goods and readymade garments to China, Dubai, Singapore and other countries. For this kind of expansion, the Company was in requirement of credit and banking facilities, which were provided by a consortium of banks, led by ESBA Bank.

The group had a Chief Finance Officer, Riyo who had been with the group for more than a decade. He was managing the treasury operations and was very close to the Management. As part of expansion plan, the group was looking for PE investment. Ariyanka PI Fund, was keen in investing in the group looking at their growth prospects. As a part of the deal, the Fund appointed Chanakya Consultants for the financial and other due diligence. The Consultants carried on a detailed evaluation as per the terms of engagement and submitted a report to the Fund. Yanky, the Chief Investment Officer of the Fund was startled when he looked at the report submitted by Consultants. He and his team, were reviewing this report when his subordinate Myank, was highlighting certain points from the report :

**Bill discounting :** The Bank was discounting the export bills of the Company against the Letters of Credit (LCs) from Prime Banks of the Buyer and credited the proceeds of the bills to the Current Account of the Company on the same day. However, the payment and acceptance of the Bills was delayed. Further, on Company's request the Bank had extended the due dates of these bills.

**False Exports** : As per the information gathered from Customs Authorities, the exports had actually not taken place against most of the bills. Goods produced for exports against Packing Credit (PC) were also not available. It appeared that either goods were not produced against the Packing Credit or disposed off locally and funds were siphoned off. The Customs Authorities had informed that exports did not take place in 2000 cases out of pending 2100 bills, as these consignments do not relate to any exports.

**Fabricated Certificates** : Completion of exports was confirmed to respective banks/ financial institutions by submitting false/fabricated certificates from the Auditors/ Accountants and false status reports were filed.

***Cash Flow** : The cash flows reflected and dealt with in the audited Balance Sheets for the respective years were found to be incorrect and did not report the true picture.*

***Multiple availments** : One of the group companies had filed the same export orders to various banks in the consortium and availed packing credit facilities fiom the banks. The company did not submit the export documents to the same bank from whom the packing credit was availed.*

***Hedging of receivables/payables** : The Company used these non-existing export orders to book hedges for forex receivable and payable to show a different picture to the banks.*

***Receivables**: The list of receivables indicated that most of the parties were foreign buyers. In the context of payment received from third parties and bills getting returned, the goods were likely to be sold to alternate buyers as the original buyers were renegotiating the price after the consignments were dispatched. Also, the borrower companies cheated the banks by submitting fake and forged export bills for purchase/ discount which were drawn in non-existent overseas buyers.*

***Inflated payables** : In respect of creditors for suppliers, full details of such suppliers were not available. Creditors for supply were fabricated in order to artificially boost the purchases and payables.*

*Looking at the above facts, Yanky immediately flagged off the report to Management team of the Fund and they decided not to go ahead with the deal. Further, Yanky personally thought that it's his responsibility to inform the same to the Consortium Banks about the fraudulent activities in the group. He wrote an anonymous letter to the ESBA Bank mentioning the facts they got to know.*

*ESBA Bank immediately called for Consortium Banks meeting and appointed, Minda, as 'Forensic Auditor' to investigate all the issues.*

*(a) Prepare a report on the procedural lapses made by the Bank's branch while discounting the export bills.*

*(b) Banks as financial institutions are required to monitor with caution the foreign bills discounting as per Regulatory/Bank guidelines. Explain the follow-up mechanism and controls missed by the banks relating to foreign bills discounting.*

*(c) In case of muitiple banking arrangements, Consortium Bank has to take additional measures/precautions to review the credit facilities granted and utilised by the Companies on behalf of member banks. Explain the measures to be taken by 'Lead Bank' in this regard.*

*(d) 'Timely information and review of the key parameters is useful to the member banks in multiple banking to avert this type of frauds.' Explain.*

*(e) ESBA Bank has filed a case against the Management of the Company and Statutory Auditors. The Statutory Auditors claims that they just followed what the Management asked them to do and hence they are not party to the fraud. Is the Auditor's claim justified ? Explain in brief the punishment for such offences.*

*(8 marks each)*

**Answer 1(a)**

Considering the facts of the given case, the following are the procedural lapses noted in the bank branch:

- The bank had discounted the bills against the terms of the sanction without ensuring acceptance of bills and confirmation of due date for payment of LC Issuing bank.
- Bank did not obtain Guaranteed Remittance (GR) Form of shipping bills verified/ issued by the Customs Authorities.
- There were several apparent and major discrepancies in set of bills submitted for discounting which should have aroused suspicion about the genuineness of the bills.
- Due date of the bills extended without ensuring acceptance of bills, analysing reasons for non-acceptance of bills and delay in acceptance of bills.
- The proceeds of Packing Credits & Foreign bills purchases (FBPs) credited to the account were withdrawn on the same day is clearly indicating possibility of improper end use and possible diversion of funds.
- The bank should have taken full details of the creditors for suppliers and verified it.
- The export transactions undertaken by the Company should have been subjected to suspicion considering the fact that within a short span of time the utilisation of the limit was to the brim under Packing Credit and Negotiation of Bills under Letter of Credit.
- Management of fraud risk in 'Large Value Advances' need a comprehensive approach.
- Banks need to have a system of Real Time information sharing among them.

**Answer 1(b)**

The following non-adherence of Bank/regulatory guidelines could be noted:

- There are lacunae in Bank's Credit and Risk Management Policies.
- Proper mechanism to be devised for review of policies of the Bank and to keep it updated as per the dynamic environments.
- The Accountants including Auditors tended to collude and conspired to be party in submitting false, fabricated and misleading bills, Financial Statements and Certificates issued to Institutions/Banks with the only intention of obtain fund disbursements.
- The empanelled list of Service Providers like Certification from Auditors is to be reviewed by the Bank from time to time based on performance parameters, etc.
- The Company had managed its affairs based on false and fabricated books of accounts to ensure easy and smooth flow of credit without any restraint by way of loans from Financial Institutions for funding cash losses.
- Credit report of all group companies has to be obtained by the bankers as per the RBI guidelines.

- Periodical inspection for Packing Credit Disbursement by the bank shall be carried out to ensure the end use.

**Answer 1(c)**

**Precautions to be taken by the Consortium Leader in 'Multiple Banking' Arrangements**

- Multiple banking arrangements in 'Large Value financing' has done more harm than good to banks.
- This type of arrangement enabled corporates to secure Multiple Finances from various banks far in excess of their requirements.
- Funds raised can be easily diverted through Company's accounts with various banks in absence of effective exchange of information between the banks.
- There is a need to review the Multiple Banking Arrangements by the member banks at regular intervals to avoid excess to finances than actual requirements.
- Realisation proceeds of export bills credited to current account of the Company which was subsequently withdrawn by the Company when "Bank Packing Credit was outstanding, was one of the major lapses from the banker's point of view.

**Answer 1(d)**

**Monitoring of systems and MIS generation has to be strengthened**

- The internal financial controls of the bank shall be strengthened and it should be ensured that they operate effectively.
- Sharing of the Company's performance details with the member banks on regular basis.
- The Financial Statements/ Projections/Cash Budget of the Company shall be obtained and reviewed by the Bank on regular basis and this information along with review points shall be shared with other member banks.
- Special focus on high value advance and regular monitoring.
- There shall not be over reliance or over confidence about the borrowers based on their history and stature.
- Bank's top management shall take considered and informed decision on the merits of the proposal irrespective of the reputation of the Company.
- Fraud monitoring in financial services shall be a specialised area and a special team with qualified personnel may be constituted to monitor and investigate such cases.

**Answer 1(e)**

As the Management of the Company and the statutory auditors have colluded to engage in the fraudulent activities as mentioned in the given case, they will be liable to the punishments as provided in the Companies Act, 2013.

**Punishment for Fraud (Section 447)**

Section 447 of the Company Act 2013 reads that "Without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force, any person who is found to be guilty of fraud, shall be punishable with imprisonment for a term which shall not be less than six months but which may extend to ten years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud provided that where the fraud in question involves public interest, the term of imprisonment shall not be less than three years."

**Punishment for False Statement (Section 448)**

If in any return, report, certificate, financial statement, prospectus, statement or other document required by, or for, the purposes of any of the provisions of this Act or the rules made thereunder, any person makes a statement, -

- which is false in any material particulars, knowing it to be false; or
- which omits any material fact, knowing it to be material

he shall be liable for punishment under section 447.

**Punishment for False Evidence (Section 449)**

If any person intentionally gives false evidence –

- upon any examination on oath or solemn affirmation; or
- in any affidavit, deposition or solemn affirmation in or about winding up of any company under this Act, or otherwise in or about any matter arising under this Act,

he shall be punishable with imprisonment for a term which shall not be less than three years but which may extend to seven years and with fine which may extend to Rs. 10 Lakh.

Auditors will also be liable under section 147(2) If an auditor of a company contravenes any of the provisions of section 139, section 143, section 144 or section 145, the auditor shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to or four times the remuneration of the auditor, whichever is less provided that if an auditor has contravened such provisions knowingly or wilfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with imprisonment for a term which may extend to one year and with fine which shall not be less than fifty thousand rupees but which may extend to twenty-five lakh rupees or eight times the remuneration of the auditor, whichever is less.

Accordingly, the Auditor's claim is not justified.

**Question 2**

*The tremendous growth in the field of Information and Communication Technologies (ICTs) coupled with an increased frequency of use of internet for different activities has also given rise to several notorious activities taking in the form of cyber-crimes.*

*To put it layman terms, Cyber Crime is a technology based crime committed by the technocrats.*

*In a recent data published, it is stated that. "With increasing mobile and internet penetration in the Country, Cyber Crimes have also increased proportionately. Between 2011 and 2015, more than 32,000 cyber-crimes were reported across the country. More than 24,000 of these cases are registered under the IT Act and the remaining under various sections of Indian Penal Code and other State level legislations."*

*As per the data reported in the Report of National Crime Report Bureau, a total of 7,201 cases were registered under the Information Technology Act, 2000 (IT Act) during the year 2014 as compared to 4,356 during the previous year 2013 showing an increase of 63.3% in 2014 over 2013. Further, 77% (5,548 cases) of the total 7,201 cases under the IT Act were computer related offences (Under Section 66A, 66B, 66C, 66D and 66E of the IT Act) followed by 10.5% (758 cases out of 7,201 cases) related to Publication/transmission of Obscene/Sexually explicit content (Under Section 67A, 67B and 67C of the IT Act). Along with it, the global spam rate, malware rate and phishing rate is increasing rapidly and there is a potential impact of Cyber Crimes on the economy, consumer trust and production time. The counter measures in the form of GPRS Security Architecture, Intrusion Detection and Prevention System and Agent Based Distributed Intrusion Detection Systems have thus been employed for security purposes.*

*In this background, answer the following questions :*

*(a) Explain the various types of Cyber Crimes and the modes of committing such crimes. Also indicate the laws concerning such Cyber Crimes in India.*

*(b) How block-chain technology helps in boosting cyber security ?*

*(6 marks each)*

**Answer 2(a)**

Cyber crime can involve criminal activities that are traditional in nature, such as theft, fraud, forgery, defamation and mischief, all of which are subject to the Indian Penal Code.

The abuse of computers has also given birth to a gamut of new age crimes that are addressed by the Information Technology Act, 2000. The Act does not define cyber crime. However, any activities which basically offend human sensibilities would come within its ambit.

Cyber Crimes can be classified into three major categories:

- Cyber crimes against Government such as Cyber Terrorism
- Crime against persons such as Cyber Pornography, Cyber Stalking , Cyber defamation, etc.
- Crime against property such as online gambling, Intellectual Property infringement, Phishing, Credit Card Frauds, etc.

There are various modes or methods by which Cyber Crime can be committed such as:

- Unauthorised access to computer systems or networks/hacking

- Theft of information contained in electronic form
- Email bombing
- Data diddling
- Salami attach
- Denial of service attach
- Virus/worm attack
- Logic bombs
- Internet time thefts.

Chapter XI of the Information technology Act, 2000 deals with the offences and punishments for most of the cyber crimes in India.

**Answer 2(b)**

The following are the ways, how block-chain technology is helping to boost cyber security in this evolving age of technology:

**DDoS Protection** : A DDoS attack is an attack in which several compromised computer systems attack a target, like a server, website, or some network resources, and cause a denial of service for users of the targeted support. By implementing block-chain technology, the Domain Name System (DNS) becomes fully decentralized and disturbs the contents to a large number of nodes and make it impossible for hackers attack.

**Fraud & Identity Theft Protection** : Identity theft is becoming a severe problem in the present age. The cyber-criminals are using this identity to commit crimes, but with the incorporation of block-chain technology, this practice can be prevented. Within the decentralized environment, the activities and the transactions will get accessed from your device by using the Decentralized Identity App. By doing so, every completed transaction will keep on record and everyone will have access to either approve or disapprove it. If there is disapproval, the transaction will not be legal and acceptable.

**Proving the Validity of Software Updates** : Trojan horses, worms, and viruses that invade computers appear in different forms. Block-chain steps in to allocate exclusive hashes for updates and downloads. This significantly reduces the chances of infecting your system with viruses that are well masked.

**IoT Security** : Block-chain technology can protect the data exchanges which happen among the IoT devices. Moreover, it can also be used to gain real-time secure data transmissions and ensure timely communication between devices located miles apart.

**Incorporating Security in Messaging Apps** : A lot of metadata is being obtained from customers during exchanges on social media. While several messaging systems are using end-to-end encryption, others are starting to use block-chain to keep that information secure and protected.

**Question 3**

*Blue Sea Foods International Ltd., is Company engaged in export of various kinds of sea foods. The Company has been in existence for more than 10 years and wants to*

*expand its operations. Till now the Company was managed and operated by the promoters. However, the promoters now want to expand the Company's operations and gradually get funding from Institutions. As a part of their immediate plan, the Management wants to fund its expansion plans through term loans and other banking arrangements.*

*The Vice-President (Treasury) of the company reached out to EXIMPO Bank for Term Loan facilities with the bank. He made a detailed presentation about the Company's history, its expansion plans and also provided projections for the next ten years.*

*The General Manager, in charge of the Advances in EXIMPO Bank approaches you to conduct a thorough investigation of the Company and submit a 'Confidential Report' based on which the Committee of the Bank will decide whether to sanction the loan or not. In this context, list out in detail the points to be covered in the investigation.* *(12 marks)*

**Answer 3**

A bank is primarily interested in knowing the purpose for which a loan is required, the sources from which it would be repaid and the security that would be available to it, incase the borrower fails to repay the loan. On these considerations, the investigating official, in the course of his inquiry, should attempt to collect information on the following points:

- The purpose for which the loan is required and the manner in which the borrower proposes to utilise the loan.
- Schedule of repayment of loan submitted by the borrower, particularly the assumptions made therein as regards amount of profits that will be earned in cash and would be available for repayment of loan.
- The financial standing and reputation for business integrity enjoyed by the Directors and Management of the Company.
- Whether the Company is duly authorised to borrow the money under its Memorandum and other approvals have been sought.
- The impact on the Company's business i.e., the sensitivity of the company's business to economic, political and social changes that are likely to take place during the loan tenor.
- Have there been any qualification/adverse reporting in the Statutory Auditor's Report.

To investigate the profitability of the business for judging the accuracy of repayment schedule furnished by the borrower, as well as the value of the security in the form of assets of the business already possessed and those which will be created out of loan, the investigating accountant should take the following steps:

- Prepare a condensed income statement from the Statement of Profit and Loss for the previous five years, showing separately therein various items of income and expenses, the amounts of gross and net profits earned and taxes paid annually during each of the five years.

- Compute the ratios separately and then include them in the statement to show the trend as well as changes that have taken place in the financial position of the Company:
  i. Sales to average inventories held
  ii. Sales to fixed assets
  iii. Current assets to current liabilities
  iv. Quick Assets to quick liabilities
  v. Equity to long term loans
  vi. Return on capital employed
- Enter in a separate part of the statement the break-up of the annual product wise sales, to show their trend.

Steps involved in the verification of assets and liabilities included in the Balance Sheet of the borrower company which has furnished to the Bank. The investigating official shall prepare a detailed schedule of Assets and Liabilities of the borrower including the following particulars:

- *Fixed Assets* : A full description of each item, its gross value, the depreciation rate, etc. Also indicate if the borrower holds any land/buildings and the realisable value of the same. State whether any of the fixed assets of the Company have been mortgaged.
- *Inventory* : The value of various inventories held and the basis for valuation. Ideally, the realisable value shall be considered. Also indicate whether any of the inventories of the Company are hypothecated.
- *Receivables* : The composition of the receivables shall be indicated including the different types of debts that are outstanding. Also, the debtors realisation period, whether the debts are collected within the credit period. Further, also do a detailed evaluation of provision for bad debts and the write offs if any.
- *Investment* : The schedule of investments should be prepared. It should disclose the date of purchase, cost and market value of each investment. If any investment is pledged as security for a loan, the full particulars of loan shall be given.
- *Secured loans* : Debentures and other loans should be included in a separate schedule.
- *Provision for Taxation* : Various contingent liabilities and the tax provisioning shall be reviewed to see if there are any open demands.
- *Other liabilities* : It should be stated whether all the liabilities, actual and contingent are correctly disclosed.

Additionally, the investigating official may also visit the various premises of the borrower and do a physical verification. Also, background checks of the promoters, key management personnel may also be performed and the information available in the public domain including charges created by the Company, if any need to be reported.

**Question 4**

*Monako Consulting, is an established consulting firm in India providing various kinds of professional services covering consulting, valuation, taxation, forensic audit, etc. The Firm had various teams handling each line of service, consisting of well experienced and qualified staff. The Managing Partner of the firm was considering to enhance the business of the firm into audit practice as well. He called for a meeting with various service line Leads, to deliberate and decide whether to venture into audit practice.*

*The Forensic Audit Lead contended that 'Forensic Auditing covers a broad spectrum of activities, with terminology not strictly defined in regulatory guidance'. Hence the scope for forensic audit is wider, whereas the audit practice is bound by regulatory and legal requirements.*

*The Managing Partner said that the Audit is the same, just that the approach would change in case of statutory audit. He also contended that they can make use of their Consulting practice by using the data analytics and other tools for their existing client and provide better services. In this background, answer the following :*

*(a) 'Forensic Auditing covers a broad spectrum of activities. with terminology not strictly defined in regulatory guidance.' Explain. (5 marks)*

*(b) 'Audit is different from forensic audit.' Explain. (4 marks)*

*(c) Explain few examples where data analytics can be used in forensic audit. (3 marks)*

**Answer 4(a)**

Forensic auditing covers a broad spectrum of activities, with terminology not strictly defined in regulatory guidance. Generally, the term 'forensic auditing' is used to describe the wide range of investigative work which the professionals in practice could be asked to perform. The work would normally involve an investigation into the financial affairs of an entity and is often associated with investigations into alleged fraudulent activity.

- Forensic Auditing refers to the whole process of investigating a financial matter, including potentially acting as an expert witness if the fraud comes to trial.
- The process of forensic accounting includes the forensic investigation itself, which refers to the practical steps that the forensic auditor takes in order to gather evidence relevant to the alleged fraudulent activity.
- The investigation is likely to be similar in many ways to an audit of financial information, in that it will include a planning stage, a period when evidence is gathered, a review process, and a report to the client.
- The purpose of the investigation, in the case of an alleged fraud, would be to discover-
  - i. If a fraud had actually taken place,
  - ii. To identify those involved,
  - iii. To quantify the monetary amount of the fraud (i.e. the financial loss suffered by the client), and

iv. To ultimately present findings to the client and potentially to court.

- Thus, 'forensic auditing' refers to the specific procedures carried out in order to produce evidence.
- Audit techniques are used to identify and to gather evidence to prove, for example, "how long the fraud has been carried out, and how it was conducted and concealed by the perpetrators.
- Evidence may also be gathered to support other issues which would be relevant in the event of a court case. Such issues could include:
  a) The suspect's motive and opportunity to commit fraud.
  b) Whether the fraud involved collusion between several suspects.
  c) Any physical evidence at the scene of the crime or contained in documents.
  d) Comments made by the suspect during interviews and/or at the time of arrest.
  e) Attempts to destroy evidence.

This way, it is proved that the tool of forensic audit is one of the strong tool in detecting the frauds, assisting financial stability and enduring economic growth of the nation under vision New India, 2022.

**Answer 4(b)**

**Major difference between Audit and Forensic Audit is discussed as below**

- Objective of financial auditing is to express opinion as to 'true & fair' presentation. Forensic Audit determines correctness of the accounts or whether any fraud has actually taken place.
- Techniques used in the financial auditing are more of Substantive and compliance procedures. The techniques used in the forensic auditing are analysis of past trend and substantive or 'in depth' checking of selected transactions.
- Normally all transactions for the particular accounting period are covered under the financial audits. Forensic audits don't face any such limitations. Forensic auditors may be appointed to examine the accounts from the beginning.
- For ascertaining the accuracy of the current assets and the liabilities financial auditor relies in the management certificate or representation of management. Forensic auditors are red to carry out the independent verification of suspected or selected items.
- Whenever the financial auditor has adverse findings, then the auditor expresses the qualified opinion, with/without quantification. In case of the adverse findings, the forensic auditors are required to quantify the damages to the clients and are also supposed to point the culprit. Many a times, Legal action will be sought.

**Answer 4(c)**

Following are few examples where data analytics can be used:

- Data analytics helps to identify relevant statistics like significant increase in business, which may indicate most likely vendors who could have received business by paying kickbacks.

- From data analytics, identification of vendors whose business have suddenly decreased or were removed from the approved list during this can be identified. Informal discussions and discrete inquires can be made with them. It is very likely that concrete information can come from such disgruntled vendors.
- Combined analysis of data analytics, background checks, document reviews, discrete enquiries with vendors no longer being favored will give a good understanding of situation as to what is going on and who is involved.
- Data analytics helps in identifying the relevant statistics on case to case basis to provide meaningful insights or directions.

**Question 5**

*Manomay Technologies Ltd., was a listed Company providing IT and ITES services. The Company was more than a decade old and had made a mark for itself in the Indian software industry. The promoters of the Company wanted to diversify their business operations. To fund these plans, the Board decided to issue Global Depository Receipts to be traded on Luxembourg Stock Exchange. The Company raised huge funds through the GDR's and the investors were also happy as the Company always paid handsome dividends and the share price indicated a growth trajectory. However, not all was well within the Board Room. The promoters were worried that the sudden slump in the real estate market would hit them hard as they had diversified and heavily invested funds into real estate business. They were anxious, as they will not be able to continue the same show in terms of numbers going forward. The promoters evaluated various options including merging their profit making subsidiaries, selling their stakes etc. However, nothing materialised and they were only able to manage the situation for couple of quarters. Meanwhile this news spread like wild fire in social circles, and the promoters were sensing there were possible takeover threats given their slumping financial position. The Statutory Auditors of the Company resigned citing other professional commitments much before their tenure was over. On this news, the share price of the Company took a beating and the Banks got anonymous letters stating there was huge fudging of books in the Company. The Banks ordered a forensic audit and a huge fraud was unearthed. The Govemment appointed Kural Consultants for investigation and submitting the final report. Basis the report, the Govemment initiated penal action against those who were involved in the fraud. It's been more than two years now and Manomay Technologies Ltd was taken over by some other Company. You were part of the Consultant team during the investigation and have been invited on WOW TV's prime show to be interviewed. Outline in brief your response to the following questions asked by the host of the show.*

*(a) What is a Financial Statements fraud ?*

*(b) Should the Companies have a diagnostic check by way of regular financial fraud investigation checks to gain credibility ?*

*(c) As an investigator, how do you detect fraud ?*

*(d) As per you, what are the warning signs that indicate presence of fraud in financial statements.* *(3 marks each)*

**Answer 5(a)**

**Financial statement fraud**

This is also known as fraudulent financial reporting, and is a type of fraud that causes a material misstatement in the financial statements. It can include deliberate falsification of accounting records; omission of transactions, balances or disclosures from the financial statements; or the misapplication of financial reporting standards. This is often carried out with the intention of presenting the financial statements with a particular bias, for example concealing liabilities in order to improve any analysis of liquidity and gearing.

**Answer 5(b)**

Financial fraud investigations are important for any organisation. Regular checks build trust of the clients or consumers and also keeps the employees vigilant. Companies that efficiently manage bribery, frauds and corruption cases are better equipped to handle crisis situations and can analyse the risk in the process that leads to frauds.

**Answer 5(c)**

Financial fraud detection has emerged as a professional field and these experts have the required training to investigate the cases of frauds or suspected frauds. They look at the misstatements in the financial statements, including incorrect or fudged sales, inflated costs, accounting irregularity, weak internal controls and untraceable deals or third party transactions.

**Answer 5(d)**

Many signals indicate the possibility of a financial fraud:

- Fragile internal control environment
- Management overriding the controls
- High influence/undue influence by promoters
- Frequent disputes between the Management and Auditors
- Huge emphasis on earnings and revenue projections

However, these signs only indicate the possibility of a fraud, a significant and in-depth analysis in the specific case is required to ascertain the frauds.

**Question 6**

*Makhana Pesticides Ltd. is engaged in manufacture and distribution of pesticides, other ancillary products and has a turnover of 1,000 Crores. The Company has branches across multiple locations and the stocks are stored and distributed though these locations. The Management of the Company noticed that in few of the branches the write off in stocks was higher.*

*The internal auditor was asked to cover in his scope these aspects and report to the Board, his findings, if any. However, the internal auditor reported that there were no material exceptions and some quantity of stock was becoming obsolete due to weather conditions and was written off. However, the Management was not satisfied*

*with the internal auditor's response, and so it appointed Amrut for an investigation. Amrut went to those branches for detailed investigation and also tried to use data analytics tools to understand the movement of stocks and deliveries. He noted that the stocks worth ₹ 5 Lakhs were pilfered and sold to small farmers in small quantities by the junior staff there. He got to know of this when he overheard a labourer discussing with a local farmer. However, there was no documentation which suggested the involvement of the Branch Manager. The Management issued a Memo to the Branch Manager, to which he agreed to strengthen the internal controls around the storage of inventory and gave explanation to the Management. In this background, answer the following :*

*(a) Outline the line of investigation by the forensic auditor.* *(4 marks)*

*(b) Can the forensic auditor go by what he heard and issue a report ?* *(4 marks)*

*(c) What is the responsibility of internal auditor in case of such frauds being detected ?* *(2 marks)*

*(d) Should the statutory auditor report such frauds ?* *(2 marks)*

**Answer 6(a)**

The following is the outline of the investigation process which can be carried out by the forensic auditor:

- Obtain the details of stock movement in the branch.
- Scrutinise in detail the quantity of stocks being received/sold and the movement thereof.
- Verify the system generated report of the quantities being received and sold including internal branch transfers etc.
- Collect the system based reports and see which product/stock indicate pilferages and write offs.
- Interview the security guard and the stock in charge to get an understanding about the process.
- Perform surprise checks to see if the stock quantities match with the records maintained.
- Verify the security registers to know, whether the movement of the personnel into stock storage/godown premises.
- Verify whether background checks were done for all the personnel employed in the branch including the contractors/labourers.
- Perform data analytics to identify if any particular stock was being pilfered. Also identify if the stocks were being moved in odd timings on holidays, etc.

**Answer 6(b)**

Section 60 of Indian Evidence Act, 1872 requires that the oral evidence must, in all cases whatsoever, be direct. Where the testimony of the witness is entirely hearsay and

on some matters hearsay of hearsay, it cannot be admitted in evidence. Where a witness gives evidence that he received information from other person and that person does not say about it, such evidence would be inadmissible being hearsay evidence.

Hearsay information is useful and acceptable during an investigation to generate leads and can lead to important evidence and witnesses. Eventually, however, investigators should try to obtain information from witnesses with direct knowledge of the facts. Direct knowledge means that the witness participated in the event, or observed it directly, or heard about it from the subject. The latter is known as an "admission, is not hearsay, and often is the best evidence of knowledge and intent.

**Answer 6(c)**

The provisions relating to reporting of fraud under section 143(12) of the Companies Act, 2013, apply to Statutory Auditors of the Company. Further, these provisions also apply to Cost Auditor and Secretarial Auditor of the Company.

However, the provisions relating to reporting of fraud are not applicable to internal auditor. Hence the internal auditor should perform a detailed audit but is not required to report under Section 143(12) of the Company Act, 2013.

**Answer 6(d)**

As per provision of Section 143(12) of the Companies Act, 2013, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts (Rs. 1crore or above), is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed.

Provided that in case of a fraud involving lesser than the specified amount as indicated above, the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as may be prescribed.

Provided further that the companies, whose auditors have reported frauds under this sub-section to the audit committee or the Board but not reported to the Central Government, shall disclose the details about such frauds in the Board's report in such manner as may be prescribed.

Accordingly, the provisions relating to reporting of fraud under section 143(12) of the Companies Act, 2013, apply to Statutory Auditors of the Company. As the amount of fraud does not exceed Rs. 1 Crore, the statutory auditor shall report the matter to the audit committee constituted under section 177 or to the Board as the case may be and shall disclose the details about such frauds in the Board's report in such manner as may be prescribed.

***

# DIRECT TAX LAWS & PRACTICE

**(Elective Paper 9.5)**

*Time allowed : 3 hours* *Maximum marks : 100*

**NOTE** : *1. Answer ALL Questions.*

*2. All the references to sections in the Question Paper relate to the Income-tax Act, 1961 and relevant to the Assessment Year 2021-22, unless stated otherwise.*

*3. Working notes should form part of the answer.*

**Question 1**

*(A) Shipa Ltd. is engaged in the business of manufacturing fabrics since 1st April, 2012 and earned a profit of ₹ 750 lakh for the previous year ended 31st March, 2021 after debiting or crediting the following items :*

*(a) Industrial power tariff concession of ₹ 4.80 lakh, received from Karnataka State Government was credited to Profit and Loss account.*

*(b) An amount of ₹ 52 lakh is charged as depreciation on the basis of useful life of assets as per the provisions of Indian Companies Act.*

*(c) An amount of ₹ 12 lakh being received as dividend from Domestic Company.*

*(d) The company has provided ₹ 18 lakh being sum paid to workers on agreement to be entered with the workers union towards periodical wage revision once in every three years.*

*(e) Loss of ₹ 17 lakh, due to destruction of a machine purchase cost worth ₹ 24 lakh by fire due to short circuit and ₹ 3 lakh received as scrap value. The insurance company did not admit the claim of the company on charge of gross negligence.*

*(f) Long term capital gain of ₹ 3 lakh on sale of equity shares on which Securities Transaction Tax was paid at the time of acquisition and sale.*

*(g) Provision for gratuity based on actuarial valuation was ₹ 320 lakh. Actual gratuity paid debited to gratuity provision account was ₹ 160 lakh.*

*(h) Advertisement charges ₹ 2.30 lakh, paid by cheque for advertisement published in the souvenir of a political party registered with the Election Commission of India.*

*(i) Interest given on advance money received from a buyer on 31st March, 2021 was ₹ 2 lakh, on which tax has not be deducted at source.*

***Additional Information :***

*(i) Normal depreciation computed as per the Income Tax Rules is ₹ 71 lakh.*

*(ii) GST ₹ 8 lakh collected from its customers was paid by the company on the due dates. On an appeal, the High Court directed the GST department to refund ₹ 3 lakh to the company. The company in turn refunded ₹2 lakh to the customers from whom it was collected and the balance ₹ 1 lakh is still lying under the head 'Current Liabilities'.*

*You are required to compute the Total Income for the assessment year 2021-22. Also explain the reasons for treatment of each item by applying the relevant provisions of Income-tax Law. (13 marks)*

*(B) Keerthana Business Trust is registered under SEBI (Real Estate Investment Trusts) Regulations, 2014 provides the following particulars of its income for the previous year 2020-21 :*

*(i) Rental income from directly owned real estate assets ₹ 2.50 crore.*

*(ii) Interest income from Birla Ltd. ₹ 4 crore.*

*(iii) Dividend income from Birla Ltd. ₹ 2 crore.*

*(iv) Short-term capital gains on sale of listed equity shares of Birla Ltd. ₹ 1.5 crore.*

*(v) Interest received from investments in unlisted debentures of real estate companies ₹ 10 lakh.*

*(vi) Short-term capital gains on sale of developmental properties is ₹ 1 crore. Birla Ltd. is an Indian company in which the business trust holds 70% of the shareholding.*

*Discuss the tax consequences of the above income earned by the business trust in the hands of the business trust and the unit holders, assuming that the business trust has distributed ₹ 10 crore to the unit holders for the assessment year 2021-22. (Assume that the above income has been distributed from June, 2020 to March, 2021 and Birla Ltd. does not apply tax under section 115BAA. (12 marks)*

*(C) Mr. and Mrs. Raju have 7 children. Their income under the head 'profits and gains from business or profession' of ₹ 3,00,000 and ₹ 4,00,000 respectively during the previous year 2020-21.*

*(i) 1st child aged 26 years is a company secretary. His annual income from profession is ₹ 4 lakh. His income from house property for the P.Y. 2020-21 is ₹ 30,000. He has a son (4 years old) who has earned interest on fixed deposit of ₹ 5,000.*

*(ii) 2nd child (aged 17 years old being a married daughter) who is a stage singer, earned income of ₹ 1 lakh during the P.Y. 2020-21 and earned interest on fixed deposit ₹8,000. Such fixed deposit has been made out of such singing income.*

*(iii) 3rd child (aged 16 years) is suffering from disability specified u/s 80U (to the extent of 55% blind). He has received interest income of ₹ 40,000 for loan given to a private firm. He is dependent on Mrs. Raju.*

*(iv) 4th child (aged 14 years) has earned income of ₹ 45,000 during the P.Y. 2020-21 out of his physical and mental effort. Expenditure incurred to earn such income is ₹15,000. His loss from house property is ₹ 30,000.*

*(v) 5th child (aged 12 years) is a partner in a partnership firm from which he earned interest income of ₹ 40,000 and share of profit of ₹ 35,000. Other two partners of the firm are Mr. and Mrs. Raju.*

(vi) *6th child (aged 9 years) has 1,000 debentures of ₹100 each of a public sector company acquired through will of his grand father. Interest income on such debenture is ₹10,000. Expenditure incurred to collect such interest is ₹200. Such debenture was sold and long-term capital gain earned is ₹25,000.*

(vii) *7th child (aged 7 years) has earned interest on fixed deposit ₹500.*

*You are required to compute taxable income of Mr. and Mrs. Raju for the assessment year 2021-22.* *(8 marks)*

(D) *Kavi is earning a salary of ₹40,000 per month from Pranshul Ltd. He is given an option by his employer either to take house rent allowance or a rent free accommodation which is owned by the company. The HRA payable was ₹7,000 per month. The rent for the hired accommodation was ₹6,000 p.m. at New Delhi. Advice Kavi whether it would be beneficial for him to avail HRA or Rent Free Accommodation. Give your advice on the basis of "Net Take Home Cash benefits". Assume Kavi does not opt for the provision of section 115 BAC.* *(7 marks)*

**Answer 1(A)**

**Computation of Total Income of Shipa Limited for AY 2021-22**

| *Particulars* | *Amount (₹)* | *Amount (₹)* |
|---|---|---|
| **I. Profits and Gains from Business and Profession** | | |
| Net profit as per the Profit and Los Statement | | 7,50,00,000 |
| **Add : Items of expenditure being debited to Profit & Loss Statement to be disallowed:** | | |
| Depreciation as per Companies Act | 52,00,000 | |
| Provision for wages payable to workers [since the provision is based on a fair estimate of wages payable with reasonable certainty, the provision is allowable as deduction. ICDS X requires a reliable estimate of the amount of obligation and 'reasonable certainty' for recognition of a provision, which is present in this case. As, the provision of ₹18 lakhs has been debited to P&L statement, **no adjustment is required** while computing business income] | - | |
| Loss due to destruction of machinery by fire [Loss of ₹17 lakhs due to destruction of machinery caused by fire is not deductible since it is capital in nature.] Since the loss has been debited to statement of profit and loss, the same is required to added back while computing business income ] | 17,00,000 | |
| Provision for gratuity [Provision of ₹320 lakhs for gratuity based on actuarial valuation is not allowable as deduction. [Section 40A(7)] | 1,60,00,000 | |

| | | |
|---|---|---|
| However, actual gratuity of Rs.160 lakhs paid is allowable as deduction. Hence, the difference has to be added back to income i.e. 320 Lakhs - 160 Lakhs] | | |
| Advertisement in souvenir of a Political Party [Advertisement charges paid in respect of souvenir published by a political party is not allowable as deduction from business profits of the company.] | 2,30,000 | |
| Interest on deposit credited on 31.3.2021 on which TDS has not been deducted [30% disallowed u/s 40(a)(ia) since tax is not deducted and deposited to government] {2,00,000 x 30 %} | 60,000 | |
| | | 2,31,90,000 |
| | | 9,81,90,000 |
| **Add : Income taxable but not credited to Profit and Loss Statement:** | | |
| GST not refunded to customers out of GST refund received from the State Government. [The amount of GST refunded to the company by the Government is a revenue receipt chargeable to tax. Out of the refunded amount of ₹ 3 lakhs, the amount of ₹2 lakhs stands refunded to customers would not be chargeable to tax. Hence, The balance amount of ₹1 lakh lying with the company would be chargeable to tax] – **[Note 2]** | | 1,00,000 |
| Sub -Total | | 9,82,90,000 |
| **Less : Items credited to Statement of Profit and Loss, but not includible in business income / permissible expenditure and allowances:** | | |
| Industrial power tariff concession received from State Government [Any assistance in the form of **inter alia**, **concession received from the Central or State Government would be treated as income.]** | - | |
| Dividend received from domestic Company [Dividend received from domestic company is now taxable w.e.f. 1.4.2020, under Income from Other Sources.] | (12,00,000) | |
| Scrap value of Machinery destroyed [Scrap value of machinery being capital in nature, has to be reduced from WDV of machinery. Since the same has been credited to the statement of profit and | (3,00,000) | |

| | | |
|---|---|---|
| loss, it has to be deducted while computing business income.] **[Note 1]** | | |
| Long term capital gains on sale of equity shares [The taxability of long term capital gain on sale of equity shares has to be considered while computing income under the head Capital Gains.] | (3,00,000) | |
| Depreciation as per Income tax Rules, 1961 | (71,00,000) | (89,00,000) |
| Profits and gains from Business or Profession | | 8,93,90,000 |
| **Capital Gains** | | |
| Long term capital gain on sale of equity shares on which STT is paid at the time of acquisition and sale [The gain in excess of ₹ 1,00,000 is taxable flat @10% u/s 112A without indexation benefit] | | 3,00,000 |
| **Income from Other Sources** | | |
| Dividend received from domestic company [w.e.f. 1.4.2020, dividend received from a domestic company is chargeable to tax under the head Income from other Sources] | | 12,00,000 |
| Gross Total Income | | 9,08,90,000 |
| **Less : Deduction Under Chapter VI-A :** Under Section 80GGB (Contribution by a company to a registered political party is allowable as deduction, since payment is made otherwise than by cash. Expenditure incurred by an Indian company on advertisement in souvenir published by such political party shall be considered as contribution to such political party) **[Note 3]** | | (2,30,000) |
| Total Income | | 9,06,60,000 |

*Note:*

1. Since scrap value has been credited to the statement of Profit and Loss, it is possible to take a view that the amount of scrap value is not reduced while computing the value of the assets. In such a case, depreciation allowable would be Rs. 70,55,000 (i.e. 71,00,000 – Rs. 45,000, being 15% of Rs.3,00,000). The business income and total income would be Rs.8,94,35,000 and Rs.9,07,05,000 respectively.

2. GST not refunded to customers out of GST refund received from the State Government is a revenue receipt chargeable to tax. Hence, the GST amount not refunded to customer i.e. ₹ 1 lakh lying with the company would be chargeable to tax. However, there may be view that it will be paid in future and would not considered as remission of liability and therefore in such cases, Rs. 1,00,000 would not be taxable.

3. Any advertisement expenses of a company on a platform owned by a political party would be considered as a contribution u/s 80GGB and therefore eligible for deduction.

**Answer 1(B)**

Tax consequences in the hands of the business trust and its unit holders:

**(i) Rental income of Rs. 2.50 crore from directly owned real estate assets :** Any income of a business trust, being a REIT, by way of renting or leasing or letting out any real estate asset owned directly by such business trust is exempt in the hands of the trust as per section 10(23FCA) of the Income tax Act, 1961.

Where the income by way of rent is credited or paid to a business trust, being a REIT, in respect of any real estate asset held directly by such REIT, no tax is deductible at source u/s 194-I.

The distributed income or any part thereof, received by a unit holder from the REIT, which is in the nature of income by way of renting or leasing or letting out any real estate asset owned directly by such REIT is deemed income of the unit holder as per section 115UA(3) of the Income tax Act, 1961. The business trust has to deduct tax at source @ 10% (7.5% for the period between 14.05.2020 To 31.03.2021) u/s 194LBA in case of distribution to a resident unit holder and at rates in force in case of distribution to a non-resident unit holder.

The rental income component received from the business trust in the hands of each unit holder would be determined in the proportion as it has been received by or accrued to the business trust (i.e. 2.5/11.1) by virtue of section 115UA(1).

**(ii) Interest income of 4 crore from Birla Ltd:** There would be no tax liability in the hands of business trust due to pass through status enjoyed by it under sub-clause (a) of section 10(23FC) in respect of interest income from Birla Ltd. being the special purpose vehicle. Therefore, Birla Ltd. is not required to deduct tax at source on interest payment to the business trust.

The distributed income or any part thereof, received by a unit holder from the REIT, which is in the nature of interest income received or receivable from a SPV is deemed income of the unit holder as per section 115UA(3).

The business trust has to deduct tax at source under section 194LBA -

- @ 10% (7.5% for the period between 14.05.2020 To 31.03.2021) on interest component of income distributed to resident unit holders; and
- @ 5% on interest component of income distributed to non-corporate non-resident and foreign companies' unit holders.
- Interest component of income distributed to unit holders is taxable in the hands of the unit holders @ 5%, in case of unit holders, being non-corporate non-residents or foreign companies; and at normal rates of tax, in case of resident unit holders.

The interest component of income received from the business trust in the hands of each unit holder would be determined in the proportion of 4/11.1, by virtue of section 115UA(1).

**(iii) Dividend income of Rs. 2 crore from Birla Ltd.:** The dividend distributed by the SPV to the business trust is exempt by virtue of section 10(23FC).

Any distributed income referred to in section 115JJA, which is in the nature of dividend income received or receivable from SPV, in a case where the SPV has exercised the option u/s 115BAA, is taxable in the hands of unit-holders by virtue of section 10(23FC).

However, since Birla Ltd. being a SPV does not opt for section 115BAA, dividend component is exempt in the hands of the unit holders. Consequently, business trust is not required to deduct tax at source on the dividend component distributed to the unit holders.

**(iv) Short-term capital gains of Rs.1.50 crore on sale of listed shares of Birla Ltd.:**

As per section 115UA(2), the business trust is liable to pay tax @ 15% under section 111A in respect of short term capital gains on sale of listed shares of special purpose vehicle.

There would however, be no tax liability on the capital gain component of income distributed to unit holders, by virtue of the exemption contained in section 10(23FD).

**(v) Interest of Rs. 10 lakh received in respect of investment in unlisted debentures of real estate companies :** Such interest is taxable @ 42.744%, being the maximum marginal rate, in the hands of the business trust, as per section 115UA(2).

However, there would be no tax liability in the hands of the unit holders on the interest component of income distributed to them, by virtue of section 10(23FD).

**(vi) Short-term capital gains of Rs. 1 crore on sale of developmental properties:** It is taxable at maximum marginal rate of 42.744% in the hands of the business trust as per section 115UA(2).

There would be no tax liability in the hands of the unit holders on the capital gain component of income distributed to them, by virtue of the exemption contained in section 10(23FD).

**Answer 1(C)**

| *Particulars* | *Mr. Raju* | | *Mrs. Raju* | |
|---|---|---|---|---|
| **Income from House Property** | | | | -30,000 |
| Income of 4th Child: loss from house property | | | | |
| **Income from Business and Profession** | | 3,00,000 | 4,00,000 | |
| Business Income | | | | |
| *Add* : Income of 5th Child | | | | |

| | | | | |
|---|---|---|---|---|
| Interest from partnership firm | | | 40,000 | |
| (Assumed upto 12% p.a.) | | | | |
| Share of profit [exempt u/s 10(2A)] | | | Nil | |
| *Less* : Exemption u/s 10(32) | | | (1500) | 4,38,500 |
| **Income from Capital Gain** | | | | |
| Income of 6th Child: | | | | |
| Long term capital gain (Exemption u/s 10(32) can be claimed once per minor) | | | | 25,000 |
| **Income from Other Sources** | | | | |
| Income of 2nd Child | | | | |
| Interest income | | | 8,000 | |
| *Less* : Exemption u/s 10(32) | | | (1500) | 6500 |
| Income of 6th Child | | | | |
| Interest on debenture (10,000-200) | | | 9,800 | |
| *Less* : Exemption u/s 10(32) | | | (1500) | 8300 |
| Income of 7th Child: | | | | |
| Interest on Fixed Deposit | | | 500 | |
| *Less* : Exemption u/s 10(32) | | | (500) | Nil |
| Gross Total Income | | 3,00,000 | | 4,48,300 |
| *Less* : Deduction u/s 80DD | | Nil | | (75,000) |
| Total Income | | 3,00,000 | | 3,73,300 |

*Note:*

1. The clubbing provision of section 64(1A) shall not apply where
   - The income arises or accrues to the minor child due to any manual work done by him; or
   - The income arises or accrues to the minor child due to his skill, talent, specialized knowledge or experience; or
   - The minor child is suffering from any disability of nature as specified u/s 80U.
2. Income shall be first computed head wise in the hands of recipient and then clubbing shall be carried out head wise.
3. Income of the 1st Child shall not be clubbed with the income of Mrs. Raju as he is a major. Income of grandchild (son of 1st Child) will be clubbed with the income of his parent.
4. Section 64(1A) includes a minor married daughter also for the purpose of clubbing of income. However any income arise or accrued to the minor child due to her own skill

and talent shall not be clubbed. Hence interest income earned from the fixed deposits made out of such singing income shall be clubbed, as such interest income does not arise to 2nd child on account of her own skill and talent of singing.

5. Income of the 3rd Child shall not be clubbed with the income of Mrs. Raju as she is suffering from disability u/s 80U.

6. It is assumed that Mrs. Raju is not claiming benefit u/s 115BAC otherwise exemption u/s 10(32) will not be allowed for clubbing of minor's Income.

7. Income of 4th Child shall not be clubbed with the income of Mrs. Raju as the income earned out of his physical and mental efforts and will be taxable in his own hand.

**Answer 1(D)**

**Computation of Tax liability of Kavi under both the options**

| *Particulars* | | | *Option I HRA (Rs.)* | *Option II RFA (Rs.)* |
|---|---|---|---|---|
| Basic Salary (40,000 x 12 months) | | | 4,80,000 | 4,80,000 |
| Perquisite value of rent-free accommodation (15% of Rs. 4,80,000) | | | | 72,000 |
| House Rent Allowance (Rs. 7,000 x 12 months) | | 84,000 | | |
| *Less* : exempt u/s.10(13A) : | | | | |
| Least of the following: | | | | |
| • Rent paid less 10% of salary | 24,000 | | | |
| • Actual HRA received | 84,000 | | | |
| • 50% of Basic Salary | 2,40,000 | (24,000) | 60,000 | |
| Gross Salary | | | 5,40,000 | 5,52,000 |
| *Less* : Standard Deduction u/s 16(ia) | | | (50,000) | (50,000) |
| Net Salary | | | 4,90,000 | 5,02,000 |
| *Less* : Deduction under chapter VI-A | | | - | - |
| Total Income | | | 4,90,000 | 5,02,000 |
| Tax on Total Income | | | 12,000 | 12,900 |
| *Less* : Rebate under section 87A | | | 12,000 | Nil |
| Lower of 12,500 or income tax of 12,000, since the total income does not exceed Rs. 5,00,000 | | | Nil | 12,900 |
| *Add* : Health and Education Cess | | | Nil | 516 |
| Total tax payable | | | Nil | 13,416 |
| Tax Payable (Roundoff) | | | Nil | 13,420 |

**Cash Flow Statement**

| *Particulars* | *Option I HRA (Rs.)* | *Option II RFA (Rs.)* |
|---|---|---|
| Inflow: Salary and HRA Received | 5,64,000 | 4,80,000 |
| *Less* : Outflow Rent paid | (72,000) | Nil |
| Tax on total income | Nil | (13,420) |
| Net Inflow | 4,92,000 | 4,66,580 |

*Conclusion* : Since the net cash inflow under option I (HRA) is higher than in Option II (RFA), it is beneficial for Kavi to avail Option I, i.e. to take House Rent Allowance.

**Question 2**

*(a) The following information is supplied to you in respect of four house properties for the previous year 2020-21*

| *Particulars* | *House 1* | *House 2* | *House 3* | *House 4* |
|---|---|---|---|---|
| *Status at* | *Mumbai* | *Abu* | *Kolkata* | *Hyderabad* |
| *Purpose of usage* | *Self-occupied* | *Self-occupied* | *Self-occupied* | *Own Business* |
| *Gross Municipal Value* | *₹3,00,000* | *₹2,00,000* | *₹7,00,000* | *₹3,00,000* |
| *Fair Rent* | *₹2,00,000* | *₹2,00,000* | *₹8,00,000* | *₹1,20,000* |
| *Standard Rent* | *₹3,00,000* | *₹2,40,000* | *₹7,00,000* | *₹2,00,000* |
| *Municipal Tax* | *15%* | *15%* | *15%* | *15%* |
| *Repairs* | *₹12,000* | *₹4,000* | *₹8,000* | *₹8,000* |
| *Ground Rent* | *₹20,000* | *Nil* | *Nil* | *₹6,000* |
| *Land Revenue* | *Nil* | *₹10,000* | *Nil* | *Nil* |
| *Interest on Loan* | *₹40,000* | *₹1,00,000* | *₹2,10,000* | *₹20,000* |
| *Loan taken on* | *1998-99* | *1998-99* | *2017-18* | *1999-2000* |

*You are required to compute income under the head "Income from House Property" for the assessment year 2021-22 and show the workings clearly. (6 marks)*

*(b) A, B and C are partners in a firm sharing profits and losses in the ratio of 1:1:2. They provide the following information from which you are required to compute net income of the firm assuming that salary and interest are not paid to partners.*

*(i) Net income of the firm in assessment year 2020-21 is (–) ₹1,20,000. Out of which unadjusted depreciation is ₹40,000.*

*(ii) C retires on 31st May, 2020 from the firm and the other partners carry on the same business.*

*(iii) The income of the firm for the assessment year 2021-22 is ₹1,20,000 before adjusting the aforesaid loss and depreciation. (6 marks)*

**Answer 2(a)**

In the given case, as there are more than 2 residential house properties, which are in the occupation of the owner for his residential purposes, then he may exercise an option to treat any 2 houses to be self occupied properties. The other house will be deemed to be let out. Accordingly, there are following options, namely:

*Option 1* : Take HI & H3 as Self-Occupied (S/O) and H2 as Deemed to be Let-Out (DLO)

*Option 2* : Take H1 as deemed to be let out and H2 & H3 as Self-Occupied

*Option 3* : Take H3 as deemed to be let out and HI & H2 as Self-Occupied

Total Income under the head House Property shall be computed applying each option separately and then the option, which yields least income under this head, shall be opted.

| *Particulars* | *Option 1 Amount (Rs.)* | | *Option 2 Amount (Rs.)* | | *Option 3 Amount (Rs.)* | |
|---|---|---|---|---|---|---|
| | *H1 & H3 S/O* | *H2 DLO* | *H1 DLO* | *H2 & H3 S/O* | *H3 DLO* | *H1&H2 S/O* |
| Gross Annual Value | Nil | 2,00,000 | 3,00,000 | Nil | 7,00,000 | Nil |
| *Less* : Municipal Tax 15% of Municipal Value | Nil | (30,000) | (45,000) | Nil | (1,05,000) | Nil |
| Net Annual Value (NAV) | Nil | 1,70,000 | 2,55,000 | Nil | 5,95,000 | Nil |
| *Less* : Standard Deduction 24(a)@30% of NAV | Nil | (51,000) | (76,500) | Nil | (1,78,500) | Nil |
| Interest on loans 24(b) | (2,00,000) | (1,00,000) | (40,000) | (2,00,000) | (2,10,000) | (30,000 Note 1) |
| Total Deduction | (2,00,000) | (1,51,000) | (1,16,500) | (2,00,000) | (3,88,500) | (30,000) |
| Income under the head house property | (2,00,000) | 19,000 | 1,38,500 | (2,00,000) | 2,06,500 | (30,000) |
| Income under the head house property | (181000) | | (61500) | | 1,76,500 | |

*Notes:*

1. In case of self occupied property, the maximum allowed interest is Rs. 30,000 if the loan is taken prior to 1st April, 1999. Such limit has been increase to Rs. 2,00,000 if loan is taken on or after 1st April, 1999.

2. Since H4 is used for own business purpose, so it is not taxable under this head.

3. It is assumed that assessee is not covered u/s 115BAC.

Total income under the head Income from House Property as per option 1 i.e. Rs. (1,81,000) should be opted, as yielding least taxable income under this head.

**Answer 2(b)**

Section 78(1) : Where a change occurs in the consultation of firm, on account of retirement or death of partner, the proportionate loss of the retired or deceased partner shall not be carried forward. However, this section shall not apply in case of unabsorbed depreciation accordingly.

**Computation of Total Income for the AY 2021-22**

| *Particulars* | | *Amount (₹)* | *Amount (₹)* |
|---|---|---|---|
| Income before adjusting brought forwarded loss and depreciation | | | 1,20,000 |
| *Less* : Brought forwarded loss (excluding unabsorbed depreciation) | 80,000 | | |
| *Less* : Loss which cannot be set off (working note 1) | (30,000) | (50,000) | |
| *Less* : Unabsorbed depreciation | | (40,000) | (90,000) |
| **Total Income** | | | **30,000** |

*Working Note 1* : Computation of share of C in brought forward loss and loss which cannot be set off.

| *Particulars* | *Amount (₹)* |
|---|---|
| Total unabsorbed brought forwarded loss | 1,20,000 |
| *Less* : Unabsorbed depreciation | 40,000 |
| Brought forwarded loss excluding depreciation | 80,000 |
| Share of C in aforesaid loss (₹ 80,000/4) * 2 | 40,000 |
| *Less* : Share of Mr. C in current profit before adjusting brought forwarded loss and depreciation [(₹1,20,000/12*2) *2/4] | (10,000) |
| **Loss which cannot be set-off** | **(30,000)** |

**Question 3**

(a) *Narmada is an individual resident retired from the service of Prasar Bharati aged 61 years, is a well known dramatist deriving income of ₹2,20,000 from theatrical works played abroad. Tax of ₹11,000 was deducted in the country where the play's were performed. India does not have any Double Tax Avoidance Agreement under section 90 of the Income-tax Act, 1961, with that country. Her income in India amounted to ₹5,60,000.*

*In view of tax planning, she has deposited ₹1,30,000 in PPF and paid contribution to approved Pension Fund of LIC ₹45,000. She also contributed ₹27,000 to Central Government Health Scheme during the previous year and gave payment of medical insurance premium of ₹28,000 to insure the health of her mother a non-resident aged 85 years, who is not dependent on her.*

*Compute the tax liability of Narmada for the assessment year 2021-22, assuming that she does not opt for section 115BAC.* *(6 marks)*

(b) *P Ltd. is shifting its undertaking from Jaipur to Napasar (other than urban area). It has sold its 4 machineries and 2 sets of furniture during the previous year 2020-21 as under :*

| *Assets* | *Rate of Depreciation* | *Book Value (₹)* | *Sold for (₹)* |
|---|---|---|---|
| *Machinery A* | *15%* | *2,00,000* | *3,00,000* |
| *Machinery B* | *15%* | *3,00,000* | *8,00,000* |
| *Machinery C* | *15%* | *5,00,000* | *6,00,000* |
| *Machinery D* | *30%* | *6,00,000* | *5,00,000* |
| *Furniture X* | *10%* | *1,00,000* | *2,00,000* |
| *Furniture Z* | *10%* | *60,000* | *90,000* |

*WDV of the Block of Asset is given under*

| ***Name of Block*** | ***Block consist of*** | ***WDV as on 1-4-2020*** |
|---|---|---|
| *Machinery 15%* | *A, B & C* | *11,00,000* |
| *Machinery 30%* | *D* | *9,00,000* |
| *Furniture 10%* | *X & Z* | *1,50,000* |

*P Ltd. is seeking wether the above transactions shall be taxable as slump sale or not. On 7.4.2021, assessee further purchased new machine worth ₹2,70,000; land worth ₹1,50,000 and new furniture worth ₹80,000 for the purpose of new industrial undertaking. Compute the taxable income from capital gain for the assessment year 2021-22.*

*(6 marks)*

**Answer 3(a)**

**Computation of Total Income and Tax liability of Narmada for the AY 2021-22**

| *Particulars* | *Amount (₹)* | *Amount (₹)* |
|---|---|---|
| Indian Income | | 5,60,000 |
| Foreign Income | | 2,20,000 |
| Gross Total Income | | 7,80,000 |
| *Less* : Deductions | | |
| Deduction u/s. 80C: | | |
| Deposit in PPF | 1,30,000 | |
| Deduction U/S 80CCC: | | |
| Contribution to approved Pension Fund of LIC | 45,000 | |
| Total of 80C, 80CCC & 80CCD(1) | 1,75,000 | |
| Deduction u/s 80CCE: | | (1,50,000) |
| The aggregate deduction u/s 80C, 80CCC and 80CCD(1) has to be restricted to ₹1,50,000 | | |
| Deduction u/s. 80D: | | |
| • Contribution to Central Government Health Scheme ₹27,000 is also allowable as deduction u/s 80D **(Note 1)** | (27,000) | |
| • Medical insurance premium of ₹28,000 paid for mother aged 85 years. Since the mother is a non-resident in India, she will not be entitled for the higher deduction of ₹50,000 eligible for a senior citizen, who is resident in India. Hence, the deduction will be restricted to a maximum of ₹25,000. | (25,000) | (52,000) |
| Total Income | | 5,78,000 |
| Tax on Total Income: | | |
| Income tax **(Note 2)** | | 25,600 |
| *Add* : Health and Education Cess @ 4% | | 1,024 |
| Total Tax | | 26,624 |
| Average rate of tax in India (i.e. Rs. 26,624 / 5,78,000 x 100) | 4.606 % | |

| | | |
|---|---|---|
| Average rate of tax in foreign country (i.e. 11,000 / 2,20,000 x 100) | 5% | |
| Deduction u/s 91 on 2,20,000 @ 4.606% (lower of average Indian-tax rate or average foreign tax rate) | | (10,133) |
| Tax payable in India (26,624 - 10,133) | | 16,491 |
| Tax Payable (Rounding off) | | **16,490** |

*Note:*

1. Section 80 D allows a higher deduction of up to ₹50,000 in respect of the medical premium paid to insure the health of a senior citizen. Therefore, Narmada will be allowed deduction of ₹27,000 u/s 80D, since she is a resident Indian of the age of 61 years.
2. Narmada is eligible for the higher basic exemption limit of ₹3,00,000, since she is 61 years old. Tax on total income of Rs. 578000 is (500000-300000) x 5% + (78000 x 20%) = Rs. 25600
3. An assessee shall be allowed deduction u/s 91, provided all the following conditions are fulfilled:
   a. The assessee is a resident in India during the relevant previous year.
   b. The income accrues or arises to him outside Indian during that previous year.
   c. Such income is not deemed to accrue or arise in India during the previous year.
   d. The income in question has been subjected to income tax in the foreign country in the hands of the assessee and the assessee has paid tax on such income in the foreign country.
   e. There is no agreement u/s.90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

**Answer 3(b)**

In the given case though assessee has transferred a group of assets still the transaction **cannot be taxed as slump sale** because value has been assigned to individual asset.

The tax treatment shall be as under:

(i) Block of Machinery 15 % (On sale of Machinery A, B & C)

| *Particulars* | *Amount (₹)* |
|---|---|
| W.D.V. as on 1st April, 2020 | 11,00,000 |
| *Add* : Purchase during the year | Nil |
| Total | 11,00,000 |
| *Less* : Sale during the year | (17,00,000) |
| Short term Capital Gain u/s 50 | 6,00,000 |

(ii) Block of Machinery 30 % (On sale of Machinery D)

| *Particulars* | *Amount (₹)* |
|---|---|
| W.D.V. as on 1st April, 2020 | 9,00,000 |
| *Add* : Purchase during the year | Nil |
| Total | 9,00,000 |
| *Less* : Sale during the year | (5,00,000) |
| Short term Capital Loss | (4,00,000) |

Since machine D is only asset in the block and was sold. Therefore block ceased to exist and section 50 is applicable.

(iii) Block of Furniture 10 % (On sale of Furniture X & Z)

| *Particulars* | *Amount (₹)* |
|---|---|
| W.D.V. as on 1st April, 2020 | 1,50,000 |
| *Add* : Purchase during the year | Nil |
| Total | 1,50,000 |
| *Less* : Sale during the year | (2,90,000) |
| **Short term Capital Gain u/s 50** | **1,40,000** |

**Computation of Total Capital Gain for P Ltd.**

| *Particulars* | *Amount (₹)* |
|---|---|
| Short term Capital Gain on Block 15% (Machinery A, B & C) | 6,00,000 |
| Short term Capital loss on Block 30% (Machinery D) | (400000) |
| Short term Capital Gain on Block 10% (Furniture X & Z) | 1,40,000 |
| Total Short Term Capital Gain | 3,40,000 |
| *Less* : Exemption u/s 54G for shifting of undertaking from urban to rural area, on purchase of new machinery and land only within 1 year before or 3 years from the date of transfer of machinery/land) (2,70,000 + 1,50,000) | (3,40,000) |
| Section 54 G cannot be availed for purchase of furniture. | |
| Taxable Short Term Capital Gain | Nil |

**Question 4**

*(a) An enterprise engaged in the business of manufacturing of steel balls discontinued its activities and decided to lease out its factory building, plant and machinery and furniture from 1st April, 2020 on a consolidated lease rent of ₹50,000 p.m. Following information is supplied for the previous year 2020-21 :*

*(i) Brokerage paid on hundi loan taken ₹ 2,000*

*(ii) Interest received on deposits ₹ 1,00,000*

*(iii) Interest paid on hundi and other loans which were given as deposits on interest to others ₹75,000*

*(iv) Expenses incurred on repairs of building, plant and machinery ₹15,000*

*(v) Fire insurance premium of plant and machinery and furniture ₹12,000*

*(vi) Depreciation for the year ₹1,47,500*

*(vii) Legal fees paid to an advocate for drafting and registering the lease agreement ₹1,500*

*(viii) Factory licence fees paid for the year ₹1,000*

*(ix) The unabsorbed depreciation for assessment year 2020-21 is ₹2,75,000. The income tax return for assessment year 2020-21 is not filed before due date u/s 139(1).*

*(x) Interest paid in (iii) above includes an amount of ₹25,000 remitted to a non-resident outside India on which tax was not deducted at source.*

*Compute the total income of enterprises for the assessment year 2021-22.*
*(6 marks)*

*(b) Ascertain the capital gains/loss on transfer of listed equity shares and units of equity oriented mutual fund (STT paid at the time of transfer of units) for the assessment year 2021-22 and also calculate tax liability, if any, payable thereon, in the following cases separately.*

*Assuming that there are the only transactions covered under section 112A during the previous year 2020-21 in respect of these assesses :*

*(i) Prasad purchased 300 shares in A Ltd. on 20th May, 2017 at a cost of ₹400 per share. He sold all the shares of A Ltd. on 31st May, 2020 at a price of ₹1,200 each. The price at which these shares were traded in NSE on 31st January, 2018 is as follows :*

*• Highest Trading Price ₹700*

*• Average Trading Price ₹680*

*• Lowest Trading Price ₹660*

*(ii) Verma purchased 200 units each of equity oriented funds, Fund A and Fund B on 1-2-2017 at a cost of ₹550 per unit. The units were not listed at the*

*time of purchase. Subsequently, units of Fund A were listed on 1-1-2018 and units of Fund B were listed on 1-2-2018 on the NSE. Verma sold all the units on 3-4-2020 for ₹900 each. The details relating to quoted price on NSE and net asset value of the units are given below :*

| *Particulars* | *Fund A* | *Fund B* |
|---|---|---|
| *Highest Trading Price* | *₹750 (on 31-1-2018)* | *₹800 (on 1-2-2018)* |
| *Average Trading Price* | *₹700 (on 31-1-2018)* | *₹750 (on 1-2-2018)* |
| *Lowest Trading Price* | *₹650 (on 31-1-2018)* | *₹700 (on 1-2-2018)* |
| *Net Asset Value on 31-01-2018* | *₹800* | *₹950* |

*(6 marks)*

**Answer 4(a)**

The income derived from leased assets shall be chargeable to tax as Income from Other Sources u/s 56(2)(iii) of the Income tax Act, 1961 but the computation thereof shall be made after allowing deductions specified under sections 30, 31 and 32 subject to section 38. This is as per the provisions of section 57(ii) and 57(iii) of the Income tax Act, 1961.

**Computation of Income under the head Income from Other Sources**

| *Particulars* | | *Amount* | *Amount* |
|---|---|---|---|
| **(A) Lease Rent for 12 months @ Rs.50, 000 p.m.** | | | 6,00,000 |
| *Less* : Expenses and deductions allowable under section 57(ii) & 57(iii): | | | |
| • Repairs | | 15,000 | |
| • Fire Insurance Premium | | 12,000 | |
| • Legal expenses for drafting of lease agreement | | 1,500 | |
| • Factory Licence fee | | 1,000 | |
| • Depreciation for the year | | 1,47,500 | |
| • Unabsorbed depreciation of earlier assessment years - eligible for deduction (Note 1) | | 2,75,000 | (4,52,000) |
| | | | 1,48,000 |
| **(B) Interest on Deposits** | | 1,00,000 | |
| *Less* : Expenses allowable u/s 57(i): | | | |
| Brokerage | ₹ 2,000 | | |
| Interest on hundi loans (note 2) | ₹ 50,000 | (52,000) | 48,000 |
| Total Income | | | 1,96,000 |

*Working Notes*

1. Unabsorbed depreciation of Rs. 2,75,000 pertains to earlier assessment years are allowed to be carried forward even if the income tax return for the relevant assessment year is filed after due date of filing of return u/s 139(1). The unabsorbed depreciation shall form part of the current year depreciation and can be set off against any other head of income. Accordingly, the amount of Rs. 2,75,000 is adjustable/allowed to be set off against income from other sources.

2. Since deposits are made by investing amount received on hundi and other loans, the interest on hundi and other loans would be eligible for deduction from the income arising on such deposits. However, interest paid to non-resident is not eligible for deduction as the tax has not been deducted as source.

**Answer 4(b)**

(i) For the purpose of computation of long term capital gains chargeable to tax u/s 112A of the Income tax Act, 1961, the cost of acquisition in relation to the long term capital asset, being an equity share in a company or a unit of an equity oriented fund or a unit of a business rust acquired before 1st February, 2018 shall be the higher of:

A. Cost of acquisition of such asset, i.e. actual cost; and

B. Lower of

i. The fair market value of such asset as on 31st January 2018; and

ii. The full value of consideration received or accruing as a result of the transfer of the capital asset.

The fair market value of listed equity shares as on 31st January, 2018 is the highest price quoted on the recognized stock exchange as on that date.

Accordingly, long term capital gain on transfer of STT paid listed equity shares by Mr. Prasad would be determined as follows:

The FMV of shares of A ltd. would be ₹700, being the highest price quoted on National Stock Exchange on 31st January, 2018. The cost of acquisition of each equity share in A Ltd. would be ₹700, being higher of actual cost i.e., Rs. 400 and Rs. 700 (being the lower of FMV of 700 as on 31st January, 2018 (i.e. the highest trading price).

The actual sale consideration is Rs.1,200. Thus, the long term capital gain would be Rs. 1,50,000 i.e. (₹1,200 – ₹700) x 300 shares.

The long term capital gain of ₹50,000 (i.e., the amount in excess of Rs. 1, 00,000) would be subject to tax @ 10% under section 112A, without benefit of indexation. Accordingly the additional tax liability on account of this LTCG chargeable u/s 112A is 5,000 + 4% HEC i.e. 5,200.

*Note* : To compute the tax liability it is presumed that Mr. Prasad would be having other income above the Maximum Exemption Limit i.e. Rs. 2,50,000

(ii) In the case of units listed on recognized stock exchange on the date of transfer, the FMV as on 31st January, 2018 would be the highest trading price on recognized stock exchange as on 31st January, 2018 (if units are listed on that date), else, it would be the net asset value as on 31st January, 2018 (where units are unlisted on that date).

Accordingly, the FMV of units of Fund A as on 31st January, 2018 would be ₹750 (being the highest trading price on 31st January, 2018, since the units of Fund A are listed on that date) and the FMV of units of Fund B as on 31st January, 2018 would be ₹950 (being the net asset value as on 31st January, 2018, since the units of Fund B are unlisted on that date).

The cost of acquisition of a unit of Fund A would be ₹750, being higher of actual cost i.e., ₹550 and ₹750 (being the lower of FMV of ₹750 as on 31st January, 2018 and actual sale consideration of Rs. 900).

Thus, the long term capital gains on sale of units of Fund A would be 30,000 (₹900 – ₹750) x 200 units.

The cost of acquisition of a unit of Fund B would be ₹900, being higher of actual cost i.e., ₹550 and ₹900 (being the lower of FMV of ₹950 as on 31st January, 2018 (net asset value) and actual sale consideration of 900).

Thus, the long term capital gains on sale of units of Fund B would be Nil (900 - ₹900) x 200 units.

Since the long term capital gains on sale of units is Rs. 30,000, which is less than 1,00,000, the said sum is not chargeable to tax under section 112A of the Income tax Act, 1961 .

**Question 5**

*(a) Ayush Motors Limited an Indian Company declared income of ₹300 crore computed in accordance with Chapter IV-D but before making any adjustments in respect of the following transactions for the previous year 2020-21.*

*(i) 10,000 cars sold to Rida Ltd., US company, which holds 30% shares in Ayush Motors Ltd. at a price which is less by $ 200 each car than the price charged from Shingto Ltd. an independent buyer.*

*(ii) Royalty of $ 1,20,00,000 was paid to Kyoto Ltd. a US Company, for use of technical know-how in the manufacturing of car. However, Kyoto Ltd. has provided the same know-how to another Indian company for $ 90,00,000. Kyoto Ltd. is the sole owner of technology used by Ayush Motors Ltd. in its manufacturing process.*

*(iii) Loan of EURO 1000 crores carrying interest @ 10% p.a. advanced by Dorf Ltd., a German company, was outstanding on 31st March, 2021. The total book value of assets of Ayush Motors Ltd. on the date was ₹90,000 crores. The said German company had also advanced a loan of similar amount to another Indian company @ 9% p.a. Total interest paid for the year was EURO 100 crores.*

*Explain in detail the provisions of the Act affecting all these transactions and compute the income of the company chargeable to tax for assessment year 2021-22 keeping in mind that the value of 1 $ and of 1 EURO was ₹63 and ₹84, respectively, throughout the year.* *(6 marks)*

*(b) Rama aged 65 years is Karta of his HUF, which consists of himself, his wife and two sons viz., C of 28 years and Minor D aged 16 years. The HUF is assessed to income tax and has business income from the year 2010-11 onwards. The business income of HUF for the year ended 31st March, 2021 is ₹5,00,000. Rama is employed in a private company and his salary income for the same period is ₹6,10,000 (computed).*

*You are required to answer the following treating each of them as independent situations :*

*(i) C gave cash gift of ₹1,00,000 to the HUF of Rama. What would be the total income of HUF ?*

*(ii) The HUF has one house property fetching rent of ₹10,000 per month and some movable assets. There is a proposal to make a partial partition of HUF by allotting the house property to C on 1st July, 2020. Is it advisable to do a partial partition ? In whose hand the rental income is taxable after the partial partition of HUF.*

*(iii) A car owned personally by Rama was blended with HUF during the year. It was leased out for a monthly rent of ₹10,000 from 1st October, 2020. How would this income be taxed ?* *(2 marks each = 6 marks)*

**Answer 5(a)**

Any income arising from an international transaction, where two or more associated enterprises' enter into a mutual agreement or arrangement shall be computed having regard to arm's length price as per the provisions of Chapter X of the Income tax Act, 1961.

Section 92A defines an “associated enterprise” and sub-section (2) of this section speaks of the situations when the two enterprises shall be deemed to associated enterprises. Applying the provisions of section 92A(2)(a) to (m) to the given facts, it is clear that “Ayush Motors Ltd." is **associated enterprises** with:

(i) Rida Ltd. as per section 92A(2)(a), because this company holds shares carrying more than 26% of the voting power in Ayush Motors Ltd.;

(ii) Kyoto Ltd. as per section 92 A(2)(g), since this company is the sole owner of the technology used by Ayush Motors Ltd. in its manufacturing process;

(iii) Dorf Ltd. as per section 92 A(2)(c), since this company has financed an amount which is more than 51% of the book value of total assets of Ayush Motors Ltd.

Hence all the transactions entered into by Ayush Motors Ltd. with different companies are covered under international transaction with associated enterprises.

**Computation of Total Income of Ayush Motors Ltd. for A.Y. 2021-22**

| *Particulars* | *Amount (₹ in crore)* |
|---|---|
| Income of Ayush Motors Ltd. as computed under Chapter IV D, prior to adjustments as per Chapter X | 300.00 |
| *Add* : Difference on account of adjustment in the value of international transactions: | |
| (i) Difference for lesser price of Car sold @ $ 200 each for 10,000 Cars ($ 200 x 10,000 x ₹63) | 12.60 |
| (ii) Difference for excess payment of Royalty of $ 30,00,000 ($ 30,00,000 x ₹63) | 18.90 |
| (iii) Difference for excess interest paid on loan of EURO 1,000 crores (₹84 * 1000 * 1/100) | 840.00 |
| Total Income | 1,171.50 |

The difference for excess payment of royalty has been added back presuming that the manufacture of cars by Ayush Motors Ltd. is wholly dependent on the use of know-how owned by Kyoto Ltd.

*Note* : It is presumed that Ayush Motors Ltd. has not entered into an Advance Pricing Agreement or opted to be subject to Safe Harbour Rules.

**Answer 5(b)**

(i) Cash gift of ₹1 lakh by Rama's major son, to the HUF of Rama would not be taxable in the hands of the HUF, since gifts from a relative of the HUF does not fall within the scope of income taxable under section 56(2)(x) of the Income tax Act, 1961. Since C being Rama's son, is a member of Rama's HUF, he is a relative of the HUF. Hence, the total income of HUF would be ₹5 lakh, being the business income computed.

However as per Sec 64(1), any income arising to HUF on the gifted money will be clubbed in the Income of C.

*Note* : Salary income of Rama, the Karta of the HUF, who is employed in a private company would be taxed in his individual hands, since the remuneration earned by the Karta on account of the personal qualifications and expertise and not on account of the investment of the family funds, cannot be treated as income of the HUF.

(ii) Partial Partition (after 31st December, 1978) is not recognized and the HUF, which has been hitherto assessed to tax, shall continue to be liable to be assessed as if no such partial partition has taken place [Section 171(9)].

The rental income in this case would continue to be assessed in the hands of the HUF, even after partial partition.

Therefore, it is **not advisable** to do a partial partition.

(iii) As per section 64(2) of the Income tax Act, 1961, where a member of the HUF blends his self-acquired property for inadequate consideration with the HUF, income derived therefrom is deemed to arise to the transferor/member and not to the HUF. In this case, Rama has blended his personal property (i.e. car) with the HUF.

Since there is no consideration in case of blending, the lease rental of the car of ₹ 60,000 (₹10,000 x 6 months) less allowable deductions] would be deemed as the income of Rama.

**Question 6**

*Murugan is an individual age 48 years set up a unit in SEZ during the financial year 2017-18 for production of washing machines. The unit fulfills all the conditions of section 10AA of the Income-Tax Act, 1961. During the financial year 2020-21, he has also set up a warehousing facility in a district of Tamil Nadu for storage of agricultural produce. It fulfills all the conditions of section 35AD. Capital expenditure in respect of warehouse amounted to ₹75 lakh (including cost of land ₹10 lakh). The warehouse became operational w.e.f. 1st April, 2021 and the expenditure of ₹75 lakhs was capitalized in the books on that date. Relevant details for the previous year 2020-21 are furnished as follows :*

*(i) Profit of unit located in SEZ ₹40,00,000*

*(ii) Export sales of above unit ₹80,00,000*

*(iii) Domestic sales of above unit ₹20,00,000*

*(iv) Profit from operation of warehousing facility (before considering deduction u/s 35AD) ₹1,05,00,000.*

*Compute income-tax liability of Murugan for the assessment year 2021-22 both as per regular provisions of the Income -Tax Act, 1961 and as per section 115BAC. Advise Murugan whether he should opt for section 115BAC ? (12 marks)*

**Answer 6**

(i) Computation of Total Income and tax liability of Murugan for the Assessment Year 2021-22 (under the regular provisions of the Income Tax Act, 1961)

| *Particulars* | *Amount (₹)* | *Amount (₹)* |
|---|---|---|
| Profits and Gains of Business or Profession | | |
| Profit from unit in SEZ | 40,00,000 | |
| *Less* : Deduction u/s 10AA **[Working Note 1]** | (32,00,000) | |
| Business Income of SEZ unit chargeable to tax | | 8,00,000 |
| Profit from operation of Warehousing facility | 1,05,00,000 | |
| *Less* : Deduction u/s 35 AD **[Working Note 2]** | (65,00,000) | |

| | |
|---|---|
| Business Income of Warehousing facility chargeable to tax | 40,00,000 |
| Total Income | 48,00,000 |
| Computation of tax liability | |
| (under the normal/regular provisions):Tax on ₹48,00,000 | 12,52,500 |
| *Add* : Health and Education Cess @ 4% | 50,100 |
| Total Tax Liability | 13,02,600 |

(ii) Computation of Adjusted Total Income of Murugan for levy of Alternate Minimum Tax

| *Particulars* | *Amount (₹)* | *Amount (₹)* |
|---|---|---|
| Total Income (computed above as per regular provisions of Income tax) | | 48,00,000 |
| *Add* : Deduction u/s 10AA | | 32,00,000 |
| | | 80,00,000 |
| *Add* : Deduction u/s 35 AD | 65,00,000 | |
| *Less* : Depreciation u/s 32 on Building @ 10% of Rs. 65 Lakh | (6,50,000) | 58,50,000 |
| Total Income | | 1,38,50,000 |
| Alternate Minimum Tax @ 18.5% | | 25,62,250 |
| *Add* : Surcharge @ 15% (since adjusted total income is more than ₹1 crore) | | 3,84,338 |
| | | 29,46,588 |
| *Add* : Health and Education Cess @ 4% | | 1,17,863 |
| | | 30,64,451 |
| Tax liability u/s 115JC (rounded off) | | 30,64,450 |

Since the regular income tax payable is less than the alternate minimum tax payable, the adjusted total income shall be deemed to be the total income and tax is leviable @ 18.50% thereof plus surcharge @ 15% and cess @ 4%. Therefore, tax liability as per section 115JC is 30,64,450.

(iii) Computation of Total Income and tax liability of Murugan
For the Assessment Year 2021-22
(under the provisions of section 115BAC of the Income Tax Act, 1961)

| *Particulars* | *Amount (₹)* | *Amount (₹)* |
|---|---|---|
| Total Income (computed above as per regular provisions of Income tax) | | 48,00,000 |
| *Add* : Deduction u/s 10AA (Not allowed) | | 32,00,000 |
| | | 80,00,000 |
| *Add* : Deduction u/s 35AD | 65,00,000 | |
| *Less* : Depreciation u/s 32 on Building @ 10% of ₹65 Lakh | (6,50,000) | 58,50,000 |
| Total Income | | 1,38,50,000 |
| Computation of tax liability as per section 115BAC: | | |
| Tax on 1,38,50,000 | | 38,92,500 |
| *Add* : Surcharge a 15% | | 5,83,875 |
| | | 44,76,375 |
| *Add* : Health and Education Cess @ 4% | | 1,79,055 |
| Total | | 46,55,430 |
| Tax liability u/s 115BAC (rounded off) | | 46,55,430 |

*Notes:*

1. Deductions u/s 10AA and 35AD are not allowable as per section 115BAC(2). However, normal depreciation u/s 32 is allowable.
2. Individuals or HUFs exercising option u/s 115BAC are not liable to alternate minimum tax u/s 115JC.
3. Since the tax liability of Murugan u/s 115JC is lower than the tax liability as computed u/s 115BAC, it would be beneficial for him not to opt for section 115BAC for A.Y. 2021-22. Moreover, benefit of alternate minimum tax credit is also available to the extent of tax paid in excess over regular tax.

AMT Credit to be carried forward under section 115JEE

| *Particulars* | *Amount (₹)* |
|---|---|
| Tax liability under section 115JC | 30,64,450 |
| *Less* : Tax liability under the regular provisions of the Income Tax Act, 1961 | 13,02,600 |
| AMT Credit | 17,61,850 |

*Working Notes*

Particulars

(1) Deduction under section 10AA in respect of Unit in SEZ = Profit of the Unit in SEZ x Export turnover of the Unit in SEZ / Total turnover of the Unit in SEZ

$$40,00,000 \times \frac{80,00,000}{1,00,00,000} = 32,00,000$$

(2) Deduction @ 100% of the capital expenditure is available u/s 35AD for AY 2021-22 in respect of specified business of setting up and operating a warehousing facility for storage of agricultural produce which commences operation on or after 1st April, 2009.

Further, the expenditure incurred, wholly and exclusively, for the purposes of such specified business, shall be allowed as deduction during the previous year in which he commences operations of his specified business is the expenditure is incurred prior to the commencement of its operations and the amount is capitalized in the books of account of the assessee on the date of commencement of its operations.

Deduction u/s 35AD would, however, not be available on expenditure incurred on acquisition of land.

[*Note* : The date of warehouse became operational mentioned as 1st April, 2021 instead of 1st April, 2020 as the questions showing profit from operations of warehousing facility during the FY 2020-21. In this case, since the capital expenditure of ₹65 lakh (i.e. ₹75 Lakh - ₹10 Lakh, being expenditure on acquisition of land) has been incurred in the FY 2020-21 and capitalized in the books of account assuming on 1st April, 2020, being the date when the warehouse became operation, ₹65,00,000, being 100% of ₹65 lakh would qualify for deduction u/s 35AD.]

**Alternate Answer 6**

(i) Computation of Total Income and tax liability of Murugan for the Assessment Year 2021-22 (under the regular provisions of the Income Tax Act, 1961)

| *Particulars* | *Amount (₹)* | *Amount (₹)* |
|---|---|---|
| Profits and Gains of Business or Profession | | |
| Profit from unit in SEZ | 40,00,000 | |
| *Less* : Deduction u/s 10AA [See Working Note 1] | (32,00,000) | |
| Business Income of SEZ unit chargeable to tax | | 8,00,000 |
| Profit from operation of Warehousing facility | 1,05,00,000 | |
| *Less* : Deduction u/s 35 AD [See Working Note 2] | NIL | |
| Business Income of Warehousing facility chargeable to tax | | 1,05,00,000 |

| | |
|---|---|
| Total Income | 1,13,00,000 |
| Computation of tax liability (under the normal/regular provisions): Tax on ₹1,13,00,000 | 32,02,500 |
| *Add* : Surcharge @15% being total income exceeding Rs. 1 crore | 4,80,375 |
| *Add* : Health and Education Cess @ 4% on Tax + Surcharge i.e. 36,82,875 | 1,47,315 |
| Total Tax Liability | 38,30,190 |

(ii) Computation of Adjusted Total Income of Murugan for levy of Alternate Minimum Tax

| *Particulars* | *Amount (₹)* | *Amount (₹)* |
|---|---|---|
| Total Income (computed above as per regular provisions of Income tax) | | 1,13,00,000 |
| *Add* : Deduction u/s 10AA | | 32,00,000 |
| | | 1,45,00,000 |
| *Add* : Deduction u/s 35 AD | NIL | |
| *Less* : Depreciation u/s 32 on Building | NIL | Nil |
| Total Income | | 1,45,00,000 |
| Alternate Minimum Tax @ 18.5% | | 26,82,500 |
| *Add* : Surcharge @ 15% (since adjusted total income is more than ₹1 crore) | | 4,02,375 |
| | | 30,84,875 |
| *Add* : Health and Education Cess @ 4% | | 1,23,395 |
| Tax liability u/s 115JC (rounded off) | | 32,08,270 |

Since the regular income tax payable is more than the alternate minimum tax payable, the adjusted total income shall not be deemed to be the total income and hence tax leviable under normal provisions of the Income Tax Act is the final tax liability i.e. 38,30,190.

(iii) Computation of Total Income and tax liability of Murugan
For the Assessment Year 2021-22
(under the provisions of section 115BAC of the Income Tax Act, 1961)

| *Particulars* | *Amount (₹)* | *Amount (₹)* |
|---|---|---|
| Total Income (computed above as per regular provisions of Income tax) | | 1,13,00,000 |
| *Add* : Deduction u/s 10AA (Not allowed) | | 32,00,000 |

| | |
|---|---|
| Total Income | 1,45,00,000 |
| Computation of tax liability as per section 115BAC: | |
| Tax on 1,45,00,000 | 40,87,500 |
| *Add* : Surcharge a 15% | 6,13,125 |
| | 47,00,625 |
| *Add* : Health and Education Cess @ 4% | 1,88,025 |
| Tax liability u/s 115BAC (rounded off) | 48,88,650 |

*Notes:*

1. Deductions u/s 10AA and 35AD are not allowable as per section 115BAC(2). However, normal depreciation u/s 32 is allowable.
2. Individuals or HUFs exercising option u/s 115BAC are not liable to alternate minimum tax u/s 115JC.
3. Since the tax liability of Murugan under normal provisions of income tax is lower than the tax liability as computed u/s 115BAC, it would be beneficial for him not to opt for section 115BAC for A.Y. 2021-22.

*Working Notes*

*Particulars*

(1) Deduction under section 10AA in respect of Unit in SEZ = Profit of the Unit in SEZ x Export turnover of the Unit in SEZ / Total turnover of the Unit in SEZ

$$40,00,000 \times \frac{80,00,000}{1,00,00,000} = 32,00,000$$

(2) Deduction @ 100% of the capital expenditure is available u/s 35AD for AY 2021-22 in respect of specified business of setting up and operating a warehousing facility for storage of agricultural produce which commences operation on or after 1st April, 2009.

Further, the expenditure incurred, wholly and exclusively, for the purposes of such specified business, shall be allowed as deduction during the previous year in which he commences operations of his specified business is the expenditure is incurred prior to the commencement of its operations and the amount is capitalized in the books of account of the assessee on the date of commencement of its operations.

Deduction u/s 35AD would, however, not be available on expenditure incurred on acquisition of land.

In this case, since the capital expenditure of ₹65 lakh (i.e. ₹75 Lakh - ₹10 Lakh, being expenditure on acquisition of land) has not been incurred in the FY 2020-21 as capitalized in the books of account on 1st April, 2021, being the date when

the warehouse became operational, ₹65,00,000, being 100% of ₹65 lakh would not qualify for deduction u/s 35AD for the Assessment year 2021-22.

[*Note* : The date of warehouse became operational mentioned as 1st April, 2021. In this case, since the capital expenditure of ₹65 lakh (i.e. ₹75 Lakh - ₹10 Lakh, being expenditure on acquisition of land) has not been incurred in the FY 2020-21 as capitalized in the books of account on 1st April, 2021, being the date when the warehouse became operational, ₹65,00,000, being 100% of ₹65 lakh would not qualify for deduction u/s 35AD for the Assessment year 2021-22.]

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# LABOUR LAWS & PRACTICE

**(Elective Paper 9.6)**

*Time allowed : 3 hours* *Maximum marks : 100*

***NOTE***: *Answer **ALL** Questions.*

**Question 1**

*A, a lawyer and B a company secretary by profession had established a firm and started giving consultancy to the various company/clients of Delhi/NCR region. In the short span of 5 years they had made good reputation and also started to appear NCLT and NCLAT.*

*For the smooth discharges of functioning of the firm they employed a team of around 20 people which includes lawyers, Stenographer, accountants, computer operators, peon and driver for smooth discharge of function. One peon X apart from his normal function also used to work as domestic servant at the house of A. The brief function of the Stenographer is to prepare the petition and other correspondence of the firm. He also entrusted with the function of making the attendance record of other staff members and maintain the diary of the cases pending before the various court, he also used to work late hours apart from his normal duty hours. After two years, the services of peon X and stenographer was terminated.*

*They raised an industrial dispute relating to their termination. Now in the lights of provisions of Industrial Disputes Act, 1947, answer the following questions :*

(a) *Whether the Firm established by Mr. A and B is covered in the domain of Industry for extending the benefits of Industrial Disputes Act, 1947 ? How far the services of domestic servants are covered under the concept of Industry of the IDA 1947 ?* *(8 marks)*

(b) *What is the principle of ''Triple Test'' for the determination of Industry ?*

*(8 marks)*

(c) *Is the term ''workman'' and ''person employed for delivering goods or services'' are the same terms under the Industrial Disputes Act, 1947 ?* *(8 marks)*

(d) *With the help of decided cases decide whether the following persons are workmen under Industrial Dispute Act, 1947 :*

*(i) A Temple Priest (ii) An engineer of XYZ Ltd. (iii) Head Constable of Delhi Police (iv) Development officer of LIC.* *(8 marks)*

(e) *With the help of decided case/reason, briefly enumerate whether the following activities can be treated as an industry :*

*(i) The ICSI, New Delhi, (ii) Central Jail (iii) A temple in which the activities of Dharma, Dhyan, Bhakti and Puja are carried out, (iv) A Registered Trade Union.*

*(8 marks)*

**Answer 1(a)**

According to the Section 2(j) of the Industrial Disputes Act, 1947, "industry" means any business, trade, undertaking, manufacture or calling of employers and includes any calling, service, employment, handicraft, or industrial occupation or avocation of workmen.

The Supreme Court carried out an in-depth study of the definition of the term industry in a comprehensive manner in the case of *Bangalore Water Supply and Sewerage Board* v. *A Rajiappa*, AIR 1978 SC 548 , after considering various previous judicial decisions on the subject and in the process, it rejected some of them, while evolving a new concept of the term "industry" by laying down triple test.

The Supreme Court observed that professions, clubs, educational institutions, co-operatives, research institutes, charitable projects and other kindred adventures, if they fulfil the triple tests listed in (1), cannot be exempted from the scope of Section 2(j). A restricted category of professions, clubs, co-operatives and gurukulas and little research labs, may qualify for exemption if, in simple ventures, substantially and going by the dominant nature criterion, substantively, no employees are entertained but in minimal matters, marginal employees are hired without destroying the non-employee character of the unit.

If in a pious or altruistic mission many employ themselves, free or for small honoranum or like return, mainly drawn by sharing in the purpose or cause, such as lawyers volunteering to run a free legal services clinic or doctors serving in their spare hours in a free medical centre or ashramites working at the bidding of the holiness, divinity or like central personality and the services are supplied free or at nominal cost and those who serve are not engaged for remuneration or on the basis of master and servant relationship, then the institution is not an industry even if stray servants, manual or technical, are hired. Such undertakings alone are exempt - not other generosity compassion, developmental compassion or project.

A solicitor's establishment can be an "industry" (as per Bangalore Water Supply and Sewerage Board v. A Rajiappa, case). Regarding liberal professions like lawyers, doctors, etc., the test of direct cooperation between capital and labour in the production of goods or in the rendering of service or that cooperation between employer and employee is essential for carrying out the work of the enterprise. The personal character of the relationship between a doctor or a lawyer with his professional assistant may be of such a kind that requires complete confidence and harmony in the productive activity in which they may be cooperating.

In view of the above, Firm established by Mr. A and B is covered in the domain of Industry for extending the benefit of and domestic service are not included in industry.

**Answer 1(b)**

According to the Section 2(j) of the Industrial Disputes Act, 1947, "industry" means any business, trade, undertaking, manufacture or calling of employers and includes any calling, service, employment, handicraft, or industrial occupation or avocation of workmen.

The Supreme Court carried out an in-depth study of the definition of the term industry in a comprehensive manner in the case of *Bangalore Water Supply and Sewerage Board* v. *A Rajiappa*, *AIR 1978 SC 548*, after considering various previous judicial decisions on

the subject and in the process, it rejected some of them, while evolving a new concept of the term "industry".

*Triple Tests for determination of "industry"*

After discussing the definition from various angles, in the above case, the Supreme Court, laid down the following tests to determine whether an activity is covered by the definition of "industry" or not. It is also referred to as the triple test.

I. (a) Where there is (i) systematic activity, (ii) organised by co-operation between employer and employee, (iii) for the production and/or distribution of goods and services calculated to satisfy human wants and wishes (not spiritual or religious but inclusive of material things or services geared to celestial bliss e.g., making, on a large scale, prasad or food) *prima facie*, there is an "industry" in that enterprise.

(b) Absence of profit motive or gainful objective is irrelevant wherever the undertaking is whether in the public, joint, private or other sector.

(c) The true focus is functional and the decisive test is the nature of the activity with special emphasis on the employer-employee relations.

(d) If the organisation is a trade or business, it does not cease to be one because of philanthrophy animating the undertaking.

II. Although Section 2(i) uses words of the widest amplitude in its two limbs, their meaning cannot be magnified to over-stretch itself. Undertaking must suffer a contextual and associational shrinkage, so also, service, calling and the like. This yields the inference that all organised activity possessing the triple elements in (i) although not trade or business, may still be "industry", provided the nature of the activity, viz., the employer - employee basis, bears resemblance to what we find in trade or business. This takes into the fold of "industry", undertaking, callings and services, adventures analogous to the carrying on of trade or business. All features, other than the methodology of carrying on the activity, viz., in organising the co-operation between employer and employee, may be dissimilar. It does not matter, if on the employment terms, there is analogy.

III. Application of these guidelines should not stop short of their logical reach by invocation of creeds, cults or inner sense of incongruity or outer sense of motivation for or resultant of the economic operations. The ideology of the Act being industrial disputes between employer and workmen, the range of this statutory ideology must inform the reach of the statutory definition, nothing less, nothing more.

**Answer 1(c)**

According to the Section 2(s) of the Industrial Disputes Act, 1947, "workman" means any person (including an apprentice) employed in any industry to do any manual, unskilled, skilled, technical, operational, clerical or supervisory work for hire or reward, whether the terms of employment be express or implied, and for the purposes of any proceeding under this Act in relation to an industrial dispute, includes any such person who has been dismissed, discharged or retrenched in connection with, or as a consequence of,

that dispute, or whose dismissal, discharge or retrenchment has led to that dispute, but does not include any such person—

(i) who is subject to the Air Force Act, 1950, or the Army Act, 1950, or the Navy Act, 1957; or

(ii) who is employed in the police service or as an officer or other employee of a prison; or

(iii) who is employed mainly in a managerial or administrative capacity; or

(iv) who, being employed in a supervisory capacity, draws wages exceeding fifteen thousand rupee per mensem or exercises, either by the nature of the duties attached to the office or by reason of the powers vested in him, functions mainly of a managerial nature.

To be a workman, a person must have been employed in an activity which is an "industry" as per Section 2(j). Even those employed in operation incidental to such industry are also covered under the definition of workman.

In the case of *J.K. Cotton Spinning and Weaving Mills Co. Ltd.* v. *L.A.T.*, AIR 1964 S.C. 737, the Supreme Court held that 'malis' looking after the garden attached to bungalows provided by the company to its officers and directors, are engaged in operations incidentally connected with the main industry carried on by the employer. It observed that in this connection it is hardly necessary to emphasise that in the modern world, industrial operations have become complex and complicated and for the efficient and successful functioning of any industry, several incidental operations are called in aid and it is the totality of all these operations that ultimately constitutes the industry as a whole. Wherever it is shown that the industry has employed an employee to assist one or the other operation incidental to the main industrial operation, it would be unreasonable to deny such an employee the status of a workman on the ground that his work is not directly concerned with the main work or operation of the industry.

Therefore, a person employed for delivering goods or services would be a workman.

**Answer 1(d)**

**(i) A Temple Priest** : A priest is not a workmen under the provisions of section 2(s) of the Industrial dispute Act. The function of the priest cannot " be equated with a mere wage earner and his services cannot be treated as manual or clerical etc. as held in the case of *Kesava Bhatt* vs. *Shree Ambulam Trust (1990) Lab LJ 192 (Ker)*.

**(ii) Engineer of XYZ Ltd.** : A person doing technical work is also held as a workmen. A work which depends upon the special training or scientific or technical knowledge of a person is a technical work. Once a person is employed for his technical qualifications, he will be held as a workmen under the provisions of Industrial Dispute Act.

**(iii) Head Constable of Delhi Police** : The Head Constable of Delhi police is not a workman under the Industrial Dispute Act, 1947 as he is performing the sovereign function, further the function of Delhi Police cannot be an Industry under any circumstance. The main function of the Delhi police is to maintain law and order which is a sovereign function. (Exception (ii) of section 2(s) of ID Act, 1947).

**(iv) Development officer of LIC** : A Development officer of LIC was held to be a workman. Keeping in view the nature of duties performed by such officers and the powers vested in them they cannot be said to be engaged in any administrative or managerial work. Designation and name of the post is not a decisive factor. It was found that a Development officer has no subordinate staff working under him, he is generally placed on par with subordinate and clerical staff. (*Standard Vacuum Oil Co.* vs. *Commissioner of labour*).

**Answer 1(e)**

(i) The ICSI, New Delhi : The ICSI is an industry within the meaning of section 2(j) of the Industrial Disputes Act, as test laid down in Bangalore Water Supply Case. As regards institutions, if the triple test of systematic activity, cooperation between employer and employee and production of goods and services were to be applied, a university, a college, a research institute or teaching institutions will be "Industry".

(ii) Central jail : Central Jail is not an industry. Maintenance of law and order is a sovereign function which strictly understood alone qualifies for exemption under the definition of Industry.

(iii) A Temple in which the activities of Dharma, Dhyan, Bhakti and puja a carried out is not an industry as held in the case of Manager, *Shri Panchasara jain derasar* vs. *Mahamandkha Gajikha Baloch*, 1993 LLJ 523. Since it falls under the inner satisfaction the triple test is not applicable in religious activities if they are merely for the satisfaction /peace for devotee.

(iv) A registered trade union cannot be held as an industry as it is meant for self-regulation of its members. Further the services for this registered trade union are voluntary and they are not undertaking any commercial activities.

**Question 2**

*(a) Mr. X was an employee of Naya International Co. with more than one-year continuous service. He was dismissed from services on account of insubordination. The Company refused to pay him bonus. Decide whether such person is entitled to any bonus ?*

*Also critically examine the disqualifications for payment of bonus.*

*(b) Write a critical analysis of significance of role of Company Secretary in case of Labour Audit.* *(6 marks each)*

**Answer 2(a)**

Payment of Bonus Act, 1965 provides for the payment of bonus to persons employed in certain establishments and for matters connected therewith. Payment of Bonus Act extends to the whole of India, and as per Section 1(3) the Act shall apply to

(a) every factory; and

(b) every other establishment in which twenty or more persons are employed on any day during an accounting year.

Every employee shall be entitled to be paid by his employer in an accounting year, bonus, in accordance with the provisions of this Act, provided he has worked in the establishment for not less than thirty working days in that year.

According to Section 9 of the Payment of Bonus Act, an employee shall be disqualified from receiving bonus under this Act, if he is dismissed from service for:

(a) fraud; or

(b) riotous or violent behaviour while on the premises or the establishment; or

(c) theft, misappropriation or sabotage of any property of the establishment.

If an employee is dismissed from service for any act of misconduct enumerated in Section 9, he stands disqualified from receiving any bonus under the Act, and not the bonus only for the accounting year in which the dismissal takes place [*Pandian Roadways Corpn. Ltd.* v. *Presiding Officer, Principal Labour Court*, (1996) 2 LLJ 606].

Thus Mr. X is not entitled for bonus in the given case.

**Answer 2(b)**

In order to ensure sound corporate governance, company secretary professional could assist the companies in conducting due diligence to ensure compliance with applicable labour laws. Due diligence is one of the core competence areas of a practicing company secretary accordingly, practicing company secretaries could assist the companies in rectifying and correcting any lacunae which are highlighted upon conducting the due diligence exercise. Labour audit covers all labour legislations applicable to an Industry/factory or other commercial establishments. Practising Company Secretaries can conduct such audits and make value addition to the business of the employer.

As stated above an Independent Professional like a Practising Company Secretary should identify various Central and State Acts and Rules that are applicable to an employer. Based on such identification, he should commence scrutinizing the compliance of provisions of the various Acts/Rules.

Labour Audit envisages a systematic scrutiny of records prescribed under labour legislations by an independent professional like Practising Company Secretary who shall report the compliance and non-compliance/extent of compliance and conditions of labour in the Indian industry/ Factory/ Other Commercial Establishments.

**Question 3**

*(a) Is the Right to Lay off can be claimed as an inherent right of the employer ?*

*(b) Briefly discuss the hours of works, welfare measures and other conditions of Building Construction Workers. (6 marks each)*

**Answer 3(a)**

According to the Section 2(kkk) of the Industrial Disputes Act, 1947, "Lay-off" (with its grammatical variations and cognate expressions) means the failure, refusal or inability of an employer to give employment due to following reasons, to a workman whose name

appears on the muster-rolls of his industrial establishment and who has not been retrenched:

(a) shortage of coal, power or raw materials, or

(b) accumulation of stocks, or

(c) break-down of machinery, or

(d) natural calamity, or

(e) for any other connected reason.

Every workman whose name is borne on the muster rolls of the industrial establishment and who presents himself for work at the establishment at the time appointed for the purpose during normal working hours on any day and is not given employment by the employer within two hours of his so presenting himself shall be deemed to have been laid-off for that day within the meaning of this clause.

Provided that if the workman, instead of being given employment at the commencement of any shift for any day is asked to present himself for the purpose during this second half of the shift for the day and is given employment, then, he shall be deemed to have been laid-off only for one-half of that day.

Provided further that if he is not given any such employment even after so presenting himself, he shall not be deemed to have been laid-off for the second half of the shift for the day and shall be entitled to full basic wages and dearness allowance for that part of the day.

From the above provisions, it is clear that lay-off is a temporary stoppage and within a reasonable period of time, the employer expects that his business would continue and his employees who have been laid-off, the contract of employment is not broken but is suspended for the time being.

The right to lay-off cannot be claimed as an inherent right of the employer. This right must be specifically provided for either by the contract of employment or by the statute (*Workmen of Dewan Tea Estate* v. *Their Management*). In fact 'lay-off' is an obligation on the part of the employer, i.e., in case of temporary stoppage of work, not to discharge the workmen but to lay-off the workmen till the situation improves. Power to lay-off must be found out from the terms of contract of service or the standing orders governing the establishment (*Workmen* v. *Firestone Tyre and Rubber Co.*, 1976 3 SCC 819).

There cannot be lay-off in an industrial undertaking which has been closed down. Lay-off and closure cannot stand together.

**Answer 3(b)**

Chapter VI (Sections 28-37) of the Building and Other Construction Workers (Regulation of Employment and Conditions of Service) Act, 1996 makes provisions for working hours, overtime wages and other social welfare of building workers.

The Appropriate Government may, by rules, a) fix the number of hours of work which shall constitute a normal working day for a building worker, inclusive of one or more specified intervals; (b) provide for a day of rest in every period of seven days

which shall be allowed to all building workers and for the payment of remuneration in respect of such days of rest; (c) provide for payment of work on a day of rest at a rate not less than the overtime rate.

Further for welfare measures and other conditions of service of building workers, the Act provides provisions pertaining to wages for overtime work; maintenance of registers and records; Prohibition of employment of certain persons in certain building or other construction work; drinking water; latrines and urinals; accommodation; creches; first-aid and canteens, etc.

**Question 4**

*(a) Discuss the constitutional validity of "Building and other Construction Workers (Regulation of Employment and Condition of Service) Act' with the help of decided cases.*

*(b) There was dispute between the management of XYZ and Co. and its workers' union, which was registered under the Trade Unions Act, 1926. The said dispute related to the introduction of productivity linked bonus scheme. The union decided to go on strike and served a notice on the management. The Union chalked out a detailed programme to make the strike success. It was decided not to resort to violence.*

*As expected, the strike which commenced on the expiry of the notice was a great success. The management wants to initiate criminal proceeding against the office bearers of the trade union and also wants to file a civil suit against the union for the loss suffered due to strike action. Advise the management according to provisions of Trade Union Act, 1926, will it make any difference in your answer, if the workers had gone on strike to protest the new Industrial policy announced by the Government? (6 marks each)*

**Answer 4(a)**

Building and Other Construction Workers (Regulation of Employment and Conditions of Service) Act, 1996 was enacted to regulate the employment and conditions of service and to provide for safety, health and welfare measures for construction workers in the country and for other matter connected therewith or incidental thereto.

The constitutional validity of the BOCW Act and the Cess Act was challenged in the Delhi High Court by the Builders Association of India. As regards the BOCW Act it was contended that it is bad for vagueness and as far as the Cess Act is concerned, it was contended that the cess is a compulsory and involuntary exaction without reference to any special benefit for the payer of the cess and therefore the cess was in fact a tax. It was contended that Parliament lacked legislative competence to impose a tax on lands and buildings which was the effect of the Cess Act.

In *Builders Association of India* v. *Union of India, ILR (2007) 1 Del 1143* the contentions urged were repelled by the Delhi High Court and the constitutional validity of the BOCW Act and the Cess Act was upheld.

The decision of the Delhi High Court was challenged and that challenge was repelled in *Dewan Chand Builders & Contractors* v. *Union of India (2012) 1 SCC 101*. The Supreme

Court, while upholding the constitutional validity of both the Acts, noted the scheme of the BOCW Act in the context of Article 21 of the Constitution and observed as follows:

*"It is thus clear from the scheme of the BOCW Act that its sole aim is the welfare of building and construction workers, directly relatable to their constitutionally recognised right to live with basic human dignity, enshrined in Article 21 of the Constitution of India. It envisages a network of authorities at the Central and State levels to ensure that the benefit of the legislation is made available to every building and construction worker, by constituting Welfare Boards and clothing them with sufficient powers to ensure enforcement of the primary purpose of the BOCW Act. The means of generating revenues for making effective the welfare provisions of the BOCW Act is through the Cess Act, which is questioned in these appeals as unconstitutional."*

The interpretation of the BOCW Act and the Cess Act was again considered in *A. Prabhakara Reddy and Company* v. *State of Madhya Pradesh (2016) 1 SCC 600*. The emphasis in this case was on registering the construction workers and providing them necessary benefits. Since the levy of cess is a fee, it was urged that urgent steps should be taken for implementation of the two Acts. It was further observed that merely because there was some delay in the effective implementation of both the statutes it could not be a ground for invalidating the levy of cess, nor could the levy of cess be said to have retrospective application.

**Answer 4(b)**

Trade Union means "any combination, whether temporary or permanent, formed primarily for the purpose of regulating the relations between workmen and employers or between workmen and workmen or between employers and employers, or for imposing restrictive conditions on the conduct of any trade or business, and includes any federation of two or more trade unions".

Trade union is a voluntary organization of workers pertaining to a particular trade, industry or a company and formed to promote and protect their interests and welfare by collective action. They are the most suitable organisations for balancing and improving the relations between the employer and the employees. They are formed not only to cater to the workers' demand, but also for inculcating in them the sense of discipline and responsibility.

Section 17 of the Act deals with Criminal conspiracy in trade disputes. It provides that no office-bearer or member of a registered Trade Union shall be liable to punishment under sub-section (2) of section 120B of the Indian Penal Code 1860, in respect of any agreement made between the members for the purpose of furthering any such object of the Trade Union as is specified in section 15, unless the agreement is an agreement to commit an offence.

Further Section 18 of the Act deals with immunity from civil suit in certain cases. It states that:

(1) No suit or other legal proceeding shall be maintainable in any Civil Court against any registered Trade Union or any office-bearer or member thereof in respect of any act done in contemplation or furtherance of a trade dispute to which a member of the Trade Union is a party on the ground only that such act induces some other person to break a contract of employment, or that it is in interference

with the trade, business or employment of some other person or with the right of some other person to dispose of his capital or of his labour as he wills.

(2) A registered Trade Union shall not be liable in any suit or other legal proceeding in any Civil Court in respect of any tortious act done in contemplation or furtherance of a trade dispute by an agent of the Trade Union if it is proved that such person acted without the knowledge of, or contrary to express instructions given by, the executive of the Trade Union.

Thus from the above and as per facts given in the case study, the management of XYZ & Co. cannot succeed in a civil suit for recovery of damages for causing loss to the property of the company or initiate criminal proceeding against the office bearers of the trade union. However, those workers who became violent and caused substantial loss to the establishment are civilly and criminally liable for their acts.

If the workers had gone on strike to protest the new Industrial policy announced by the government, the office bearers would be liable for damages as the strike in that case would not be in contemplation or furtherance of a trade dispute as defined in section 2(g) of the Trade Union Act, 1926.

**Question 5**

*(a) Highlight the importance of "Vishaka Judgement" in enactment of "The Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013".*

*(b) Necessity of Consolidation of labour laws is the need of hour. Discuss in the context of the Code on Industrial Relations, 2020. (6 marks each)*

**Answer 5(a)**

The principle of gender equality is enshrined in the Constitution, in its Preamble, fundamental rights, fundamental duties and Directive Principles. However, workplace sexual harassment in India, was for the very first time recognized by the Supreme Court of India in its landmark *judgment of Vishaka* v. *State of Rajasthan*, 1997 6 SCC 241: AIR 1997 SC 3011 ("Vishaka Judgment"), wherein the Supreme Court framed certain guidelines and issued directions to the Union of India to enact an appropriate law for combating workplace sexual harassment. In the absence of a specific law in India, the Supreme Court, in the Vishaka Judgment, laid down certain guidelines making it mandatory for every employer to provide a mechanism to redress grievances pertaining to workplace sexual harassment. ("Vishaka Guidelines") which were being followed by employers until the enactment of the Act.

The Vishaka judgment initiated a nationwide discourse on workplace sexual harassment and threw out wide open an issue that was swept under the carpet for the longest time. The first case before the Supreme Court after Vishaka in this respect was the case of *Apparel Export Promotion Council* v. *A.K Chopra*,(1999) 1 SCC 759. In this case, the Supreme Court reiterated the law laid down in the Vishaka Judgment and upheld the dismissal of a superior officer of the Delhi based Apparel Export Promotion Council who was found guilty of sexually harassing a subordinate female employee at the workplace.

In light of the above judgment, the very first efforts, towards implementing a law for protection of women from sexual harassment at workplace, were taken in 2007 when the Protection of Women against Sexual Harassment at Workplace Bill, 2007, was introduced in the Parliament. However, this Bill never saw the light of the day. On December 7, 2010, the Protection of Women against Sexual Harassment at Work Place Bill, 2010 (the "Original Bill") was introduced in Lok Sabha and was referred to a Parliamentary Standing Committee on Human Resource Development, led by Shri Oscar Fernandes ("Standing Committee"), on December 30, 2010 for examination, and the Standing Committee came out with its report in December, 2011.

Further to the report, subsequent changes were made to the Original Bill, including to the title of the Bill, which was changed to Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Bill, 2013 (the "Bill").

India's first legislation specifically addressing the issue of workplace sexual harassment; the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013 ("POSH Act") was enacted by the Ministry of Women and Child Development, India in 2013 – after 16 years of the Supreme Court judgment in the case of *Vishaka & Ors.* vs. *State of Rajasthan & Ors.* (1997 (7) SCC 323). The Act came into force w.e.f. 9th December, 2013.

**Answer 5(b)**

Labour law reforms are an ongoing and continuous process and the Government has been introducing new laws and amending the existing ones in response to the emerging needs of the workers in a constantly dynamic economic environment. The Second National Commission on Labour, which submitted its report in June, 2002 had recommended that the existing set of labour laws should be broadly amalgamated into the following groups, namely:- (a) industrial relations; (b) wages;(c) social security; (d) safety; and (e) welfare and working conditions. The Labour Code is a means to consolidate various statutes into a pruned and uncomplicated form. The amalgamated form of multiple statutes thus obtained is called a labour code. This operation is done with a view to have a unified law which can be understood and implemented with ease.

Industrial Relations Code, 2020 is an Act to consolidate and amend the laws relating to Trade Unions, conditions of employment in industrial establishment or undertaking, investigation and settlement of industrial disputes. It amalgamates, simplifies and rationalises the relevant provisions of — (a) the Trade Unions Act, 1926; (b) the Industrial Employment (Standing Orders) Act, 1946; and (c) the Industrial Disputes Act, 1947.

The important salient features of the Industrial Relations Code, 2020, inter alia, are as follows:—

— to provide for fixed term employment with the objective that the employee gets all the benefits like that of a permanent worker (including gratuity), except for notice period after conclusion of a fixed period, and retrenchment compensation.

— to bring concerted casual leave within the ambit of the definition of strike;

— to provide the maximum number of members in the Grievance Redressal Committee up to ten in an industrial establishment employing twenty or more workers.

— to provide for appeal against non-registration or cancellation of registration of Trade Union before the Industrial Tribunal;

— to empower the Central Government and the State Governments to recognise a Trade Union or a federation of Trade Unions as the Central Trade Union or State Trade Unions, respectively;

— to provide for applicability of threshold of three hundred or more workers for an industrial establishment to obtain certification of standing orders, if the standing order differ from the model standing order made by the Central Government;

— to set up Industrial Tribunals in the place of existing multiple adjudicating bodies like the Court of Inquiry, Board of Conciliation and Labour Courts;

— to remove the reference system for adjudication of Industrial Disputes, except the reference to the National Industrial Tribunal for adjudication;

— to provide that the commencement of conciliation proceedings shall be deemed to have commenced on the date of the first meeting held by the conciliation officer in an industrial dispute after the receipt of the notice of strike or lock-out by the conciliation officer;

— to prohibit strikes and lock-outs in all industrial establishments without giving notice of fourteen days;

— to provide for the obligation on the part of industrial establishments pertaining to mine, factories and plantation having three hundred or more workers to take prior permission of the appropriate Government before lay-off, retrenchment and closure with flexibility to the appropriate Government to increase the threshold to higher numbers, by notification;

— to set up a re-skilling fund for training of retrenched workers.

— to provide for penalties for different types of violations to rationalise with such offences and commensurate with the gravity of the violations;

— to empower the appropriate Government to exempt any industrial establishment from any of the provisions of the Code in the public interest for the specified period.

**Question 6**

*The legality or illegality of a strike has nothing to do with the liability for deduction of wages.*

*Even if the strike is legal, it does not save the workers from losing the salary for the period of strike. Comment with the help of decided cases.* *(12 marks)*

**Answer 6**

As per Section 2(q) of the Industrial Disputes Act, 1947 "strike" means a cessation of work by a body of persons employed in any industry acting in combination or a concerned refusal, or a refusal under a common understanding, of any number of persons who are or have been so employed to continue to work or to accept employment.

The Industrial Disputes Act, 1947 does not grant an unrestricted right of strike or lock-out. Under Section 10(3) and Section 10A (4A), the Government is empowered to issue order for prohibiting continuance of strike or lock-out. Sections 22 and 23 make further provisions restricting the commencement of strikes and lock-outs.

If a strike is in contravention of the above provisions, it is an illegal strike. Since strike is the essence of collective bargaining, if workers resort to strike to press for their legitimate rights, then it is justified. Whether strike is justified or unjustified will depend upon the fairness and reasonableness of the demands of workers.

In the case of *Chandramalai Estate* v. *Its Workmen, (1960) II L.L.J. 243 (S.C.)*, the Supreme Court observed: "While on the one hand it be remembered that strike is a legitimate and sometimes unavoidable weapon in the hands of labour, it is equally important to remember that indiscriminate and hasty use of this weapon should not be encouraged. It will not be right for labour to think that for any kind of demand a strike can be commenced with impunity without exhausting reasonable avenues for peaceful achievement of their objects. There may be cases where the demand is of such an urgent and serious nature that it would not be reasonable to expect labour to wait till after asking the Government to make a reference. In such cases, strike even before such a request has been made, will be justified".

Thus, if workmen go on strike without contravening statutory requirements, in support of their demands, the strike will be justified. In the beginning strike was justified but later on workmen indulged in violence, it will become unjustified.

In the case of *Indian General Navigation and Rly. Co. Ltd.* v. *Their Workmen, (1960) I L.L.J. 13*, the Supreme Court held that the law has made a distinction between a strike which is illegal and one which is not, but it has not made distinction between an illegal strike which may be said to be justifiable and one which is not justifiable. This distinction is not warranted by the Act and is wholly misconceived, especially in the case of employees in a public utility service. Therefore, an illegal strike is always unjustified.

It is well settled that in order to entitle the workmen to wages for the period of strike, strike should be legal as well as justified. A strike is legal if it does not violate any provision of the statute. Again a strike cannot be said to be unjustified unless the reasons for it are entirely perverse or unreasonable. Whether a particular strike is justified or not is a question of fact which has to be judged in the light of the facts and circumstances of each case, it is also well settled that the use of force or violence or acts of sabotage resorted to by the workmen during a strike disentitled them to wages for the strike period (*Crompton Greaves Limited* v. *Workmen, 1978 Lab. I.C. 1379*).

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# VALUATIONS & BUSINESS MODELLING
**(Elective Paper 9.7)**

*Time allowed : 3 hours* *Maximum marks : 100*

***NOTE** : 1. Answer ALL Questions.*

*2. Suitable assumptions, if considered necessary, may be made while answering a question. However, such assumptions must be stated clearly.*

*3. Working notes should form part of answer.*

## PART A

**Question 1**

*A Limited and B Limited are in negotiations in which A Limited has expressed the desire to acquire B Limited and it is decided that A Limited will acquire B Limited.*

*For this purpose, the following information has been extracted from the books of both and companies for Financial Year 2018-19 :*

| *Particulars* | *A Limited (₹)* | *B Limited (₹)* |
|---|---|---|
| ***Statement of profit Operations*** | *1,200* | *630* |
| *Less: cost of materials consumed, net of expenses capitalized* | *634* | *280* |
| *Other Operations Expenses* | *62* | *32* |
| *Interest* | *10* | *5* |
| *Depreciating and Amortization* | *64* | *75* |
| *Operating profit* | *430* | *238* |
| *Net Non-operating Income* | *42* | *27* |
| *Profit before tax* | *472* | *265* |
| *Tax* | *160* | *90* |
| *Profit after Tax* | *312* | *175* |
| ***Balance Sheet*** | | |
| *Share capital (Face value of shares of both the Companies 10)* | *300* | *200* |
| *Reserve and surplus* | *3210* | *1356* |
| *Non-current Liabilities* | *440* | *104* |
| Current Liabilities | 1235 | 750 |
| Total Liabilities | 5185 | 2410 |
| Net fixed Assets | 2985 | 1850 |

| | | |
|---|---|---|
| *Non-current Investments & Other Non-current Assets* | *575* | *355* |
| *Current Assets* | *1625* | *205* |
| *Total Assets* | *5195* | *2410* |
| ***Additional Information:*** | | |
| *Promoters holding in the Company* | *40%* | *30%* |
| *Free float Market Capitalization (Assuming that promoters shares are not available for trading in the market)* | *3,150* | *1,400* |

*In a joint meeting of the directors of both companies, the following decisions are taken :*

*(i) The swap ratio will be decided by considering the following parameters with the weights as given below :*

| | |
|---|---|
| *(a) Book Value* | *25%* |
| *(b) Market Price* | *40%* |
| *(c) EPS* | *25%* |
| *(d) Net Profit Ratio* | *10%.* |

*(ii) All assets and liabilities will be taken over by A Limited at book values.*

*(iii) The combined profit will increase by 10% due to synergy gains arising because of higher scale of operations.*

*(iv) It is expected that the market will look this decision of A Limited as 'a value creator' decision and consequently, it is expected that A Limited's P/E Ratio will increase by 10% from its existing level after the acquisition of B Limited.*

*Considering the above information, you are required to answer the below questions assuming that the acquisition will be completed as per the terms, given.*

*(a) Find out the Exchange Ratio of Shares for the proposed acquisition of B Limited by A Limited.*

*(b) Find out:*

*(i) Book Value per share of A Limited after acquisition (considering Capital Reserve on Takeover and without considering Capital Reserve on Takeover).*

*(ii) Earnings per share of A Limited after acquisition.*

*(iii) Market price of A Limited's share after acquisition.*

*(c) (i) Find out the new Exchange (Swap) Ratio assuming that 100% weightage is applied on Book Value, Market Value, EPS and Net Profit Ratio.*

*Give your reasoning for changes in Exchange Ratio, if any.*

*(ii) Find out the new Exchange (Swap) Ratio if Promoters holdings in A Limited is 50% and B Limited is 75% instead of 40% and 30% respectively as given above and also give your reasoning of its impact in exchange ratio, if any (Consider the same weightage given in the Problem).*

*(d) Across the world there is a fear/resistance for takeovers briefly discuss on pre-takeover and post-takeover defence strategies. (10 marks each)*

**Answer 1(a)**

| | | *A Limited (Rs. lakhs)* | *B Limited (Rs.lakhs)* |
|---|---|---|---|
| Net Worth (Share Capital + Reserves and Surplus) | (1) | 3,510.00 | 1,556.00 |
| No. of Shares (Share Capital/Face Value) (in lakhs) | (2) | 30 | 20 |
| Book Value per share | (A) = (1)/ (2) | 117.00 | 77.80 |
| Free float Market Capitalization | (3) | 3,150.00 | 1,400.00 |
| Free float in the Market = No. of shares x (1 - Promoters holding) | (4) | 18 (30 x(1-40%) | 14 (20 x{1-30%) |
| Market Price | (B) = (3)/(4) | 175.00 | 100.00 |
| Net Profit (PAT) | (5) | 312.00 | 175.00 |
| No. of Shares | (6) | 30 | 20 |
| Earnings Per Share (EPS) | (C) - (5)/(6) | 10.40 | 8.75 |
| PAT | (7) | 312.00 | 175.00 |
| Revenue from Operation | (8) | 1200.00 | 630.00 |
| Net Profit Ratio | (D) = (7)/(8) | 26% | 27.78% |

| | *A Limited* | *B Limited* | *Swap Ratio* | *Weight* | *Swap Ratio x Weight* |
|---|---|---|---|---|---|
| | *(a)* | *(b)* | *(c)= (b).(a)* | *(d)* | *E= (c)x(d)* |
| Book Value per share (A) | 117.00 | 77.80 | 1:0.665 | 25% | 0.1663 |
| Market Price (B) | 175.00 | 100.00 | 1:0.571 | 40% | 0.2284 |
| Earnings Per Share (EPS) (C) | 10.40 | 8.75 | 1:0.841 | 25% | 0.2103 |
| Net Profit Ratio (D) | 26% | 27.78% | 1:1.068 | 10% | 0.1068 |
| | | | | | **0.7118** |

Exchange or Swap Ratio is 0.712 shares of A Limited for every share of B Limited. Therefore, total no. of shares to be issues by A Limited (20 ~ 0.712) 14.24 Lacs

**Answer 1(b)(i)**

**Book Value per share of A Limited after acquisition**

Net Worth of A Limited after acquisition:

Share Capital (30+14.24) 10) = Rs. 442.40 Lacs

Reserves and Surplus (3210+1356) = Rs. 4,566.00 Lacs

Net Worth of A Limited after acquisition Rs. 5,008.40 Lacs

**Book Value per share** = (5008.40 / 44.24) = Rs.113.21

*Note: Capital Reserve of Rs. 57.60 lakhs (=20 – 14.24 = 5.76x10) arising on takeover of all assets and liabilities by A Ltd. at book value is not considered as it is not a part of distributable surplus. If the same is included Net worth is Rs. 5,066 lakhs & book value is Rs. 114.51 (5066 / 44.24).*

**Answer 1(b)(ii)**

**Earnings per share of A Limited after acquisition**

Net Profit of A Limited after acquisition

Considering 10% synergy gain = (312 + 175) x1.1= Rs. 535.70

**EPS = (535.70/44.24) Rs.12.11**

**Answer 1(b)(iii)**

**Market Price of A Limited's share after acquisition**

P/E ratio of A Limited before acquisition 16.83 (175 ÷10.40)

= New P/E Ratio of A Limited after acquisition (10% synergy impact) 18.51 [Rs. 16.83+ 1.68 (10% of 16.83)]

Therefore, Market Price (18.51 12.11(New EPS as determined in answer to question No. 1(b)(ii)) Market Price of A Limited's share after acquisition – Rs. 224.16

**Answer 1(c)(i)**

| | *A Limited* | *B Limited* | *Swap Ratio (100% Weight)* | *Present share capital of B Ltd.* | *Shares to be issued by A Limited* |
|---|---|---|---|---|---|
| | *(a)* | *(b)* | *(c)= (b)/(a)* | *20.00* | *13.30* |
| Book Value per share (A) | 117.00 | 77.80 | 1: 0.665 | 20.00 | 11.42 |
| Market Price (B) | 175.00 | 100.00 | 1: 0.571 | 20.00 | 16.82 |
| Earnings Per Share (EPS) (C) | 10.40 | 8.75 | 1:0.841 | | |
| Net Profil Ratio (D) | 26% | 27.78% | 1: 1.068 | 20.00 | 21.36 |

| **Reasons** | |
|---|---|
| Book Value | As the Book value of B Limited is almost of two third of A Limited the Shares are reduced by one third of the Value. The weighted Ratio is higher because of EPS and Net Profit Ratio, which has higher ratio than Book Value and Market Price. |
| Market Price | As the Market value of B Limited is only less than 60% of Market Price of A Limited, the swap ratio is very less and the same is also affected by promoter holdings |
| EPS | The Ratio of EPS and Weighted Average is close though only 25% weightage is given to it because the same is connected with profitability of the Company so it is close to the weighted Ratio. |
| Net Profit Ratio | As the Net Profit Ratio of B Limited is higher the swap ratio of is higher the Nominal value of shares of B Limited. But the exchange ratio under this method may be deceiving because of smaller capital base and higher profitability of B Limited. |

**Answer 1(c)(ii)**

| | | *A Limited* | *B Limited* |
|---|---|---|---|
| Free float Market Capitalization | (1) | 3,150.00 | 1,400.00 |
| Free float in the Market = No. of shares x (1 - Promoters holding) | (2) | 15 (30 % (1- 5096) | 5 (20 x(1- 75%) |
| Market Price | (B) = (1)/(2) | 210.00 | 280.00 |

| | *A Limited* | *B Limited* | *Swap Ratio* | *Weight* | *Swap Ratio x Weight* |
|---|---|---|---|---|---|
| | *(a)* | *(b)* | *(c) = (b) /(a)* | *(d)* | *e = (C) x (d)* |
| Book Value per share (A) | 117.00 | 77.80 | 1: 0.665 | 25% | 0.1663 |
| Market Price (B) | 210.00 | 280.00 | 1: 1.333 | 40% | 0.5332 |
| Earnings Per Share (EPS) (C) | 10.40 | 8.75 | 1:0.841 | 25% | 0.2103 |
| Net Profit Ratio (D) | 26% | 27.78% | 1: 1.068 | 10% | 0.1068 |
| | | | | | **1.0166** |

Exchange or Swap Ratio is 1.0166 shares of A Limited for every share of B Limited. Therefore, total no. of shares to be issues by A Limited (20 x 1.0166) 20.332 Lacs.

**Reasons:**

Free float in market has increased the number of shares to be obtained from 14.24 Lacs

to 20.332 Lacs as a result of this B Limited shareholders will get more than what they have got because of higher promoter holding and free float Market price. One more interesting thing will be the ratio is almost close to the Net Profit Ratio. So it is clear that higher will be the promoter holding higher will be free float Market price of a share due to lesser amount of quantity of shares available for trading.

**Answer 1(d)**

**Pre-takeover Defence Strategies**

The takeovers are often subject to resistance and some of the key ones are listed and described below.

**Poison Pills** : The poison pill is a legal device that makes it prohibitively costlier for an acquirer to take control of the target, without the prior approval of the target's board of directors. Most poison pills make the target company less attractive by creating rights that allow for issuance of shares of the target company at a substantial discount to market value.

There are two types of such poison pills, flip-in pill and flip-over pill. In case of a flip-in pill, these rights remain inactive until a threshold limit is reached, say 10%. So, in case 10% of the shareholding for any investor is breached, these pills are activated and immediately allow the shareholders (except the acquirer) of the targel company to purchase the shares of the target company at a substantial discount (say 50%). Now, suppose all the existing shareholders exercise the right, and purchase these shares. Hence, the number of existing shares double and if it is a cash-for-share exchange, the number of shares that need to be compensated for by the acquirer doubles and if the acquisition price remains unchanged, the cash outlay for the acquirer would double and hence makes the transaction unattractive. In case of a flip-over pill, these allow rights to the shareholders of the target company to acquire shares of the acquirer (or the surviving combined firm) at a substantial discount which also makes the deal unattractive at the outset.

**Poison Puts** : In case of poison puts, the bond-holders of the target company have the right to put the bonds back at the company at a pre-specified redemption price. Hence, this provision also gels triggered by a hostile takeover attempt and what happens is that there is an immediate cash drain as these bonds have to be redeemed by the Company at a higher than par value price , typically. The effect of this poison put therefore is that an acquirer must be prepared to refinance the target's debt immediately after take over to cover the cash crunch and hence raises the cost of acquisition.

**Restricted Voting Rights** : Some target companies adopt a mechanism that restricts the shareholders who have recently acquired a big chunk of shares or who have exceeded a threshold % of shareholding, from voting on these shares. Shareholders who exceed this trigger point are no longer able to exercise voting rights on these shares unless the board of the target company releases the constraint. Hence, the very possibility of taking the effort to acquire a controlling stake but not being able to vote on these shares serves as a dampener.

**Golden Parachutes** : These are compensation arrangements between the senior management and the target company. These contracts allow the senior executives to receive hefty cash settlements, if they leave pursuant to a change in control, and this stretches 10 a number of years' salary which is an attractive exit option. One reason

these persist is that the senior executives have little fear of job losses and prefer to stick on till they exercise the exit option and without these Golden Parachutes, the target company executives would have left for better offers quicker to secure their future. However, from an acquirer's perspective, the impact may not be much as compared to the overall takeover consideration,

***Post-takeover defence strategies***

**Share Repurchase** : After the takeover is initiated. a target may initiate a cash tender offer for its own outstanding shares. An effective repurchase offer has the potential to increase the cost for the takeover (takeover premium) as the acquirer will now have to alter its bid upwards for it to remain competitive. That itself could be a put off for the deal.

**Leveraged Buy Out** : In case of a leveraged buyout, the management of the target can partner with a private equity firm that specialises in buyouts to put in some capital and the remaining purchase price comes through from borrowings and hence the term "leveraged". With the proceeds that come in, that is used to is used to buy all the shares of the target company. Hence, essentially what is done is the target company buys all its shares to convert in to a private limited company in the transaction, called Leveraged Buy Out (LBO). The stakes therefore in the target company now shift to the Private Equity Firm (may be 10%) and the balance 90% of the firm is financed by debt (Banks). Now, the Private Equity Firms enjoy the effects of financial leverage that can magnify the returns, the only catch is that there has to be a due diligence conducted prior to conclude that the target company has sufficient strength in the profit and cash forecasts to be able to cover the future debt payments. The management then is compensated basis the performance of the f firm post the LBO is completed.

This strategy therefore allows the target to defend against a hostile bid provided that the LBO provides to the target shareholders a price that is greater than the takeover price offer by the acquirer.

**Pac Man Defence** : The target can defend itself by making a counter-offer to acquire the hostile bidder. This is a rarely used technique as it is unlikely that the smaller company (target) makes a bid for the larger company (acquirer).

**White Knight Defence** : This is probably one of the best outcomes for the target shareholders. The way it works essentially is that the management or board of the target company to seek a third party to purchase the company in lieu of the hostile bidder. This third party is called the "White Knight", as it is coming to the aid of the target. This technique is used by the target when the acquisition by the white knight sounds like a strategic fit as compared to the hostile bidder. Based on this strategic fit, the third party can also justify a higher price for the target than what the hostile bidder is offering. In such cases, the winners curse prevails, as often such negotiations are driven by a tendency for the winner to overpay to grab the deal and this competitive bidding ends up being extremely favourable for the target shareholders.

**Question 2**

*(a) PQ Machines Ltd. has a machine having an additional life of 5 years, which costs ₹ 2,00,00,000 and which has present book value of ₹50,00,000, which will run for another 5 years without additional maintenance cost and has no salvage value. A new machine costing ₹ 4,40,00,000 is available. Though its capacity is same as that of the old machine, it will mean a saving in variable costs to the*

*extent of ₹1,40,00,000 p.a. The life of the machine will be 5 years at the end of which it will have a scrap value of ₹ 80,00,000. The rate of income tax is 30% and PQ Machines Ltd. does not make an investment, if it yields less than 12%. The old machine, if sold, will fetch ₹ 20,00,000.*

*Advise PQ Machines Ltd. whether the old machine should be replaced or not.*

*Note :*

*P.V. of ₹1 receivable annually for 5 years at 12% = 3.605*

*P.V. of ₹1 receivable at the end of 5 years at 12% = 0.567*

*P.V. of ₹1 receivable at the end of 1 year at 12% = 0.893.*

*(b) State whether the following statements are true or false with reasons :*

*(i) Divestitures represent the sale of a part of a total undertaking.*

*(ii) In a reverse merger a smaller company acquires a larger company.*

*(iii) Stock Dividends and Stock Splits may increase the stock price but not the value of the business.*

*(iv) Under discounted cash flow model of asset valuation, estimated cash flows during life of the asset are not required.*

*(v) Buying the units of mutual funds is an indirect investment. (5 marks each)*

**Answer 2(a)**

**Statement Showing the Net Present Value of New Machine**

| | | |
|---|---|---|
| Cash Inflow Saving in Variable Cost | | 1,40,00,000 |
| *Less* : Dep. on new machine | | |
| = (4,40,00,000 - 80,00,000)/5 | 72,00,000 | |
| *Less* : dep. On old machine | 10,00,000 | |
| = (50,00,000/5) | | 62,00,000 |
| Net Profit | | 78,00,000 |
| *Less* : Tax @ 30% | | 23,40,000 |
| **Net Inflow/ saving after Tax** | | 54,60,000 |
| *Add* : depreciation | | 62,00,000 |
| Annual Cash inflow | | 1,16,60,000 |
| P.V. of Cash inflow for 5 years = Rs. 1,16,60,000 x 3,605 | | 4,20,34,000 |
| *Add* : P.V. of scrap value at the end of 5 years | | |
| = Rs. 80,00,000 x 0.567 | | 45.36.000 |
| **P.V. of total cash inflow** | | **4,65,70,000** |
| *Less* : P.V. of cash outflow | | |
| (4,40,00,000 – 20,00,000) | | 4,20,00,000 |
| Net Present Value | | 45,70,000 |

Since, the NPV is positive; it is profitable to install the new machine. The old machine should be replaced.

**Answer 2(b)**

(i) **True.** Divestiture is the partial or full disposal of an investment or asset through sale, exchange, closure or bankruptcy. Divestiture can be done slowly and systematically over a long period of time, or in large lots over a short time period. For a business, divestiture is the removal of assets from the books.

(ii) **True.** Reverse Merger is the acquisition of a public company by private company.

(iii) **True.** A stock split increases the number of shares in a public company. The price is adjusted such that before and after, market capitalisation of company remains same. Stock dividend is payment of dividend in form of shares without increasing the market capitalisation of company.

(iv) **False.** Under DCF model, present value of asset is arrived at determining the present values of all expected future cash flows from the use of the asset.

(v) **True.** A mutual fund is simply a collection of stocks, bonds, another securities owned by a group of investors and managed by professional investment company.

**Question 3**

*(a) A project costs 600 Crore, has a life time of 10 years, and SV = ₹100 Crore at the end of 10 years. The company uses straight-line depreciation and the corporate tax rate is 25%. A new machine generates revenue of ₹200 Crore yearly for the next ten years and has expenses of ₹75 Crore yearly for the next ten years. The cost of capital is 10%. Find NPV and Payback period (PVIFA = 6.145, PVIF = .386).*

*(b) Zigzag Ltd. belongs to a risk-class for which the appropriate PE ratio is 15. It currently has 75,000 outstanding shares selling at ₹150 each. The company is contemplating declaration of dividend @ ₹ 12 per share at the end of the current fiscal year, which has just started. Given the assumption of Modigliani Miller approach, answer the following questions :*

*(i) What will be the price of the share at the end of the year, if :*

*(a) dividend is not declared ?*

*(b) dividend is declared ?*

*(ii) Assuming that the company pays dividend, has net income of ₹7,50,000 and makes new investments of ₹15,00,000 during the period, how many new shares must be issued ?* *(5 marks each)*

**Answer 3(a)**

Depreciation = INR 600 Crore / 10 years = INR 60 Crore years

= CF1 – 10 = (R-E) (1-t) +D (t) = (200 – 75) (1 - 25) + 60 (.25)

= (125) (.75) + 60(.25)

= 93.75 + 15

= 108.75 Crore

CFT = 10 Recovery of SV after tax = 100 (1 - 25) = INR 75 Crore

PV of cash inflow = 108.75 [PVIFA (10%, 10 year) + 75 [PVIF (10%, 10 year)]

= [108.75 (6.145) + 75 (.386)]

= 668.27 + 28.95

= INR 697.22 Crore

NPV = 697.22 – 600 = INR 97.22 Crore

Pay Back = 600 / 108.75 = 5.5 Years

**Answer 3(b)**

Given

| | | |
|---|---|---|
| P/E | = | 15 |
| N | = | 75,000 shares |
| P0 | = | 150 |
| D1 | = | Rs. 12 |
| E | = | Rs. 7,50,000 |
| I(Investment) | = | Rs. 15,00,000 |
| Ke | = | 1/(P/E Ratio) |

**(a) If dividend is not declared:**

P0 = (DI + P1)/(1 + Ke)

DI = 0,: P0 = PI/(1+Ke); or P1 = P0 (1+Ke)

: P1 = 150 (1+1/15); or P1 = Rs. 160

**(b) If dividend is declared:**

Then, P0 = (DI + P1)/(1 + Ke)

or 150 = (12 + P1)/(1+1/15)

or 12 + P1 = (150 x 16/15); or PI = 160 - 12 = Rs. 148

**If the Company pays Dividend:**

P1 = Rs. 148;

No. of shares to be issued: n = (1 - E+nDI)/P1

No. of New shares, n= [(15,00,000 - 7,50,000 + (75,000x12)] / 148

or, n= (7,50,000 + 9,00,000)/148; or n= 16,50,000 /148 = 11,148.65 (11,149) shares

**Question 4**

*(a) This Standard will bring much needed uniformity in valuation and accounting of share-based benefits—Name the Standard. Discuss its objective, scope and recognition. (5 marks)*

*(b) The following financial share data pertaining to XYZ Tech Ltd. an IT company are made available to you :*

*(₹ in Crore)*

| *Years ended March, 31st* | *2018* | *2017* | *2016* |
|---|---|---|---|
| *EBIT* | *696.03* | *325.65* | *155.86* |
| *Non-branded Income* | *53.43* | *35.23* | *3.46* |
| *Inflation Compounded Factor @ 8%* | *1.000* | *1.087* | *1.181* |
| *Remuneration of Capital* | *5% on Average Capital employed* | | |
| *Average Capital Employed* | *₹1112.00 Crores* | | |
| *Corporate Tax rate* | *35%* | | |
| *Capitalization Factor* | *16%* | | |

*You are required to calculate the Brand value for XYZ Tech Ltd. (5 marks)*

**Answer 4(a)**

Ind AS 102 will bring much needed uniformity in valuation and accounting of share-based benefits.

The objective of this Standard is:

1. To specify the financial reporting by an entity when it undertakes a share-based payment transaction.
2. It requires an entity to show in its profit or loss and financial position what is the effects of share-based payment transactions, including expenses.

   To summarize, the objective of this Accounting standard is to recognise share-based payment transactions in its financial statements.

   **Scope**

   1. This standard is applicable for all share-based payment transactions
   2. All share-based payment transactions even if entity can't identify specifically some or all Services received, including
      - Equity settled share-based payment transactions
      - Cash settled share-based payment transactions
      - As per terms of arrangement of receiving goods or services, the entity or supplier can settle transaction in cash or equity shares

**Examples**

i) Share options

ii) Share based payments with cash alternatives

iii) Share appreciation rights

iv) Restricted shares

3. Ind AS 102 covers share-based payment arrangements, not merely share-based payment transactions A share-based payment arrangement is an agreement between the entity (or another group entity as defined in Ind AS 110 or any shareholder of any group entity) and another party (includes an employee) that entitles the other party to receive.
4. Ind AS 102 thus applies to share-based payment transaction settled by another group entity

**Recognition**

**Unless a transaction is not recognised there would be no accounting entry passed for it.**

**The following transactions are recognised:**

Goods or services received or acquired in a share based payment transaction are recognised only when it receives the goods or as the services. It shall also recognise a corresponding increase in equity if goods and services were acquired in a equity settled share based payment transaction and liability in case of cash settled share based payment transaction When goods or services so acquired or received under share based payment transaction, do not qualify for recognition as assets, they shall be recognised as expenses.

An expenses arises from consumption of goods or services. Consumption of services: immediately and hence recognised immediately Consumption of goods : over a period of time or at a later date, so the expense is recognised when the goods are consumed

**Answer 4(b)**

| *Year ended March 31st* | *2018* | *2017* | *2016* |
|---|---|---|---|
| **EBIT** | 696.03 | 325.65 | 155.86 |
| *Less* : Non-brand income (Rs.) | 53.43 | 35.23 | 3.46 |
| Adjusted Profits (Rs.) | 642.60 | 290.42 | 152.40 |
| Inflation compound factor @ 8% 1.000 | 1.087 | 1.181 | |
| Present value of profits for the period (Rs.) | 642.60 | 315.69 | 179.98 |
| Weightage Factor | 3 | 2 | 1 |
| Weighted Profits (Rs.) | 1927.80 | 631.38 | 179.98 |
| Profits (Rs.) | 456.53 | | |
| Remuneration of capital (5% of Average capital employed) | 55.60 | | |
| Brand Related Earnings | 400.93 | | |

| | |
|---|---|
| Corporate Tax @ 35% | 140.33 |
| Brand Earning | 260.60 |
| Capitalization Factor | 16% |

Brand Value: (Return / Capitalization Rate) 260.60/0.16= Rs. 1628.75 Crore

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**PART B**

**Question 5**

*(a) State whether the following statements are true or false with reasons :*

*(i) Price ratios are not a parameter to get an idea of whether a stock (share) price is reasonable or not.*

*(ii) Return on Assets (RoA) is not an indicator that how good a Company is using its assets to make money.*

*(iii) The current ratio measures a Company's ability to pay its long-term liabilities with its short-term assets.*

*(iv) The more the interest coverage ratio riskier it is.*

*(v) Each Company sets its own dividend policy according to what it thinks is in the best interest of its shareholders. (5 marks)*

*(b) Divya, an Information Technology graduate has developed a Mobile application to connect professionals of a same profession across country. She would like to attract more users for her app and also wants to generate revenue through them. But she is confused to devising a suitable business model for her idea. She has approached you to device a suitable business model for her application.*

*As a Business Model consultant advice Divya on suitable business and explain her why it will work and also brief her success stories on the model suggested by you. (5 marks)*

*(c) The following figures apply to a small manufacturing company.*

| *Particulars* | *Amount (₹)* |
|---|---|
| *Annual sales for the previous year* | *46,00,000* |
| *Profit after tax for the previous year* | *2,70,960* |
| *Budgeted annual sales for the next year* | *48,40,000* |
| *Budgeted profit after tax for the next year* | *2,80,000* |

*In the first of the two years, the average total assets amounted to ₹ 40,00,000, and are estimated to be ₹ 44,00,000 for the next year. Assuming full budget realization and taking turnover into account, calculate the alteration that will take place in the ratio representing return on capital employed and discuss the reasons for such alteration.*

*(5 marks)*

**Answer 5(a)**

a) State whether the following statements are true of false with reasons:

i) Price ratios are not a parameter to get an idea of whether a stock (share) price is reasonable or not

**False, Price ratios are used to get an idea of whether a stock price is reasonable or not.** But it is a relative metrics. They are useful only when comparing one company's ratio to anther company's ratio. A company's ratio to itself over time or a company's ratio to a bench mark.

ii) Return on Assets (RoA) is not an indicator that how good a Company is using its assets to make money.

**False, Assets Ratio indicates how good a Company is using its assets to make money**

iii) The current ratio measures a Company's ability to pay its long-term liabilities with its short-term assets.

**False, the current ratio measures a Company's ability to pay its short-term liabilities with its short-term assets.**

iv) The more the interest coverage ratio riskier it is.

**False, the ratio measures how well a company can meet its interest payment obligations. It's by measured by EBIT/Interest expenses. The more the interest coverage ratio less risky it is.**

v) Each Company sets its own dividend policy according to what it thinks is in the best interest of its shareholders.

**True, Shareholders are the ultimate authorities to decide the amount of dividend to be declared and there is no policy prescribed under the Companies Act on this.**

**Answer 5(b)**

Divya can follow freemium model for her application. This combination of "free" and "premium" has become a widely used approach amongst startups over the last decade. Broken down, the model offers a basic service to consumers for free, while charging for premium services (advanced features and perks) to paying members. Linkedin is one of the best examples of a successful freemium model, with the free version letting users share professional profiles, while the premium offerings are talent solutions and premium subscriptions with added features. One of the most interesting reasons Linkedin's model works is because each new member that signs up for free or premium increases the value for other members. Make sure if you choose this model that you find a balance between what you give away so that users will still need or want to upgrade to a paid plan.

**Why It Works** : One of the greatest advantages to a freemium strategy lies in its ability to be a marketing tool for your service, which helps early stage startups scale by attracting a user base without costly ad campaigns. Freemium models also tend to be

more successful that 30 day free trials and other offers like that. Customers are much more comfortable with accessing a service for free, and the no strings attached feeling that comes with before deciding to make a purchase.

**Others Who Have Followed** : Dropbox, Hulu, and Match.com are all very popular services that have adopted a successful freemium model. Dating app Tinder has also adopted a freemium model, offering exclusive features to users who pay a low monthly fee. Survey service PollDaddy, video sharing service Vimeo, and photo sharing service Flickr are all members of the freemium model group as well.

**Answer 5(c)**

**Previous Year:**

(Profit / Sales x 100) x (Sales / Capital employed x 100) = (Profit / Capital employed x 100)

(2,70,960/46,00,000x100)x (46,00,000/40,00,000 x 100) = (2,70,960 / 40,00,000 x 100)

5.89% x 115% = 6.77%

**Next Year:**

(Profit / Sales x 100) x (Sales / Capital employed x 100) = (Profit / Capital employed x 100)

(2,80,000/48,40,000x100) x (48,40,000 / 44,00,000 x 100) = (2,80,000 / 44,00,000 x 100)

5.79% x 110% = 6.36%

The reasons for the change in the ratio of return on capital employed, i.e., from 6.77 per cent to 6,36 per cent are:

I. The profit to turnover ratio has decreased from 5.89 per cent to 5.79 per cent representing a very slight declination.

II. The capital turnover ratio has declined significantly from 115 per cent to 110 per cent. Although sales have improved, the additional capital employed has not resulted in a proportionate increase in sales this will be clear from the following:

Increase in capital employed by Rs. 4,00,000 i.e., 10 per cent on original capital.

Increase in sales Rs. 2,40,000 i.e., 5.2 per cent over previous year's sales.

Again, if the additional return on additional capital employed is compared with the previous year's return on capital employed, the following result will be obtained:

= (Addl. Profit / Addl. Capital employed) x 100

(9,040 / 4,00,000 ) x 100 = 2.26%

When the amount of capital employed is computed on the basis of the assets side of the balance sheet, the following adjustments should be made:

1. Intangible assets like goodwill, patents, trademarks, etc. should be excluded unless they have definite market values.

2. Fictitious assets, e.g., preliminary expenses, cost of issue of share/debentures, deferred advertisement expenses, should be excluded.

3. Idle or unused assets, e.g., plant and machinery, excess cash and bank balance, if any, should not be taken into account.

4. Obsolete stock items and debts, which are likely to become had should be deducted from inventories and debtors respectively.

While computing profit, extraneous and fortuitous expenditure and income and abnormal losses and gains should be excluded.

The ROCE ratio is the indicator of the profitability or otherwise of a firm. In other words, the higher the return, the more profitable is the position of the firm, and vice versa.

**Question 6**

*(a) State whether the following statements are true or false with brief reasons :*

*(i) Cash flows cannot be managed by improving receivables.*

*(ii) Top-line sales growth can conceal a lot of problems.*

*(iii) Don't always focus on the lowest price when choosing suppliers.*

*(iv) Subtracting total cash required from opening cash balance yields the cash position before borrowings and inflows from savings.*

*(v) Cash flow Management means delaying outlays of cash as long as possible and encouraging anyone who owes you money to pay it as rapidly as possible.*
*(5 marks)*

*(b) 'Forecasting revenue is one of the biggest challenges for the business Modeller'. Comment and discuss on various approaches to Revenue Forecasting.*
*(5 marks)*

*(c) AKQJ Ltd. sells goods on a gross profit of 25%. Depreciation is considered as a part of cost of production. The following are the annual figures given to you :*

| | |
|---|---|
| *Sales (Debtors: 2 Months of Cost of Sales)* | *₹18,00,000* |
| *Materials consumed (1 month credit)* | *₹4,50,000* |
| *Wages paid (1 month lag in payment)* | *₹3,60,000* |
| *Cash manufacturing expenses (1 month lag in payment)* | *₹4,80,000* |
| *Administrative expenses (1 month lag in payment)* | *₹1,20,000* |
| *Sales promotion expenses (paid quarterly in advance)* | *₹60,000* |

*The company keeps one month's stock each of raw materials and finished goods.*

*It also keeps ₹ 1,00,000 in cash. You are required to estimate the working capital requirements of the company on cash cost basis, assuming 15% safety margin.* *(5 marks)*

**Answer 6(a)**

**State whether the following statements are true or false with brief reasons:**

i) Cash flows cannot be managed by improving receivables

**False, better receivable management system will solve lots of cash flow issues**

ii) Top-line sales growth can conceal a lot of problems

**True, while managing growing company it is very important to have control on expenses, faster growth in sales will conceal all these problems**

iii) Don't always focus on the lowest price when choosing suppliers

**True, sometimes more flexible payment terms can improve cash flow more than a bargain-basement price.**

iv) Subtracting total cash required from opening cash balance yields the cash position before borrowings and inflows from savings.

**False, subtracting total cash required from total cash available only yields the cash position before borrowings and inflows from savings.**

v) Cash flow Management means delaying outlays of cash as long as possible which encouraging anyone who owes you money to pay it as rapidly as possible.

**True, Managing the time, you have to pay your suppliers and employees and time you collect from you customers is called cash flow Management.**

**Answer 6(b)**

Forecasting revenue is one if the biggest challenges for the business modeller. The first problem is producing a meaningful and useful definition of the market place. In the telecommunications, information technology and media sectors. for instance, there is such a high degree of convergence that it is becoming increasingly difficult to distinguish between the separate markets. Modellers may also have incomplete or inaccurate data as a basis for their forecasts. Even when an industry-wide revenue forecast has been produced, estimating a business's market share of that revenue can be even more difficult. Market share has many determinants and some important factors, like, brand strength, are difficult to gauge and incorporate in the model.

**Approaches to Revenue Forecasting**

The different approaches to forecasting can be classified in several ways. A useful classification is as follows:

i) *Extrapolation techniques* : Extrapolation techniques, like, lime series analysis, implicitly assume that the past will be a reasonable predictor of the future. This assumption may be valid for mature and stable businesses, like the water and gas utilities. However, many industry sectors are experiencing rising levels of structural change. The use extrapolative techniques for these sectors may provide poor results.

ii) *Causative techniques* : Causative techniques, such as, multiple regression, attempt to comprehend the basic relationships that determine the dynamics of a market. This understanding, combined with a set of assumptions about the

future, provides the basis for the forecast. Because the underlying relationships are often estimated from historical data, these techniques are useful when only small, incremental changes in assumptions are expected in the future.

iii) *Judgmental techniques* : Modellers may often be asked to produce a forecast for a new product or market where there are no available historic data. In these cases, forecasting can become judgmental and highly subjective. Although the forecasts can be refined through studying the results of market research and by examining the experiences of similar or related products in other markets and countries, the task of forecasting becomes more like an art than a science.

In practice, majority of modellers depend on a blend of all three techniques. They may establish the current market trends through time series analysis, and attempt to understand market dynamics through multiple regression methods. This understanding will then be combined with their belief of how these relationships might develop in the future to produce a forecast.

**Answer 6(c)**

**Statement of Working Capital Requirement**

*(In Rs.)*

| *Particulars* | *Amount* | *Amount* |
|---|---|---|
| **Current Assets** | | |
| Minimum Cash Balance | 1,00,000 | |
| Debtors (Cost of Sales: (14,70,000 x 2/12) | 2,45,000 | |
| Prepaid Sales promotion expenses | 15,000 | |
| **Inventories:** | | |
| Raw Materials (450,000/12) | 37,500 | |
| Finished Goods (12,90,000/12) | 1,07,500 | |
| **Total Current Assets** | | 5,05,000 |
| **Current Liabilities** | | |
| Sundry Creditors (450,000/12) | 37,500 | |
| Outstanding Manufacturing Expenses (480,000/12) | 40,000 | |
| Outstanding Administrative Expenses (120,000/12) | 10,000 | |
| Outstanding Wages (360,000/12) | 30,000 | |
| **Total Current Liabilities** | | 1,17,500 |
| **Excess of Current Assets over Current Liabilities** | | 3,87,500 |
| *Add* : 15% for contingencies | | |
| Net Working Capital | | 58,125 |
| | | 4,45,625 |

*Workings*

| Cost Structure | Amount | Amount |
|---|---|---|
| Sales | 18,00,000 | |
| Gross Profit (25%) | 4,50.000 | |
| Cost of Production | | 13,50,000 |
| *Less* : Cost of Materials | 4,50,000 | |
| *Less* : Wages | 3,60,000 | |
| *Less* : Cash Manufacturing Expenses | 4,80,000 | 12,90,000 |
| **Depreciation** | | **60,000** |
| Total Cash Cost | | |
| Cost of Production | | 13,50,000 |
| *Less* : Depreciation | | 60,000 |
| Total Cash Cost of Production | | 12,90,000 |
| *Add* : Administrative Expenses | 1,20,000 | |
| *Add* : Sales Promotion Expenses | 60,000 | 1,80,000 |
| **Total Cash Cost of Sales** | | **14,70,000** |

***

# INSOLVENCY - LAW AND PRACTICE

**(Elective Paper 9.8)**

*Time allowed : 3 hours* *Maximum marks : 100*

**NOTE** : *Answer **ALL** Questions*

**Question 1**

*Images Gym Ltd. was granted credit facility of ₹100 lakh under consortium arrangements.*

*Under the consortium, there were 5 five banks, and credit facility provided by the respective banks were as under :*

| | | |
|---|---|---|
| *A-One Bank Ltd.* | - | *₹45 lakh,* |
| *Best Bank Ltd.* | - | *₹20 lakh,* |
| *Good Deal Bank Ltd.* | - | *₹15 lakh,* |
| *Credit Arrangers Bank Ltd.* | - | *₹10 lakh and* |
| *Your Bank Ltd* | - | *₹10 lakh* |

*Among theses the A-One Bank Ltd. was the leader.*

*Images Gym Ltd. was engaged in the business of manufacturing and trading of Gym exercise machines. However, due to poor demand of the products, the company could not sell out the machines and as a result the account of the company with respective banks were classified as Non-performing Advances (NPAs).*

*Apart from credit facility from the above banks, the company was also having outstanding dues of the creditor, which the company was not able to pay-off. The total amount outstanding of such operational creditors amounted ₹30 lakh.*

*The company has also not paid the salary to its employees and workers for the last 6 months and the total dues amounted to ₹10 lakh.*

*The leader of the consortium filed Corporate Insolvency Resolution Process (CIRP) with the Adjudicating Authority (AA) and proposed the name of Saket Sharma, as Interim Resolution Professional (IRP).*

*The AA accepted the application and appointed Saket Sharma as IRP and put moratorium.*

*The IRP constituted the Committee of Creditors (CoC) and first meeting of the CoC was called upon.*

*The operational creditors objected about the constitution of the committee and asked the IRP to include operational creditors also in the CoC, which the IRP denied.*

*The CoC observed that IRP is not discharging his functions properly and was reluctant in calling the expression of interest from Resolution Applicant(s), so they proposed*

*for the change of the existing IRP and appointment of the new Resolution Professional (RP) named as Anubhav Dutt.*

*The RP called the expression of interest from the eligible applicants and each proposal was placed before the CoC, but no consensus had arrived at. The initial period of 180 days was going to elapsed so the CoC through the RP sought extension which the Adjudicating Authority for further 90 days. The RP again called the expression of interest from other Resolutionm Applicants, but it was also not agreed upon by the CoC and after lapse of total 270 days, the Adjudicating Authority ordered for its liquidation and the present RP was appointed as Liquidator.*

*The Liquidator sold off the assets of the Company and realised only ₹150 lakh, whereas the outstanding dues of the various stakeholders remained as under.*

| ***Dues of*** | ***₹ in Lakhs*** |
|---|---|
| *Fee payable as Resolution Professional* | *10* |
| *Fee payable as Liquidator* | *10* |
| *Dues of the banks with interest* | *110* |
| *Outstanding from Operational Creditors* | *30* |
| *Dues of Govts.* | *15* |
| *Workmen's dues* | *10* |
| *Employee's salary* | *15* |
| *Equity shareholders* | *30* |
| ***Total*** | ***230*** |

*Based on the above information, answer the following questions:*

*(a) Mention the provisions relating to the constitution of the Committee of Creditors (CoC) under the Insolvency and Bankruptcy Code, 2016. In the instant case, the IRP did not included the Operational Creditors. Whether this action of the IRP was justified? (10 marks)*

*(b) Comment on the following:*

*(i) How the voting of share shall be determined in the meeting of the CoC, since in the given case the finance was made available under the consortium arrangement.*

*(ii) What would have been the position of constitution of the CoC, if some of the operational creditor had assigned their rights in favour of the financial creditor? (7+3=10 marks)*

*(c) What is the meaning of 'Resolution Plan' and 'Resolution Applicant'? List out the persons not eligible to be 'Resolution Applicant'. (2+2+6=10 marks)*

*(d) Explain relevant provisions for distribution of assets by the liquidator. How the liquidator will pay-off the dues in priority order of various stakeholders in the given case? (5+5=10 marks)*

**Answer 1(a)**

Section 21 of the Insolvency and Bankruptcy Code, 2016 (IBC) deals with the provisions relating to the committee of creditors (CoC):

(1) The interim resolution professional shall after collation of all claims received against the corporate debtor and determination of the financial position of the corporate debtor, constitute a committee of creditors.

(2) The committee of creditors shall comprise all financial creditors of the corporate debtor:

Provided that a financial creditor or the authorized representative of the financial creditor referred to in sub-section (6) or sub-section (6A) or sub-section (5) of section 24, if it is a related party of the corporate debtor, shall not have any right of representation, participation or voting in a meeting of the committee of creditors:

Provided further that the first proviso shall not apply to a financial creditor, regulated by a financial sector regulator, if it is a related party of the corporate debtor solely on account of conversion or substitution of debt into equity shares or instruments convertible into equity shares or completion of such transactions as may be prescribed, prior to the insolvency commencement date.

(3) Subject to sub-sections (6) and (6A), 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 and their voting share shall be determined on the basis of the financial debts owed to them.

(4) Where any person is a financial creditor as well as an operational creditor-

a. such person shall be a financial creditor to the extent of the financial debt owed by the corporate debtor, and shall be included in the committee of creditors, with voting share proportionate to the extent of financial debts owed to such creditor;

b. such person shall be considered to be an operational creditor to the extent of the operational debt owed by the corporate debtor to such creditor.

(5) Where an operational creditor has assigned or legally transferred any operational debt to a financial creditor, the assignee or transferee shall be considered as an operational creditor to the extent of such assignment or legal transfer.

(6) Where the terms of the financial debt extended as part of a consortium arrangement or syndicated facility provide for a single trustee or agent to act for all financial creditors, each financial creditor may-

a. authorize the trustee or agent to act on his behalf in the committee of creditors to the extent of his voting share;

b. represent himself in the committee of creditors to the extent of his voting share;

c. appoint an insolvency professional (other than the resolution professional) at his own cost to represent himself in the committee of creditors to the extent of his voting share; or

d. exercise his right to vote to the extent of his voting share with one or more financial creditors jointly or severally.

(6A) Where a financial debt-

a. is in the form of securities or deposits and the terms of the financial debt provide for appointment of a trustee or agent to act as authorized representative for all the financial creditors, such trustee or agent shall act on behalf of such financial creditors;

b. is owed to a class of creditors exceeding the number as may be specified, other than the creditors covered under clause (a) or sub-section (6), the interim resolution professional shall make an application to the Adjudicating Authority along with the list of all financial creditors, containing the name of an insolvency professional, other than the interim resolution professional, to act as their authorized representative who shall be appointed by the Adjudicating Authority prior to the first meeting of the committee of creditors;

c. is represented by a guardian, executor or administrator, such person shall act as authorized representative on behalf of such financial creditors,

and such authorized representative under clause (a) or clause (b) or clause (c) shall attend the meetings of the committee of creditors, and vote on behalf of each financial creditor to the extent of his voting share.

(6B) The remuneration payable to the authorized representative-

i. under clauses (a) and (c) of sub-section (6A), if any, shall be as per the terms of the financial debt or the relevant documentation; and

ii. under clause (b) of sub-section (6A) shall be as specified which shall be form part of the insolvency resolution process costs.

(7) The Board may specify the manner of voting and the determining of the voting share in respect of financial debts covered under sub-sections (6) and (6A).

(8) Save as otherwise provided in this Code, all decisions of the committee of creditors shall be taken by a vote of not less than fifty-one per cent. of voting share of the financial creditors:

Provided that where a corporate debtor does not have any financial creditors, the committee of creditors shall be constituted and shall comprise of such persons to exercise such functions in such manner as may be specified.

(9) The committee of creditors shall have the right to require the resolution professional to furnish any financial information in relation to the corporate debtor at any time during the corporate insolvency resolution process.

(10) The resolution professional shall make available any financial information so required by the committee of creditors under sub-section (9) within a period of seven days of such requisition.

As per section 21(2) of IBC the CoC shall comprise of financial creditors. The Operational Creditors do not have right to vote in the meeting of Committee of Creditors,

however, the directors, partners and one representative of operational creditors may attend the meetings of Committee of Creditors.

**Answer 1(b)**

(i) Section 21(3) of the Insolvency and Bankruptcy Code, 2016 provides that subject to sub-sections (6) and (6A), 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 and their voting share shall be determined on the basis of the financial debts owed to them.

Section 21(6) of the Insolvency and Bankruptcy Code, 2016 provides that where the terms of the financial debt extended as part of a consortium arrangement or syndicated facility provide for a single trustee or agent to act for all financial creditors, each financial creditor may-

a. authorize the trustee or agent to act on his behalf in the committee of creditors to the extent of his voting share.

b. represent himself in the committee of creditors to the extent of his voting share.

c. appoint an insolvency professional (other than the resolution professional) at his own cost to represent himself in the committee of creditors to the extent of his voting share; or

d. exercise his right to vote to the extent of his voting share with one or more financial creditors jointly or severally.

Section 21(6B) provides that the remuneration payable to the authorized representative-

i. under clauses (a) and (c) of sub-section (6A), if any, shall be as per the terms of the financial debt or the relevant documentation; and

ii. under clause (b) of sub-section (6A) shall be as specified which shall be form part of the insolvency resolution process costs.

(ii) Section 21(5) of the Insolvency and Bankruptcy Code, 2016 provides that where an operational creditor has assigned or legally transferred any operational debt to a financial creditor, the assignee or transferee shall be considered as an operational creditor to the extent of such assignment or legal transfer.

**Answer 1(c)**

In terms of Section 5(26) of the Insolvency and Bankruptcy Code, 2016 -"Resolution Plan" means a plan proposed by resolution applicant for insolvency resolution of the corporate debtor as a going concern in accordance with Part II.

*Explanation* - For removal of doubts, it is hereby clarified that a resolution plan may include provisions for the restructuring of the corporate debtor, including by way of merger, amalgamation and demerger.

Section 5(25) of the Insolvency and Bankruptcy Code, 2016 provides that "resolution

applicant" means a person, who individually or jointly with any other person, submits a resolution plan to the resolution professional pursuant to the invitation made under clause (h) of sub-section (2) of section 25 or pursuant to section 54K, as the case may be.

**Persons not eligible to be resolution applicant – Section 29A:**

A person shall not be eligible to submit a resolution plan, if such person, or any other person acting jointly or in concert with such person-

a) is an undischarged insolvent;

b) is a wilful defaulter in accordance with the guidelines of the Reserve Bank of India issued under the Banking Regulation Act, 1949 (10 of 1949);

c) at the time of submission of the resolution plan has an account, or an account of a corporate debtor under the management or control of such person or of whom such person is a promoter, classified as non-performing asset in accordance with the guidelines of the Reserve Bank of India issued under the Banking Regulation Act, 1949 (10 of 1949) or the guidelines of a financial sector regulator issued under any other law for the time being in force, and at least a period of one year has lapsed from the date of such classification till the date of commencement of the corporate insolvency resolution process of the corporate debtor:

Provided that the person shall be eligible to submit a resolution plan if such person makes payment of all overdue amounts with interest thereon and charges relating to nonperforming asset accounts before submission of resolution plan:

Provided further that nothing in this clause shall apply to a resolution applicant where such applicant is a financial entity and is not a related party to the corporate debtor.

d) has been convicted for any offence punishable with imprisonment –

i. for two years or more under any Act specified under the Twelfth Schedule; or

ii. for seven years or more under any law for the time being in force:

Provided that this clause shall not apply to a person after the expiry of a period of two years from the date of his release from imprisonment:

Provided further that this clause shall not apply in relation to a connected person.

e) is disqualified to act as a director under the Companies Act, 2013:

Provided that this clause shall not apply in relation to a connected person.

f) is prohibited by the Securities and Exchange Board of India from trading in securities or accessing the securities markets;

g) has been a promoter or in the management or control of a corporate debtor in which a preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction has taken place and in respect of which an order has been made by the Adjudicating Authority under this Code:

Provided that this clause shall not apply if a preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction has taken place prior to the acquisition of the corporate debtor by the resolution applicant

pursuant to a resolution plan approved under this Code or pursuant to a scheme or plan approved by a financial sector regulator or a court, and such resolution applicant has not otherwise contributed to the preferential transaction, undervalued transaction, extortionate credit transaction or fraudulent transaction;

h) has executed a guarantee in favour of a creditor in respect of a corporate debtor against which an application for insolvency resolution made by such creditor has been admitted under this Code and such guarantee has been invoked by the creditor and remains unpaid in full or part;

i) is subject to any disability, corresponding to clauses (a) to (h), under any law in a jurisdiction outside India; or

j) has a connected person not eligible under clauses (a) to (i).

**Answer 1(d)**

Section 53 of the Insolvency and Bankruptcy Code, 2016 deals with distribution of assets in liquidation. The Insolvency and Bankruptcy Code, 2016 makes significant changes in the priority of claims for distribution of liquidation proceeds. In case of liquidation, the assets will be distributed in the following order in case of liquidation:

i. the insolvency resolution process costs and the liquidation costs paid in full,

ii. workmen's dues for the preceding 24 months and secured creditors, who have relinquished security,

iii. wages and any unpaid dues owed to employees other than workmen for the period of twelve months preceding the liquidation commencement date,

iv. financial debts owed to unsecured creditors,

v. government dues and remaining secured creditors (any remaining debt if they enforce their collateral),

vi. any remaining debt and dues,

vii. preference shareholders, and

viii. equity shareholders or partners, as the case may be.

In the given case the liquidator will distribute the assets in the following order of priority:

| *Payment in order of priority* | *Amount to paid in lakhs* | *Fund available for distribution (Rs. in Lakhs)* |
|---|---|---|
| | | 150 |
| Fees of insolvency professional and Liquidator | 20 | 130 |
| Workmen's dues for the preceding 24 months and secured creditors | 10 | 120 |

| | | |
|---|---|---|
| Employee Salary | 15 | 105 |
| Unsecured Creditors (Operational creditors) | 30 | 75 |
| Government dues | 15 | 60 |
| Remaining secured creditors (any remaining debt if they enforce their collateral) | 60 | 0 |

Thus, in the instant case the liquidator shall consider the dues of the various stake holder in the priority as mentioned above. Accordingly, the banks will get only the residual amount which Rs. 60 lakh only.

**Question 2**

*(a) Whether a foreign company can merge into an Indian company or vice versa ? Discuss the relevant provisions of the Insolvency and Bankruptcy Code, 2016. (6 marks)*

*(b) What do you mean by the Doctrine of Repugnancy ? Where a law, earlier enacted by any State, is now contradictory to the provisions of the Insolvency and Bankruptcy Code, 2016, then which law will prevail ? Write your answer with the decided case law. (2+4=6 marks)*

**Answer 2(a)**

Sections 234 and 235 of the Insolvency and Bankruptcy Code, 2016 make provisions to deal with cases involving cross border insolvency.

**Agreements with foreign countries** : Section 234 empowers the central government to enter into an agreement with other countries to resolve situations pertaining to cross border insolvency. Section 234 of the Code provides that: The Central Government may enter into an agreement with the Government of any country outside India for enforcing the provisions of this Code. [(Section 234(1)].

The Central Government may, by notification in the Official Gazette, direct that the application of provisions of this Code in relation to assets or property of corporate debtor or debtor, including a personal guarantor of a corporate debtor, as the case may be, situated at any place in a country outside India with which reciprocal arrangements have been made, shall be subject to such conditions as may be specified. [Section 234(2)].

**Letter of request to a country outside India in certain cases** : Section 235 of the Insolvency and Bankruptcy Code, 2016 lays down that notwithstanding anything contained in this Code or any law for the time being in force if, in the course of insolvency resolution process, or liquidation or bankruptcy proceedings, as the case may be, under this Code, the resolution professional, liquidator or bankruptcy trustee, as the case may be, is of the opinion that assets of the corporate debtor or debtor, including a personal guarantor of a corporate debtor, are situated in a country outside India with which reciprocal arrangements have been made under section 234, he may make an application to the Adjudicating Authority that evidence or action relating to such assets is required in connection with such process or proceeding. [(Section 235(1)]

The Adjudicating Authority on receipt of an application under sub-section (1) and, on being satisfied that evidence or action relating to assets under sub-section (1) is required

in connection with insolvency resolution process or liquidation or bankruptcy proceeding, may issue a letter of request to a court or an authority of such country competent to deal with, such request. [Section 235(2)]

The current cross border insolvency framework in India is dependent on India entering bilateral agreements with other countries. Finalisation of bilateral agreements is a long drawn process as it involves long term negotiations and thus takes a lot of time. Moreover, every trade is distinct and thus it would be difficult for the adjudicating authorities to enforce the agreements/treaties entered into with other countries.

**Answer 2(b)**

Doctrine of Repugnancy means the conflict between two pieces of legislation which when applied to the same facts produce different results. Repugnancy arises when the provisions of two laws are so inconsistent and irreconcilable that it is impossible to do one without disobeying the other.

A plain reading of Article 254 of the Constitution of India gives an impression that if both central and state governments frame laws on a same entry under the concurrent list, only then the Central law will prevail.

**Case of *Innoventive Industries Ltd. v. ICICI Bank:***

The reference of Doctrine of Repugnancy was taken by the Supreme Court in the above case.

**Facts of the Case** : ICICI Bank had taken Innoventive Industries Ltd. to NCLT for the recovery of its due as the company had defaulted on loan repayment. The NCLT had given a verdict in favour of the ICICI Bank, which Innoventive Industries challenged in the National Company Law Appellate Tribunal (NCLAT), where it received yet another setback. The company later filed an appeal in the Supreme Court seeking relief under the Maharashtra Act, which states that if a company is facing bankruptcy, protection needs to be provided for the employees.

**Judgement** : On a bare reading of the judgement, it seems that the case involved more adjudication on grounds related to Constitutional Law than on the Code. This case related to the first-ever application filed for initiating insolvency proceedings under the new Code. The Court was cognizant of the fact and hence wanted to settle the law so that all 'Courts and Tribunals take notice of the paradigm shift in the Law'.

The case involved contradictory provisions in the Code and a state law of Maharashtra state, Maharashtra Relief Undertakings (Special Provisions) Act, 1958. This state law provided for overtaking of industries by the state by declaring them 'relief undertakings'. Such overtaking can be done through government notifications to that effect under the Act. This is done to protect employment of the people who are working in such an undertaking.

The Code instead provides for overtaking of an undertaking's business by an 'Insolvency Professional through a committee of creditors. In the instant case, insolvency application was filed against Innoventive Industries which later claimed to be a relief undertaking under the Maharashtra Act. This brought the two legislations on a collision course, for the simple reason that enforcement of one will hinder the enforcement of the other.

Supreme Court dealt with the constitutional law doctrine of repugnancy. This doctrine stems from the operation of Article 254 of the Constitution. As per this doctrine, whenever central and state laws are framed on the same subject and are contradictory to each other, it is the central law which prevails, and the state law is rendered void.

In the instant case, however, the laws even though coming in conflict with each other, were framed under different entries of the concurrent list. This involved adjudication by the Supreme Court on this point. The National Company Law Tribunal (NCLT) had ruled that Innovative Industries cannot claim any relief under Maharashtra Act. It also decided that there is no repugnancy between the two laws, as they operate in different fields.

The appeal to the Supreme Court, hence involved two major questions. One was, whether the petitioner can seek relief under the Maharashtra Act at the cost of the Code. The second was, whether both the laws are repugnant to each other.

Invoking a lot of international cases, especially of the Commonwealth countries and previous judgments of the Supreme Court, the bench ruled that there is indeed repugnancy between the two laws. The court held that even if the two legislations are framed on different entries of the concurrent list, the Central law will always prevail if it comes in conflict with the State law. The State law, therefore, was held inoperable to the extent that it was in contradiction to the Code.

The court delved into great detail of the provisions of the Code and held it to be intended as an 'exhaustive legislation by the Parliament, to cover the whole field of its operation. In such instances involving an exhaustive law, even though the State law may not be in strict violation of the Code, it will even then be rendered inoperative to give way to implement the exhaustive law on the point.

With respect to the Code, being acknowledged as an exhaustive law on the point is a very progressive step. It also, now brings in more clarity that the provisions of the Code will have supremacy over every other law, whenever and wherever any conflict arises.

**Question 3**

*(a) Financial Creditor of M/s XYZ Ltd. (Corporate Debtor) filed an application for Corporate Insolvency Resolution Process (CIRP) before the Adjudicativng Authority and Interim Resolution Professional (IRP) was appointed. The IRP for the purpose of formation of Committee of Creditors (CoC), verified the claims submitted by the all the financial creditors and observed that all such financial creditors comes under the purview of related parties to the Corporate Debtor. Apart from the financial creditors there are 5 Operational Creditors only.*

*In the given situation, how the CoC will be formed ? Explain by qouting the relevant provisions contained in the Insolvency and Bankruptcy Code, 2016.*
*(6 marks)*

*(b) What are the powers of the disciplinary committee of Insolvency and Bankruptcy Board of India (IBBI) ? Also elaborate the circumstances when the IBBI can cancel or suspend the registration of an Insolvency Professional Agency (IPA).*
*(3+3=6 marks)*

**Answer 3(a)**

The provisions as contained in the Regulation 16 of the Insolvency and Bankruptcy (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 are very much relevant in this regard. This Regulation provides as under:

(1) Where the corporate debtor has no financial debt or where all financial creditors are related parties of the corporate debtor, the committee shall be set up in accordance with this Regulation.

(2) The committee formed under this Regulation shall consist of following members:-

a. eighteen largest operational creditors by value:

Provided that if the number of operational creditors is less than eighteen, the committee shall include all such operational creditors;

b. one representative elected by all workmen other than those workmen included under sub-clause (a); and

c. one representative elected by all employees other than those employees included under sub-clause (a).

(3) Every member of the committee formed under this Regulation shall have voting rights in proportion of the debt due to such creditor or debt represented by such representative, as the case may be, to the total debt.

*Explanation* – For the purposes of this sub-regulation, 'total debt means the sum of-

a. the amount of debt due to the creditors listed in sub-regulation 2(a);

b. the amount of the aggregate debt due to workmen under sub regulation 2(b); and

c. the amount of the aggregate debt due to employees under sub regulation 2(c)

(4) A committee formed under this Regulation and its members shall have the same rights, powers, duties and obligations as a committee comprising financial creditors and its members, as the case may be.

Now, according to the above Regulation 16 the answer to the given problem is as under:

Since all the Financial Creditors are related party to the Corporate Debtor, hence no Financial Creditor shall be a part of the CoC as per Regulation 16(1).

Further since there are Operation Creditors and their numbers are FIVE, hence all such Operational Creditors will be included in the CoC. As required by Regulation 16(2)(b) & (c) one representative shall also be included in the CoC.

**Answer 3(b)**

**Powers of the Disciplinary Committee**

Section 220 of the Insolvency and Bankruptcy Code, 2016 deals with the appointment of disciplinary committee. It provides that-

1. The Board shall constitute a disciplinary committee to consider the reports of the investigating authority submitted under section 218(6).

Provided that the members of the disciplinary committee shall consist of whole-time members of the Board only.

2. On examination of the report of the Investigating Authority, if the disciplinary committee is satisfied that sufficient cause exists, it may impose penalty as specified in sub-section 3 or suspend or cancel the registration of the Insolvency Professional (IP) or suspend or cancel the registration of Insolvency Professional Agency (IPA) or Information Utility (IU).
3. Where any IPA or IP or an IU has contravened any provisions of this Code or rules or regulations made, thereunder, the disciplinary committee may impose penalty which shall be-
   i. Three time the amount of the loss caused, or likely to have been caused, to persons concerned on account of such contravention; or
   ii. Three times the amount of the unlawful gain made on account of such contravention, whichever is higher.

   Provided that where such loss or unlawful gain is not quantifiable, the total amount of the penalty imposed shall not exceed more than one crore rupees.
4. Notwithstanding anything contained in sub-section (3), the board may direct any person who has made unlawful gains or averted loss by indulging in any activity in contravention of this Code, or the rules or regulations made thereunder, to disgorge an amount equivalent to such unlawful gain or aversion of loss.
5. The Board may take such action as may be required to provide restitution to the person who suffered loss on account of any contravention from the amount so disgorged, if the person who suffered such loss is identifiable and the loss suffered is directly attributable to such person.
6. The Board may make regulations to specify-
   a. the procedure for claiming restitution under sub-section (5),
   b. the period within which such restitution may be claimed, and
   c. the manner in which restitution of amount may be made.

**Cancellation or suspensions of registration of IPA**

Section 201(5) of the Insolvency and Bankruptcy Code, 2016 deals with the provisions relating to the cancellation or suspension of registration of IPA. It provides that the Board may, by order, suspend or cancel the certificate of registration granted to an IPA on any of the following grounds namely:

a. that is has obtained registration by making a false statement or misrepresentation or by any other unlawful means;
b. that it has failed to comply with the requirements of the regulations made by the Board or bye-law made by the IPA;
c. that is has contravened any of the provisions of the Act or the rules or the regulations made thereunder;
d. on any other ground as may be specified by regulations.

Provided that no order shall be made under this sub-section unless the IPA concerned has been given a reasonable opportunity of being heard.

Provided further that no such order shall be passed by any member except whole-time members of the Board.

**Question 4**

*(a) On what grounds, an aggrieved debtor or creditor, may make an application to the Adjudicating Authority against the action taken by the Resolution Professional under the Fresh Start Process ? Also elaborate the restrictions imposed on a debtor during moratorium period of Fresh Start Process. (3+3=6 marks)*

*(b) Financial Creditors initiated Corporate Insolvency Resolution Process (CIRP) against a corporate debtor and invited the expression of interest (EOI) of Resolution Plan from the eligible persons. One company, showed interest and submitted the EOI, which was agreed upon by the Committee of Creditors (CoC) and proposal was submitted by the CoC with the Adjudicating Authority (AA). As per the Resolution Plan, the Resolution Applicant agreed to pay in cash to acquire the controlling stake in the Corporate Debtor to tune of 75% and the Operational Creditors will be paid in instalments in settlement of their claims stretchable upto the next 12 months.*

*The AA accepted the Resolution Plan. However, the promoters of the Corporate Debtors and other Operational Creditors objected and appealed before the NCLAT raising the following points :*

*(i) The promoters of Corporate Debtor contended that the Resolution Applicant is not eligible to submit the Resolution Plan, since its subsidiary company in the UK was fined by the English court under the provisions of UK Act, which provides for imprisonment for a term not exceeding 12 months or a fine or both. Hence in terms of Section 29A(d) of the Insolvency and Bankruptcy Code, 2016 (IBC) the Resolution Applicant is ineligible to submit the Resolution Plan.*

*(ii) The Operational Creditors also objected taking the plea that there was unfair distribution of settlement amount in instalments for their claims under the provisions of the IBC.*

*Explain with relevant case law, whether the Resolution Applicant was eligible to submit the Resolution Plan? (6 marks)*

**Answer 4(a)**

Grounds on which the aggrieved debtor or creditor may make an application to the Adjudicating Authority against the action taken by the Resolution Professional under the Fresh Start Process

Section 87 of the Insolvency and Bankruptcy Code, 2016 provides that debtor or the creditor who is aggrieved by the action taken by the Resolution Professional under Section 86 may within ten days of such decision may make an application to the Adjudicating Authority challenging such action on any of the following grounds, namely:–

a) that the Resolution Professional has not given an opportunity to the debtor or the creditor to make a representation; or

b) that the Resolution Professional colluded with the other party in arriving at the decision; or

c) that the Resolution Professional has not complied with the requirements of Section 86.

The Adjudicating Authority shall decide the application referred within fourteen days of such application and make an order as it deems fit. Where the application has been allowed by the Adjudicating Authority it shall forward its order to the Board and the Board may take such action as may be required against the Resolution Professional.

**Restrictions imposed on a debtor during moratorium period of Fresh Start Process**

The following restrictions are imposed on debtor during the moratorium period of Fresh Start Process, as provided under section 85(3) of the IBC:

a. shall not act as a director of any company, or directly or indirectly take part in or be concerned in promotion, formation or management of the company.

b. shall not dispose-off or alienate any of the assets.

c. shall inform his business partners that he is undergoing a fresh start process.

d. shall be required to inform prior to entering into any financial or commercial transaction of such value as may be notified by the Central Government, either individual or jointly, that he is undergoing a fresh start process.

e. shall disclose the name under which he enters into business transactions, if it is a different name then the one under the application.

f. shall not travel outside India except with the permission of the Adjudicating Authority.

**Answer 4(b)**

Yes, the Resolution Applicant will be succeeded in the NCLAT. The facts of the case are similar to that of the case of acquisition of Bhushan Steel Ltd by Bamnipal Steel Ltd (BNL), a subsidiary of Tata Steel Ltd, which is as under:

The acquisition of Bhushan Steel Ltd (BSL) for Rs. 35,200 crore by Bamnipal Steel Ltd (BNL), a subsidiary of Tata Steel Ltd. in May 2018, has been the first major case of acquisition of a major stressed asset under the Insolvency and Bankruptcy Code. BNL completed the acquisition of controlling stake of 72.65 per cent in BSL in accordance with the approved resolution plan under the Corporate Insolvency Resolution Process (CIRP) of the IBC. Tata Steel has paid Rs.35,200 crore in cash to acquire Bhushan Steel. It would pay another Rs.1,200 crore over next 12 months to operational creditors.

The promoters of BSL approached the National Company Law Appellate Tribunal (NCLAT) over issue of ineligibility of Tata Steel to acquire BSL. L&T, an operational creditor also approached the Hon'ble NCLAT over issue of unfair distribution of settlement amount for its claim under the provisions of IBC, 2016.

NCLAT upheld the acquisition of Bhushan Steel, rejecting allegations of its ineligibility by the promoters of the company. The NCLAT also rejected the claims of L&T, an

operational creditor of Bhushan Steel Ltd, opposing Tata Steel's resolution plan seeking a higher priority in debt settlement.

The NCLAT said that Tata Steel UK, a foreign subsidiary of Tata Steel, which was fined by an English Court in February 2018 under UK Act, had a provision of 'imprisonment for a term not exceeding twelve months, or a fine, or both'. While, the provision in section 29A(d) of the Code, which deals with eligibility, stipulates "has been convicted for any offence punishable with imprisonment for two years or more", cannot be equated with Section 33(1)(a) of the U.K Act, said NCLAT. Section 29A of the IBC mandates that a person convicted for any offences punishable with imprisonment for two years or more is ineligible for submitting a resolution plan.

Over the claims of L&T, which had supplied goods and machineries over Rs.900 crore, NCLAT said that Tata Steel's resolution plan was fair towards operational creditors of Bhushan Steel which has a total demand of Rs.1,422 crore. The NCLAT observed that the company has allotted Rs.1,200 crore for them and L&T plea for a higher priority could not be accepted.

Moreover, it also declined the plea of the promoters family, contending Tata Steel's Resolution Plan' was illegal as it purports to transfer shares' of the 'preference shareholders' of Bhushan Steel without their consent for a fixed consideration of Rs. 100 as against Rs.2,269 crore.

**Question 5**

*(a) WTC Ltd. had been incurring losses since inception and decided to wind up. The company had several pending litigations and that claim against the company, exceeded the value of its assets and thus, debt due to creditors could not be discharged in total. The company seeks your opinion for voluntary liquidation proceedings. Advise the company the relevant provisions under the Insolvency and Bankruptcy Code, 2016.*

*(b) Mention the circumstances in which a Company may be wound up by Tribunal.*

*(6 marks each)*

**Answer 5(a)**

Section 59 (1) of the Insolvency and Bankruptcy Code, 2016 provides that a corporate person who intends to liquidate itself voluntarily and has not committed any default may initiate voluntary liquidation proceedings.

**Conditions for voluntary liquidation proceedings:**

Section 59(3) of the Insolvency and Bankruptcy Code, 2016 provides that voluntary liquidation proceedings of a corporate person registered as a company shall meet the following conditions:

a. A declaration from majority of the directors of the company verified by an affidavit stating that-

   i. they have made a full inquiry into the affairs of the company and they have formed an opinion that either the company has no debt or that it will be able to pay its debts in full from the proceeds of assets to be sold in the voluntary liquidation; and

ii. the company is not being liquidated to defraud any person;

b. The declaration under sub-clause (a) shall be accompanied with the following documents:

i. audited financial statements and record of business operations of the company for the previous two years or for the period since its incorporation, whichever is later;

ii. a report of the valuation of the assets of the company, if any prepared by a registered valuer;

c. Within four weeks of a declaration under sub-clause (a), there shall be –

i. a special resolution of the members of the company in a general meeting requiring the company to be liquidated voluntarily and appointing an insolvency professional to act as the liquidator; or

ii. a resolution of the members of the company in a general meeting requiring the company to be liquidated voluntarily as a result of expiry of the period of its duration, if any, fixed by its articles or on the occurrence of any event in respect of which the articles provide that the company shall be dissolved, as the case may be and appointing an insolvency professional to act as the liquidator:

The proviso appended to sub-section (3) of section 59 lays down that if the company owes any debt to any person, creditors representing two thirds in value of the debt of the company shall approve the resolution passed under sub-clause (c) within seven days of such resolution.

Thus, as per section 59(1) & (3) voluntary liquidation could only be done if corporate debtor discharged its debts to satisfaction of creditors and if there was no litigation pending against corporate debtor. In the instant case since both these ingredients are not satisfied, hence the option for voluntary liquidation of the company could not be advised.

The company could take steps to have recourse under section 271 of the Companies Act, 2013 or could take steps for compulsory liquidation by filing an application under section 10 of the Insolvency and Bankruptcy Code, 2016.

**Answer 5(b)**

Section 271 of the Companies Act provides that a company may, on a petition under section 272, be wound up by the Tribunal-

a. if the company has, by special resolution, resolved that the company be wound up by the Tribunal;

b. if the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality;

c. if on an application made by the Registrar or any other person authorised by the Central Government by notification under this Act, the Tribunal is of the opinion

that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company he wound up;

d. if the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years; or

e. if the Tribunal is of the opinion that it is just and equitable that the company should be wound up.

**Question 6**

*The Insolvency and Bankruptcy Board of India (IBBI) and Insolvency Professional Agencies (IPAs) have come across, some mistakes being committed by some of the Insolvency Professionals (IPs) in conduct of Corporate Insolvency Resolution Process (CIRP). These mistakes costs to the Corporate Debtor (CD) and to the economy, and often amounts to contravention of provisions of the law.*

*Explain in detail the mistakes committed by the Insolvency Professionals (IPs) with reference to the:*

*(i) Accepting the assignment without having the Authorisation for Assignment (AFA),*

*(ii) Fee payable to the IP,*

*(iii) Appointment of Professionals and*

*(iv) Appointment of Registered Valuers, by qouting the relevant provisions of the Insolvency and Bankruptcy Code, 2016. (3 marks each, total 12 marks)*

**Answer 6**

Yes, it is true to say that the Insolvency and Bankruptcy Board of India (IBBI) and Insolvency Professional Agencies (IPAs) have come across some mistakes being committed by some of the IPs in conduct of CIRPs. These mistakes are costs to the Corporate Debtor (CD) and the economy, and often amount to contravention of provisions of the law.

The mistakes committed by the IPs and the relevant provisions of the IBC are as under:

(i) *Assignment without having Authorisation* : Regulation 7A of the IBBI (Insolvency Professionals) Regulations, 2016 (IP Regulations) requires that an IP shall not accept or undertake any assignment, including CIRP, unless he holds an authorisation for assignment (AFA) on the date of such acceptance or commencement of such assignment, as the case may be.

As per Regulation 12A(5) of Insolvency and Bankruptcy Board of India (Model Bye- Laws and Governing Board Of Insolvency Professional Agencies) Regulations, 2016 i.e. (bye-laws of the IPAs) provide that, if the AFA is not issued, renewed or rejected by the IPA within 15 days of the date of receipt of

application, the authorisation shall be deemed to have been issued or renewed, as the case may be, by the IPA. The Insolvency and Bankruptcy Board of India (IBBI) has made available an IT facility for the IPs to apply for the issuance or renewal of AFA and the IPAs to issue or renew AFAs, as the case may be, in a time bound manner. There are, however, instances where an IP undertook CIRP without having an AFA and in some cases, without even applying for an AFA, in contravention of the provisions of law.

(ii) *Fee payable to IP* : The Code of Conduct for Insolvency Professionals (IPs) under the IBBI (Insolvency Professionals) Regulations, 2016 require that an IP must provide services for remuneration which is charged in a transparent manner, and is a reasonable reflection of the work necessarily and properly undertaken.

Regulation 33 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations) requires that the applicant shall fix the expenses to be incurred on or by the IRP. Regulation 34 requires that the committee of creditors (CoC) shall fix the expenses to be incurred on or by the RP. Regulation 39D requires the CoC to fix the fee payable to the liquidator, in the event the CD proceeds for liquidation.

It is, however, observed that in a few cases, the fee payable to an IP was not fixed beforehand and the IP drew a fee on his own without approval of such fee from the competent authority, in contravention of the provisions of law.

(iii) *Appointment of professionals* : It is the duty of the Resolution professional (RP) to preserve and protect the assets of the Corporate Debtor (CD), including continuing its business operations. Section 25(2) of the Code empowers an RP to appoint accountants, legal or other professionals for this purpose. Clause 23B of the Code of Conduct under the IBBI (Insolvency Professionals) Regulations, 2016 prohibits an IP from engaging or appointing any of his relatives or related parties for or in connection with any work relating to any of his assignment.

An IP is, therefore, required to satisfy himself that there is a need for services of a professional; such services are not available within the CD; the person is qualified to render professional service; the professional to be appointed is suitable for the purpose; the professional is not a relative or related party of the IP; the fee to be paid to the professional is reasonable; etc.

RP needs to apply his mind to these and other related aspects while appointing a professional. RP must not appoint any person who is not a professional, or who is his relative or a related party, or who is choice of a stakeholder. RP must not appoint a professional to provide services to a stakeholder, or a professional because a stakeholder wants that professional to be appointed. There are instances where the RP appointed a professional who is the choice of a stakeholder or a person who is not a professional for professional services. This compromises the independence of the IP as well as that of the professionals and imposes avoidable cost on the CD and other stakeholders.

(iv) *Appointment of registered valuers* : Regulation 27 of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (CIRP Regulations)

envisages estimation of fair value and liquidation value of the assets of the Corporate Debtor (CD). These values serve as reference for evaluation of choices, including liquidation, and selection of the choice that decides the fate of the CD, and consequently of the stakeholders. A wrong valuation may liquidate an otherwise viable CD, which may be disastrous for an economy. Given the importance of valuation in CIRP, the CIRP Regulations require that fair value and liquidation value of the CD shall be determined by two registered valuers (RVs) and it is the duty of the RP to appoint RVs only. There are, however, a few instances where the RP appointed persons other than RVs for conduct of valuations and in some cases, appointed only one RV instead of two. This indicates lack of due diligence and sincerity of the IP and probably demonstrates mala fide intent in some cases to get a valuation done to subserve certain interests. This potentially risks the life of the CD and adversely affects the interests of stakeholders, and drives out qualified and regulated valuation professionals out of practice.

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