GUIDELINE ANSWERS

PROFESSIONAL PROGRAMME

(New Syllabus)

DECEMBER 2020

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

The Guideline Answers contain information based on the Laws/Rules relevant for the Session. Students are expected to be well versed with the amendments in the Laws/Rules made upto **six** months prior to the date of examination.

C O N T E N T S

PROFESSIONAL PROGRAMME EXAMINATION

DECEMBER 2020

CORPORATE FUNDING & LISTING IN STOCK EXCHANGES

Time allowed : 3 hours *Maximum marks : 100*

NOTE : *Answer ALL Questions.*

PART A

Question 1

(a) *Define and discuss the conditions for Preferential Issue. When an issuer becomes ineligible to make a such issue ?*
(5 marks)

(b) *State the guidelines issued by RBI (Reserve Bank of India) for large borrowers under the cash credit facility.* *(5 marks)*

(c) *Balance Sheet of X company as at 31st March, 2018 and its statement of changes in financial position for the year ending on 31st March, 2019 are presented below:*

Balance Sheet as at 31st March, 2018

Liability	*₹*	*Assets*	*₹*
Common Stock	*6,000*	*Land*	*9,800*
Reserves	*6,560*	*Equipment*	*12,200*
Preferential Stock	*2,500*	*Accumulated Depreciation*	*(2,000)*
Long term Bonds	*7,000*	*Inventory*	*2,370*
Amount Payable	*2,140*	*Amount Receivable*	*1,300*
		Cash	*530*
	24,200		*24,200*

Statement of changes in Financial Position for the year ended on 31st March, 2019 :

Sources	*₹*	*Uses*	*₹*
Net Income	*1,200*	*Paid Cash Dividend*	*360*
Depreciation	*600*	*Repaid Preferential Stock*	*2,500*
Loss on sale of land	*(80)*	*Retired Bond Payable*	*1,400*
Issued Stock	*4,000*	*Purchased Equipment*	*3,000*
Sold land	*1,880*	*Increase in Working Capital*	*340*
	7,600		*7,600*

Calculate the working capital as on 31st March, 2019. *(5 marks)*

Answer 1(a)

Define and discuss the conditions for preferential issue:

A listed issuer may make a preferential issue of specified securities, if:

- all equity shares allotted by way of preferential issue shall be made fully paid up at the time of the allotment;
- a special resolution has been passed by its shareholders;
- all the equity shares, if any, held by the proposed allottees in the issuer are in dematerialised form;
- the issuer is in compliance with the conditions for continuous listing of equity shares as specified in the listing agreement with the recognised stock exchange where the equity shares of the issuer are listed, SEBI Listing Regulations, 2015 as amended, and any circular or notifications issued by SEBI thereunder;
- the issuer has obtained the Permanent Account Number of the proposed allottees.

When an issuer becomes ineligible to make a such issue

1. Preferential issue of specified securities shall not be made to any person who has sold or transferred any equity shares of the issuer during the six months preceding the relevant date.
2. An issuer shall not be eligible to make a preferential issue if any of its promoters or directors is a fugitive economic offender.
3. Where any person belonging to promoter(s) or the promoter group has previously subscribed to warrants of an issuer but failed to exercise the warrants, the promoter(s) and promoter group shall be ineligible for issue of specified securities of such issuer on preferential basis for a period of one year from :
   (a) the date of expiry of the tenure of the warrants due to non-exercise of the option to convert; or
   (b) the date of cancellation of the warrants, as the case may be.

Answer 1(b)

In respect of borrowers having aggregate fund based working capital limit of Rs. 1500 million and above from the banking system, a minimum level of 'loan component' of 40 percent shall be effective from April 1, 2019. Accordingly, for such borrowers, the outstanding 'loan component' (Working Capital Loan) must be equal to at least 40 percent of the sanctioned fund based working capital limit, including ad hoc limits and TODs. Hence, for such borrowers, drawings up to 40 percent of the total fund based working capital limits shall only be allowed from the 'loan component'. Drawings in excess of the minimum 'loan component' threshold may be allowed in the form of cash credit facility. The bifurcation of the working capital limit into loan and cash credit components shall be effected after excluding the import credit limits and bills limit for inland sales from the working capital limit. {Ok in terms of page no.200 of module}

Answer 1(c)

Working capital as on 31st March, 2018

Opening w. c.(Rs.) = Cash + AR + Inv. - AP

= 530+1300+ 2370 -2140

= 2060

Hence W.C. as on 31st March 2019

= Opening w.c. + change in w.c. for the year ended on march 31, 2019

= Rs. 2060 + Rs.340

= Rs. 2400

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

Question 2

(a) Explain guidelines issued by SEBI on participation by the strategic investors in InvITs and REITs vide its circular dated 18th January, 2018.

(b) Explain the provisions relating to maintenance of records by an investment manager pertaining to the activity of the InvIT.

(c) Define briefly the following in context of Indian equity private funding :

(1) Alternative Investment Fund

(2) Infrastructure Fund

(3) Social Venture Fund

(4) Sponsor

(5) Venture Capital Fund. (5 marks each)

OR (Alternate question to Q. No. 2)

Question 2A

(i) Explain the conditions to become an Angel investor under SEBI (Venture Capital Fund) Regulations, 1996.

(ii) On 30th May, 2017 SEBI came out with a circular stating the disclosure requirements for issuance and listing of Green Debt Securities in India. Explain the Disclosure Document and other requirements in this context.

(iii) Differentiate between Hire Purchase and Hypothecation. (5 marks each)

Answer 2(a)

Participation by the 'strategic investors' in the public issue of the REITs

(i) *Holding requirements*

- Holding by strategic investors – Minimum 5%, maximum 25%.
- Holding by public, other than strategic investors and sponsor– Minimum 25%
- Holding by sponsor – Minimum 5%, maximum 70%

(ii) *Issue price of the units and utilisation of funds*

- The price at which units are offered to the strategic investors must not be less than the price determined in the public issue.
- It must be ensured that the subscription amount is kept in the separate account until the public issue is opened.

(iii) *Lock-in period*

- The units subscribed by strategic investors, pursuant to the unit subscription agreement, will be locked-in for a period of 180 days from the date of listing in the public issue.

Answer 2(b)

The investment manager shall maintain records pertaining to the activity of the InvIT, wherever applicable, including,–

(a) all investments or divestments of the InvIT and documents supporting the same including rationale for such investments or divestments;

(b) agreements entered into by the InvIT or on behalf of the InvIT;

(c) documents relating to appointment of persons;

(d) insurance policies for infrastructure assets;

(e) investment management agreement;

(f) documents pertaining to issue and listing of units including placement memorandum, draft and final offer document, in- principle approval by designated stock exchanges, listing agreement with the designated stock exchanges, details of subscriptions, allotment of units, etc;

(g) distributions declared and made to the unit holders;

(h) disclosures and periodical reporting made to the trustee, SEBI, unit holders and the designated stock exchanges including annual reports, half yearly reports, etc.;

(i) valuation reports including methodology of valuation;

(j) books of accounts and financial statements;

(k) audit reports;

(l) reports relating to activities of the InvIT placed before the board of directors of the investment manager;

(m) unit holders' grievances and actions taken thereon including copies of correspondences made with the unit holder and SEBI, if any;

(n) any other material documents.

Answer 2(c)

1. *Alternative investment fund* : means any fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which:

   (i) is a privately pooled investment vehicle which collects funds from investors, whether Indian or foreign, for investing it in accordance with a defined investment policy for the benefit of its investors; and

(ii) is not covered under the SEBI (mutual funds) regulations, 1996, SEBI (Collective Investment Schemes) regulations, 1999 or any other regulations of the SEBI to regulate fund management activities. [ok]

2. *Infrastructure Fund* : means an Alternative Investment Fund which invests primarily in enlisted securities or partnership interest or listed debt or securitized debt instruments of investee companies or special purpose vehicles engaged in or formed for the purpose of operating, developing, or holding infrastructure projects. Infrastructure shall be as defined by GOI from time to time.

3. *Social Venture Fund* : means an alternative investment fund which invests primarily in securities or units of social ventures and which satisfies social performance norms laid down by the fund and whose investors may agree to receive restricted or muted returns.

4. *Sponsor* : means any person or persons who set up the Alternative Investment Fund and includes promoter in case of a company and designated partner in case of a limited liability partnership

5. *"Venture Capital Fund"* : means an Alternative Investment Fund which invests primarily in unlisted securities of start-ups, emerging or early-stage venture capital undertakings mainly involved in new products, new services, technology or intellectual property right based activities or a new business model and shall include an angel fund as defined under Chapter III-A of the SEBI (AIF) Regulations,2012.

Answer 2A(i)

'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 two 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 ten 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.

Answer 2A(ii)

The issuer of a Green Debt Securities shall make following disclosures:

(i) A statement on environmental objectives of the issue of Green Debt Securities;

(ii) Brief details of decision-making process issuer have followed/would follow for determining the eligibility of project(s) and/or asset(s), for which the proceeds

are been raised through issuance of Green Debt Securities. An indicative guideline of the details to be provided is as under:

- process followed/to be followed for determining how the project(s) and/or asset(s) fit within the eligible green projects categories;
- the criteria, making the project(s) and/or asset(s) eligible for using the Green Debt Securities proceeds; and
- environmental sustainability objectives of the proposed green investment.

(iii) Issuer shall provide the details of the system/procedures to be employed for tracking the deployment of the proceeds of the issue.

(iv) Details of the project(s) and/or asset(s) or areas where the issuer, proposes to utilise the proceeds of the issue of Green Debt Securities, including towards refinancing of existing green project(s) and/or asset(s), if any.

(v) The issuer may appoint an independent third party reviewer/certifier, for reviewing/ certifying the processes including project evaluation and selection criteria, project categories eligible for financing by Green Debt Securities, etc. Such appointment is optional and shall be disclosed in the offer document.

Answer 2A(iii)

Hire Purchase

HP transactions are very similar to leasing transactions. Like Leasing Finance, in Hire Purchase, the ownership of the vehicle continues to remain with the Leasing Company till the agreement period ends. However, at the end of the stipulated period, the hirer (lessee) has options either to return the asset to leasing company while terminating the agreement or purchase the asset upon terms set out in the hire-purchase agreement. . Under Hire Purchase the financing entity may get the benefit of depreciation as well as ownership of the asset financed. Also, banks cannot take advantage of Hire Purchase Arrangement, as ownership aspect of the asset will result in violating permitted line of activity under the banking license granted by RBI

Hypothecation

Before SARFARSI Act, 2002, it was not define legally in India. It is a charge on any movable asset of a borrower for which bank has extended its finance. It is an equitable charge on the assets in favour of the financing bank where the asset is owned by the borrower as well as possession is with him on behalf of the bank. If a borrower fails to repay the finance extended for the movable asset the bank can repossess the asset with the consent of the borrower. If the borrower surrenders the asset to the bank, bank has a legal right to sell the asset without the intervention of the court and adjust the proceeds towards the loan dues. Under SARFAESI Act bank also has got the right to sell the movable asset of a defaulted borrower without the intervention of a court subject to following rules laid down in this regard.

Question 3

(a) State the conditions pertaining to conversion of External Commercial Borrowings (ECBs) into Equity.

(b) From the following particulars, calculate the effective interest cost per annum to ABC Ltd., which is planning a CP (Commercial Paper) issue:

Issue price of a CP	*₹97,350*
Face Value	*₹1, 00,000*
Maturity period	*3 Months*

(c) Advantages and disadvantages of taking loans against shares by promoters in a listed company. (5 marks each)

Answer 3(a)

Conditions for converting ECBs into Equity

Conversion of ECBs into Equity is permitted (including those which are matured but unpaid) subject to the following conditions:

(i) The activity of the borrowing company is covered under the automatic route for FDI or approval route from the Foreign Investment Promotion Board, wherever applicable, for foreign equity participation has been obtained as per the extant FDI policy.

(ii) The conversion, which should be with the lender's consent without any additional cost, will not result in breach of applicable sector cap on the foreign equity holding.

(iii) Applicable Pricing guidelines of RBI should be fulfilled.

(iv) If borrower concerned has availed of other credit facilities from the Indian banking system, including overseas branches/ subsidiaries, the applicable prudential guidelines issued by the Department of Banking Regulation of RBI, including guidelines on restructuring are compelled with,

(v) Consent of other lenders, if any, to the same borrower is available or at least information regarding conversion is exchanged with other lenders of the borrower.

(vi) In-principle approval of the Stock Exchange where equity shares of the borrower is listed is required before issuance of ECB(FCCBs) which has conversion options.

(vii) Post conversion of ECBs into equity shares, the listing and trading permission is to be obtained from the Stock Exchange where its equity shares are listed

Answer 3(b)

Interest amount (Rs.) = 1,00,000 – 97,350

= 2,650

Maturity period = 3 months

Effective interest = $\frac{f - p}{p} \times \frac{12}{m} \times 100$

= $\frac{1,00,000 - 97,350}{97,350} \times \frac{12}{3} \times 100$

= 10.89%

Answer 3(c)

Generally, wherever the promoter decides to set up another venture, funds are required as promoter's contribution.

Advantages of taking loans against shares by promoters in a listed company

i) Funds can be raised easily because the shares have liquidity and are easily saleable valuation is determined based on market price. After hair cut/ margin loan against equity is granted by Banks, NBFCs or other entities.

ii) Large funds can be raised.

iii) Share are pledged in favour of lender but voting rights remain with the promoter.

iv) Promoter can make repayment based on the availability of funds.

Disadvantages of taking loans against shares by promoters in a listed company

i) If the market price of the share goes down, the margin has to be maintained. The shortfall is to be met by either additional pledge of shares, or by making repayment of loan to the extent of shortfall.

ii) In case the promoter is not able to fulfil has commitment, the lender has a right to sell the shares to the extent of short fall as per terms and conditions of agreement. Such large scale sale may result into further downtrend in the stock market, thus creating further shortfall.

iii) This situation does not leave any room sometimes with the promoter and the confidence of its shareholders goes down.

iv) Multiplier impact worsen the situation.

v) The promoter has to be disclose details of pledge of its equity and all charges. A higher percentage of pledge may result into confidence shake of the investors.

Question 4

(a) What do you mean by Foreign Currency Exchangeable Bonds (FCEB) ? Explain the pricing norms for issuing of FCEB under the Foreign Currency Exchangeable Bonds Scheme, 2008.

(b) Explain Continuous Listing in context of corporate debts.

(c) Explain briefly the documents handled under Letter of Credit.

(d) Write a note on Rupee Deemed Export Credit.

(e) "In a growing company, ESOPs are being used to retain talent." Discuss.

(3 marks each)

Answer 4(a)

Indian promoters can raise money abroad by issuing foreign currency bonds against the value of their investments in shares of listed groups company, termed as Foreign Currency Exchangeable Bonds (FCEB). The issue of these bonds helps the promoter to meet the financing requirements within the group. Issue of FCEBs are governed by Foreign

Currency Exchangeable Scheme, 2008 issued by Ministry of Finance, Department of Economic Affairs. According to the "Issue of Foreign Currency Exchangeable Bonds (FCEBs) Scheme, 2018, FCEB means :

- a bond expressed in foreign currency.
- the principal and the interest in respect of which is payable in foreign currency.
- issued by an issuing company, being an Indian company.
- subscribed to by a person resident outside India.
- Exchangeable into equity shares of another company, being Offered Company in any manner .

Pricing of Foreign Currency Exchangeable Bonds (FCEBs)

At the time of issuance of FCEB the exchange price of the offered listed equity shares shall not be less than the higher of the two:-

(i) the average of the weekly high and low of the closing prices of the shares of the offered company quoted on the stock exchange during the six months.

(ii) the average of weekly high and low of the closing prices of the shares of the offered company quotes on a stock exchange during the two weeks preceding the relevant date.

Answer 4(b)

Continuous Listing

(1) All the issuer shall comply with the conditions of listing specified in the respective listing agreement for debt securities while making public issues of debt securities or seeking listing of debt securities issued on private placement basis.

(1A) the listed issuer is also required to comply with the post listing requirements for entities that have listed their debt securities as specified under Chapter V of the **SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015** and Circulars issued by SEBI under this regulations.

(2) Each rating obtained by the issuer shall be periodically reviewed by the registered credit rating agency and any revision in the rating shall be promptly disclosed by the issuer to the stock exchange(s) where the debt securities are listed.

Submit half yearly financial statement with the stock exchange containing information as specified by SEBI.

(3) Any change in rating shall be promptly disseminated to investors and prospective investors in such manner as the stock exchange may determine from time to time.

(4) Debenture trustee must disclose the information to the investors and the general public by issuing a press release in any of the following events:

a) Default by the issuer to pay interest on debt securities or redemption amount;

b) Failure to create a charge on the assets;

c) Revision of rating assigned to the debt securities

Answer 4(c)

Documents handed under letter of credit-

(i) Bill of exchange

(ii) Commercial invoice

(iii) Transport document

(iv) Bill of lading

(v) Insurance Policy / Certificate

(vi) Certificate of origin

Answer 4(d)

Rupee Deemed Export Credit

A deemed export transaction is one in which goods are supplied to a project in India itself which are funded by International / Multilateral agencies or where goods are supplied to units in SEZs or foreign shipping companies calling on Indian ports, supply of goods to foreign tourists etc., such that the proceeds of such goods supplied will be paid in foreign currencies. Such transactions are treated as prima facie export transactions and enjoy incentives and other concessions given to normal export transactions.

Pre-shipment and Post-shipment credit facilities granted to Rupee Deemed Export Credit transactions are similar to finance / credit extended under Rupee Export credit Pre-shipment as well as Post-shipment as described herein. However in deemed export transactions the date of supply to the projects /SEZ units / foreign tourists is taken as date of export. Also the value of the transaction will be based on Free on Rails (FOR) basis instead of usual Free on Board (FOB) basis, usually associated with export transactions.

Answer 4(e)

ESOP is a sweetner given to an employee at the time of joining or may be later on. The company need not make any payment to the employee. The stocks are issued to an employee by the company based on the entitlement.

Listed Companies can offer attractive Employee Stock Option (ESOP) or Employee Share Purchase Schemes (ESPS) to attract required talent pool and also to retain them. Being listed, the ESOP/ESPS may command good price gain and attraction to the employees. ESOP & ESPS are used to attract talent as well as to retain the key employees and managerial personnel which is an important human capital for business. In case the company is growing, the stock price keep on moving upward. The employee drives huge benefits from ESOP which may run beyond his emoluments otherwise. Such benefits helps the company to retain the talented employees for a longer period.

PART B

Question 5

(a) Explain the grievance redressal mechanism under Regulation 13 of SEBI (LODR) Regulations, 2015 for listed entities.

(b) Explain 'Designated Securities' as per the SEBI Listing Regulation 2015.

(c) Discuss the role of US Securities and Exchange Commission in regulating Securities Market.

(d) ABC Ltd. is considering a right issue by issuing one share against two shares to raise funds to finance a new project requiring ₹4.5 Crore. The floatation cost will be 10% of funds raised. The company currently has 18 Lakh shares outstanding and the current price of its share is ₹100. The subscription price has been fixed at ₹50 per share.

Calculate the value of a right. *(5 marks each)*

Answer 5(a)

Grievance Redressal Mechanism

As per Regulation 13 of SEBI (LODR) Regulations, the Listed entity shall ensure that:

- Adequate steps are taken for expeditious redressal of investors complaints.
- It is registered with SCORES platform or any other platform of SEBI for resolving investors complaint electronically as specified by SEBI.
- Submission of Statement of Investors compliant.
    - o Submit statement to stock exchange within 21 days from the end of quarter.
    - o Statement should contain-
        - o number of complaints pending at the beginning of the quarter.
        - o received during the quarter.
        - o resolved / disposed of during quarter and
        - o remaining unsolved at the end of the quarter.

The statement of investor's complaints shall be placed before the Board of Directors of the listed entity on quarterly basis.

Answer 5(b)

Definition of designated securities is given under clause h) of sub-regulation 1 of Regulations 2 of SEBI (Listing obligations and disclosure requirements) regulations, 2015.

designated securities" means **specified securities**, non-convertible debt securities, non-convertible redeemable preference shares, perpetual debt instrument, perpetual non-cumulative preference shares, Indian depository receipts, securitised debt instruments, security receipts, units issued by mutual funds and any other securities as may be specified by the Board

- Further, clause (zl) of sub-regulation 1 of Regulation 2 of SEBI (Listing obligations and disclosure requirements) regulations, 2015 defines specified securities as under:Specified securities means equity shares and convertible securities as defined

under clause (zj) of sub regulation (1) of regulation 2 of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.

Answer 5(c)

The mission of the U.S. Securities and Exchange Commission is to protect investors, maintain fair, order, and efficient markets, and facilitate capital formation.

As more and more first time investors turn to the markets to help secure their futures, pay for homes, and send children to college, U.S. Securities and Exchange Commission's investor protection mission is more compelling than ever.

The laws and rules that govern the securities industry in the United States derive from a simple and straight forward concept, i.e. all investors whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it, and so long as they hold it.

To achieve this, the Securities and Exchange Commission overseas the key participants in the securities world, including securities exchanges, securities brokers and dealers, investment advisors, and mutual funds. Here the Securities and Exchange Commission is concerned primarily with promoting the disclosure of important market related information, maintaining fair dealing, and protecting against fraud.

Though it is the primary overseer and regulator of the U.S. securities markets, the Securities and Exchange Commission works closely with many other institutions, including Congress, other federal departments and agencies, the self-regulatory organisations. (e.g. the stock exchanges), state securities regulators, and various private sector organisations. In addition, the Chairman of the Securities and Exchange Commission represents the agency as a member of the Financial Stability Oversight Council (FSOC).

The laws that govern the Securities Industry in U.S.:

- Securities Act of 1933
- Securities Act of 1934
- Trust Indenture Act of 1939
- Investment Company Act of 1940
- Investment Advisors Act of 1940
- Sarbanes-Oxley Act of 2002
- Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

Answer 5(d)

$$\text{Value of rights} = \frac{MP_{CR} - OP}{N_0 + N_1}$$

$$= \frac{100 - 50}{2 + 1}$$

$$= ₹16.67$$

Note : Since the ratio of rights issue is given (1:2) it means the number of shares to be issued on rights issue is fixed. Also the subscription price is give which is Rs.50. therefore total amount that will be raised is fixed which is number of shares to be issued multiplied with price at which it will be issued. Accordingly, the value of rights can be calculated as explained in above suggested solution and floating cost of 10% will not have any bearing on such calculation hence it was an additional information in the question which was not required for arriving at the answer.

Alternate Solution

Market value of 2 shares presently held	=	Rs.200
Add : price to be paid for buying one share	=	Rs.50
Total value of 3 shares	=	Rs. 250
Average value of one share	=	Rs. 250/3 = Rs.83.33

Value of rights (Rs.) =Market value of one share - Average price of one share

= 100 – 83.33

= 16.67

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

Question 6

(a) State the principles governing Corporate Governance in protecting the interest of Minority Shareholders.

(b) Discuss the benefits of listing on International Stock Exchange.

(c) List out the event based compliance calendar under Regulation 29 as per SEBI Listing Regulations, 2015.

(d) State the principles Governing Disclosures under the Listing Obligations and Disclosure Requirements, 2015. (5 marks each)

OR (Alternate question to Q. No. 6)

Question 6A

Explain the following:

(i) Advertisement in Newspapers by a listed company in terms of Regulation 47 under SEBI (LODR) Regulations, 2015.

(ii) Continual disclosures under Regulation 7(2) of (Prohibition of Insider Trading) Regulations 2015.

(iii) Statutory disclosures on a company website in terms of Listing Regulations.

(iv) Regulation 43A regarding Dividend Distribution Policy. (5 marks each)

Answer 6(a)

A listed entity having listed its specified securities shall comply with the corporate governance principles as specified in Chapter IV, which shall be implemented in a manner

so as to achieve the objectives of the principles as included under Chapter II of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 and mentioned below:

a) The rights of shareholders

The listed entity shall seek to protect and facilitate the exercise of the following rights of shareholders:

i) Right to participate in and to be sufficiently informed of, decisions concerning fundamental corporate changes.

ii) Opportunity to participate effectively and vote in general shareholder meetings.

iii) Being informed of the rules, including voting procedures that govern the general shareholder meetings.

iv) Opportunity to ask questions to the board of directors to place items on the agenda of general meetings, and to propose resolutions, subject to reasonable limitations.

v) Effective shareholder participation in key corporate governance decisions, such as the nomination and election of members of board of directors.

vi) Exercise of ownership rights by all shareholders, including institutional investors.

vii) Adequate mechanism rights by all shareholders, including institutional investors.

viii) Protection of minority shareholders from abusive action by, or in the interest of, controlling shareholders acting either directly or indirectly, and effective means of redress.

b) Timely information

The listed entity shall provide adequate and timely information to shareholders, including but not limited to the following:

i) Sufficient and timely information concerning the date, location and agenda of general meetings.

ii) Capital structure and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership.

iii) Rights attached to all series and classes of shares, which shall be disclosed to investors before they acquire shares.

c) Equitable treatment

The listed entity shall ensure equitable treatment of all shareholders, including minority and foreign shareholders, in the following manner:

i) All shareholders of the same series of a class shall be treated equally.

ii) Effective shareholder participation in key corporate governance decisions, such as the nomination and election of members of board of directors, shall be facilitated.

iii) Exercise of voting rights by foreign shareholders shall be facilitated.

Answer 6(b)

A company may choose to list its shares in a stock exchange of a country or of a country other than that in which the company is based. Firms may adopt international listing to obtain advantages that include lower cost for capital, expanded global shareholder base, greater liquidity in the trading of shares, prestige and publicity. Decision makers also need to be satisfied that the benefits exceed possible costs, such as listing costs, exposure to legal liabilities, taxes and various trading frictions, and reconciliation of financial statements with varying national standards. Because of the benefits of being cross border listed more and more companies are getting themselves listed on stock exchange markets based outside of their home countries.

Here are more benefits of such a move.

1. **Increased Market Liquidity**

   International listing enables companies to trade its shares in numerous time zones and multiple currencies. This increases the issuing company's liquidity and gives it more ability to raise capital.

2. **Market Segmentation**

   Market segmentation is the practice of dividing a large into clear segments with similar needs. International listing enables firms to divide foreign investor markets into segments which are easy to access. Companies seek to list internationally because they anticipate gaining from a lesser cost of capital . This arises because their stocks become more available to foreign investors. Their access to these stocks may otherwise be restricted due to international investment barrier.

3. **Capital needs and growth opportunities**

   Companies in emerging markets need to use international listing to raise capital to continue to grow beyond their home market.

4. **Wider shareholder base**

   International listing provides access to a larger pool of potential investors (both retail and institutional). Wider shareholder base are less risky.

5. **Other benefits**

   Higher visibility / brand awareness, increased opportunities for mergers and acquisitions, entering markets with better investment protection reduces costs and creates and bonding (a signal of corporate governance)

Answer 6(c)

Regulation Reference	*Frequency*	*Date by which to be filed*
29(1)(a) - Prior intimations of Board Meeting for financial result	Event based	At least 5 clear days in advance
29(1)(b), 29(1)(c), 29(1)(a), 29(1)e and 29(1) f - Prior intimation of Board Meeting for, fund raising,	Event based	At least 2 clear working days in advance.

declaration / recommendation of dividend, the proposal for declaration of bonus securities, buyback, voluntary delisting etc		
29(3)- Prior intimations of Board Meeting for alteration in nature of securities.	Event based	At least 11 clear working days in advance.

Answe 6(d)

Principles governing disclosures are included under Regulation 4 under Chapter II of SEBI (Listing obligations and Disclosure Requirements) Regulations, 2015. These principles includes following:

(i) Information shall be prepared and disclosed in accordance with applicable standards of accounting and financial disclosure.

(ii) The listed entity shall refrain from misrepresentation and ensure that the information provided to recognised stock exchange (s) and investor is not misleading.

(iii) The listed entity shall provide adequate and timely information to recognised stock exchanges and investors.

(iv) The listed company shall ensure that dissemination made under provisions of these regulations and circulars made thereunder, are adequate, accurate, explicit, timely and presented in simple language.

(v) Channels for disseminating information shall provide for equal, timely and cost efficient access to relevant information by investors.

(vi) The listed entity shall abide by all the provisions of the applicable laws including the securities laws and also such other guidelines as may be issued from time to time by the Board and the recognised stock exchange(s) in this regard and as may be applicable. (h)

(vii) The listed entity shall make the specified disclosures and follow its obligations in letter and spirit taking into consideration the interest of all stakeholders.

(viii) Filings, reports, statements, documents and information which are event based or are filed periodically shall contain relevant information.

(ix) Periodic filings, reports, statements, documents and information reports shall contain information that shall enable investors to track the performance of a listed entity over regular intervals of time and shall provide sufficient information to enable investors to assess the current status of a listed entity.

Answer 6A(i)

To publish the following information in the newspapers in terms of Regulation 47 of SEBI (LODR) Regulations, 2015 -

(a) Notice of meeting of the board of directors where financial results shall be discussed.

(b) Financial results, along with the modified opinion (s) / reservation (s), if any, expressed by the auditor.

(c) Submission of standalone and consolidated financial results.

(d) Statements of deviation(s) or variation(s) as specified in sub-regulation (1) of regulation 32 on quarterly basis, after review by audit committee and its explanation in directors report in annual report;

(d) Notices given to shareholders by advertisement.

Financial results shall be published within 48 hours of conclusion of the Board Meeting.

The information shall be published in at least one English language national daily newspaper circulation in the whole or substantially the whole of India and in one daily newspaper published in the language of the region, where the registered office of the listed entity is situated.

The listed entity shall give a reference in the newspaper publication, in sub-regulation (1), to link of the website of listed entity and stock exchange(s), where further details are available.

Answer 6A(ii)

Under Regulation 7(2) under (Prohibition of Insider Trading) Regulation 2015:

Continual Disclosures:

(a) Every promoter, employee and director of every company shall disclose to the company the number of such securities acquired or disposed of within two trading days of such transaction if the value of the securities traded, whether in one transaction or a series of transactions over any calendar quarter, aggregate to a traded value in excess of ten lakh rupees or such other value as may be specified.

(b) Every company shall notify the particulars of such trading to the stock exchange on which the securities are listed within two trading days of the receipt if disclosure or from becoming aware of such information (Transaction type include buy / sales / revoke / invoke).

Answer 6A(iii)

This covers many Regulations under SEBI (LODR) Regulations, 2015 and therefore all such points if mentioned than marks may be given.

Regulation 46 specifically states which information shall be uploaded on the website of the company points mentioned there if written by the student the same shall be considered and marks may be awarded.

1. *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 company for past 3 financial years also are required to be uploaded.

2. Shareholding Pattern
3. *Policies* : Listed companies shall disclose certain management policies on website of company such as:
   - Code of conduct for board of directors and senior management.
   - Code of conduct in terms of insider trading regulations.
   - Code of practices and procedures for fair disclosure of unpublished price sensitive information.
   - Appointment letters to independent directors.
   - Familiarization program for independent directors.
   - Whistle blower policy.
   - Policy of related party transaction.
   - Material subsidiary policy.
   - Materiality Policy for determination of material and price sensitive information
   - Risk Management policy.
   - Archival policy.
   - Policy for disclosure of material information.
   - Internal financial control
   - Dividend Policy
   - Policy against sexual harassment

Answer 6A(iv)

Top 500 listed entities based on market capitalisation shall formulate a dividend distribution policy.

Dividend distribution policy shall be disclosed in their annual reports and on their websites

The dividend distribution policy shall include the following parameters:

(a) The circumstances under which the shareholders of listed entities may or may not expect dividend.

(b) The financial parameters that shall be considered while declaring dividend;

(c) Internal and external factors that shall be considered while declaring dividend;

(d) Policy as to how the retained earnings shall be utilized; and

(e) Parameters that shall be adopted with regard to various classes of shares.

If the listed entity proposes to declare dividend on basis of parameters in addition to clauses (a) to (e) 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.

f) Listed entities other than top 500 may disclose their dividend distribution policies on a voluntary basis in their annual reports and on their websites

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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 and answer the questions given at the end :

The Competition Commission of India (CCI) (Respondent) has ordered a probe against Google Inc. for allegedly abusing its dominant position in 'On line search' advertising on a complaint filed by Mr. Vishal Gupta, a businessman. Gupta has alleged that companies owned by him had been submitting advertisements in Google Adwords from January 2013 to October 2013, before the account was terminated by the Google. On 15th April, 2014, the Competition Commission of India (CCI) passed an order under section 26(1) of the Act basd on the prima-facie opinion, directing the Director General (DG) to investigate into the matter. The Google Inc. (Appellant) filed an application for receiving the investigation order as it was passed without, giving them an opportunity of hearing. The application was dismissed by Competition Commission of India (CCI) on 31st July, 2014 for the following reasons :

(a) CCI was of the prima-facie view that a case for investigation under section 26(1) was made out.

(b) Issues could be dealt with at a later stage post competition of the investigation.

(c) In any event, the power of review was not conferred upon CCI under the Act and therefore, it is impersonable in law for a authority to review/recall its orders.

(d) As there was no statutory provision for appeal against such an order, the appellants filed a writ petition before the Delhi High Court against the impugned order.

Appellant's Argument :

Applicant contended that CCI had ordered the investigation without affording an opportunity of hearing. The application for recalling the order was dismissed by CCI on grounds of lack of territorial jurisdiction. The appellant relying on Supreme Court's ruling in Competition Commission of India Vs. Steel Authority of India (SAIL) submitted that merely because Section 37 of the Act had been deleted by 2007 amendment to Act which took away the power of review does not mean that the power to recall an order also ceases, as recall and review are not the same.

Respondent's Argument :

Counsel for the respondent submitted that though CCI did have their power to review its order before 2007 amendment, but with the deletion of section 37 of the Act, the said power has been taken away. The scheme of the act does not permit review or recall of the orders. CCI also submitted that since investigation was at initial stage and not determinative in nature, the appellant would not suffer any prejudice and therefore, no right for hearing existed.

Respondent further submitted that the application was made only to receive complete hearing at initial stage, which can be entertained even at a subsequent stage. Power of substantial review is expressly prohibited, any interference in the investigation would only lead to unnecessary delay in the proceedings as CCF jurisdiction to deal with the matter is a mixed question of fact and law. The Act does not permit any interference in the investigation once set in motion. CCI classified that the applicability of Section 26(1) of the Act is at a preparatory stage and, therefore, not applicable.

Questions

(a) Whether the Appellant is in order requesting the CCI of recall the investigation? (10 marks)

(b) Whether CCI has enherent powers to recall/review its investigation orders in exercise of powers u/s 26(1) of the Act? (10 marks)

(c) Whether any provision of the Act indicates that an order u/s 26(1) cannot be reviewed or recalled ? (10 marks)

(d) Whether writ petition filed against CCI order directing investigation is maintainable? (10 marks)

Answer 1(a)

Filing of review application by the Appellant for recalling the investigation order passed by CCI u/s 26 (1) of the Competition Act without giving the opportunity of hearing to Appellant may be justified on the following grounds keeping in mind the decision given by Hon'ble Delhi High Court in the case of *Google Inc. and Others* v. *Competition Commission of India, W.P. (C) No. 7084/ 2014*. In terms of the aforesaid case, following may be noted.

Firstly, the Appellant should show in its application for review that complaint on which investigation has been ordered is without merit disclosing material/information. However, it may be noted that such material/information should not be such which will require CCI to resolve any factual controversy after hearing lengthy arguments.

Secondly, the Appellant should show that the opportunity of being heard will ensure that CCI forms it's prima facie view u/s 26 (1) of the Competition Act, 2002 appropriately on the basis of cogent reasons and not on extraneous considerations. However, it is important to note that the opportunity of being heard asked by the Appellant in review application for recalling prima facie order u/s 26 (1) directing investigation should not be considered as an inherent right in the light of decision of Hon'ble Supreme Court in the case of *Competition Commission Of India* vs. *Steel Authority Of India & Anr, Civil Appeal No. 7779 of 2010*.

Accordingly, mere contention that CCI had ordered investigation without affording an opportunity of hearing may not be sufficient. Appellant/Applicant needs to show in the application that investigation has been ordered is without merit disclosing material/ information. In the aforesaid context, Appellant/Applicant should show necessary facts in the application. However, it may be noted that the information should not be such that it will require CCI to resolve any factual controversy after hearing lengthy arguments.

Answer 1(b)

Hon'ble Delhi High Court in the case of *Google Inc. and Others* v. *Competition Commission of India, W.P. (C) No. 7084 / 2014* has held that the order of the CCI in exercise of power under Section 26(1) of the Competition Act, 2002 with direction to the Director General to cause investigation, is capable of review/recall under its inherent powers.

In this regard, Hon'ble Delhi High Court observed that deletion of section 37 relating to power of CCI to review its orders by the Competition (Amendment) Act, 2007 cannot be a conclusive indication of the legislature having intended to divest the CCI of the power of review. Further, in this regard, Hon'ble Delhi High Court, also noted that, it is possible that the legislature deleted Section 37 finding the same to be superfluous in view of the inherent power of the CCI to review/recall its orders.

Taking note of the judgment passed by the Hon'ble Supreme Court of India in CCI vs. SAIL, Delhi High Court also observed that *"Just like it is in the discretion of the CCI to hear or not to hear the person / enterprise complained / referred against at the stage of Section 26(1) of the Act, CCI cannot be held to be without jurisdiction to recall/ review the order."*

Hon'ble Delhi High Court cautioned and clarified that *"….we are not to be understood as conveying that in every case in which CCI has ordered investigation without hearing the person/ enterprise complained/ referred against, such person/enterprise would have a right to apply for review/ recall of that order."*

Hon'ble Delhi High Court also noted that the power of review/recall has to be sparingly exercised and ensuring that the reasons which prevailed with the Supreme Court in *CCI* vs. *SAIL* for negating a right of hearing to a person are not subverted.

Answer 1(c)

At the outset, it may be noted that as per scheme of the Competition Act, 2002, order passed by CCI u/s 26 (1) is not appealable. Further, as noted by Hon'ble Delhi High Court in the case of *Google Inc. and Others* v. *Competition Commission of India, W.P. (C) No. 7084/ 2014*, deletion of section 37 relating to power of CCI to review its orders by the Competition (Amendment) Act, 2007 cannot be a conclusive indication of the legislature having intended to divest the CCI of the power of review. In this regard, Hon'ble Delhi High Court also noted that it is possible that the legislature deleted Section 37 finding the same to be superfluous in view of the inherent power of the CCI to review/ recall its orders.

That said, it may be noted that with regard to jurisdiction of CCI to recall/review its order, Hon'ble Delhi High Court in the aforesaid case of Google Inc. and Others taking note of the judgment passed by the *Hon'ble Supreme Court of India in CCI* vs. *SAIL*, observed *"Just like it is in the discretion of the CCI to hear or not to hear the person / enterprise complained / referred against at the stage of Section 26(1) of the Act, CCI cannot be held to be without jurisdiction to recall/ review the order."*

Answer 1(d)

Writ petition filed against CCI order directing investigation is maintainable. Hon'ble

Delhi High Court in the case of *Google Inc. and Others* v. *Competition Commission of India, W.P. (C) No. 7084/ 2014* petition under Article 226 of the Constitution of India against an order under Section 26(1) of the Act would lie on the same parameters as prescribed by the Supreme Court in State of Haryana Vs. Bhajan Lal 1992 Supp (1) SCC 335 i.e. where treating the allegations in the reference/information/complaint to be correct, still no case of contravention of Section 3(1) or Section 4(1) of the Act would be made out or where the said allegations are absurd and inherently improbable or where there is an express legal bar to the institution and continuance of the investigation or where the information/reference/complaint is manifestly attended with mala fide and has been made/ filed with ulterior motive or the like.

Hon'ble Delhi High Court in the aforesaid case of *Google Inc. and Others* also relied upon decision of the Hon'ble Supreme Court in *Vinod Kumar* Vs. *State of Haryana (2013) 16 SCC 293* where it was held that if a wrong and illegal administrative act can in the exercise of powers of judicial review be set aside by the Courts, the same mischief can be undone by the administrative authority by reviewing such an order if found to be ultra vires and that it is open to the administrative authority to take corrective measure by annulling the palpably illegal order.

With regards to maintainability of writ petition under Article 226 against the order of CCI directing investigation, Hon'ble Delhi High Court in the aforesaid case of *Google Inc. and Others* observed that *"CCI can order/direct investigation only if forms a prima facie opinion of violation of provisions of the Act having been committed. Our Constitutional values and judicial principles by no stretch of imagination would permit an investigation where say CCI orders/directs investigation without forming and expressing a prima facie opinion or where the prima facie opinion though purportedly is formed and expressed is palpably unsustainable. The remedy of Article 226 would definitely be available in such case."*

Question 2

(a) *Canara Bank had made an application before the CLB seeking relief against the Nuclear Power Corporation of Indian Ltd. which had refused in its books in the name of the Canara Bank bonds of the Nuclear Power Corporation purchased by the Canara Bank. The Standard Chartered Bank had also claimed ownership of the said bonds. The Canara Bank alleged that it had acquired the said bonds from the Andhra Bank Financial Services Ltd. through one of his broker. The application of the Canara Bank was pending disposal before the CLB when, on 25th January, 1994 the Special Court Act was amended by the Special Court (Trial of Offences Relating to Transactions in Securities) Amendment Ordinance, 1994 and Section 9(A) was introduced. Canara Bank and Nuclear Power Corporation took the stand that the application of the CanaraBank stood transferred to the Special Court by virtue of the provisions of section 9A(2) of the Special Court Act. The Standard Chartered Bank (Stan Chart) contended that the CLB retained the jurisdiction to deal with the application. Whether CLB has jurisdiction? (6 marks)*

(b) *What is the degree of proof required to hold brokers/sub-brokers liable for fraudulent/ manipulative practices under the SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations and/or*

liable for violating the code of conduct specified in Schedule II read with Regulation 9 of the SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 ? (Conduct Regulations 1992). *(6 marks)*

Answer 2(a)

In the present case, the issue whether an application filed by Canara Bank before Company Law Board (CLB) seeking relief against Nuclear Power Corporation of India Ltd. (NPCIL) in relation to refusal to recognise in the name of Canara Bank bonds of NPCIL purchased by Canara Bank stood transferred to the Special Court in view of section 9A (2) of the Special Courts Act as amended by the Special Court (Trial of Offences Relating to Transactions in Securities) Amendment Ordinance, 1994.

In the case of *Canara Bank* vs. *Nuclear Power Corporation of India Ltd & Ors* (1995 SCC, Supl. (3) 81), Hon'ble Supreme Court of India looked into the scope of Section 9A(1) (b) read with 9A(2) as introduced by Special Court (Trial of Offences Relating to Transactions in Securities) Amendment Ordinance, 1994.

In the above case. Supreme Court noted the relevant Section 9A(1) which provided that *"On and from the commencement of the Special Court (Trial Offences Relating to Transactions in Securities) Amendment Ordinance, 1994, the Special Court shall exercise all such jurisdiction, powers and authority as were exercisable, immediately before such commencement, by any civil court in relation to any matter of claim -…."(emphasis supplied)*

Supreme Court also noted the relevant Section 9A(2) which provided that *"Every suit, claim or other legal proceedings (other than on appeal) pending before any court immediately before the commencement of the Special Court (Trial of Offences Relating to Transactions in Securities) Amendment Ordinance, 1994, being a suit claim or proceeding, the cause of action whereon it is based is such that it would have been, if it had arisen after such commencement, within the jurisdiction of the Special Court under sub-section (1). shall stand transferred on such commencement to the Special Court and the Special Court may, on receipt of the records of such suit, claim or other legal proceeding, proceed to deal with it, so far as may be, in the same manner as a suit, claim or legal proceeding from the stage which was reached before such transfer or from any earlier stage of de novo as the Special Court may deem fit." (emphasis supplied)*

In the aforesaid case, Hon'ble Supreme Court looked into the issue of whether the use of the words 'civil court' in subsection (1) excludes the application of Section 9 A to the CLB?

For the purposes of deciding the aforesaid issue, Hon'ble Supreme Court noted that *"The question to pose, therefore, is: is the CLB a court. If it is, it is divested of the jurisdiction, powers and authority to entertain matters or claims arising out of transactions in securities entered into between the stated dates in which a notified person is involved, by reason of sub-section (3); and, by reason of sub-section (2), such matters or claims pending before it on the commencement of the Amendment Ordinance stand transferred to the Special Court."*

Thereafter for the purposes of ascertaining "what are courts and tribunals", Supreme Court took note of the leading decision by the Constitution Bench of Hon'ble Supreme Court in *M/s. Harinagar Sugar Mills Ltd.* v. *Shyam Sundar Jhunjhuwala and Ors.*, *(1962)*

2 S.C.R. 339 wherein Supreme Court held that "The authority of the Central Government to entertain an appeal under Section 111 was an investiture of the judicial power of the State. As the dispute between the parties related to civil rights and the Companies Act provided for a right of appeal and made detailed provisions about hearing and disposal according to law. It was impossible to avoid the inference that a duty was imposed upon the Central Government in deciding the appeal to act judicially." Further, it was observed that "all tribunals were no courts though all courts were tribunals. The word "courts" was used to designate those tribunals which were set up in an organised State for the administration of justice. By administration of justice was meant the exercise of the judicial power of the State to maintain and uphold rights and to punish wrongs."

Hon'ble Supreme Court also took note of the functions of the Central Government under section 111 of the Companies Act which were akin to exercise of judicial power. In this regard, Supreme Court noted that *"The Central Government was also empowered to include in its orders directions as to payment of costs or otherwise. The function of the Central Government was curial and not executive. There was provision for a hearing and a decision on evidence, and that was indubitably a curial function. In its functions the Central Government often reached decisions but all its decisions could not be regarded as those of a tribunal. Resolutions of Government might affect rights of parties and yet they might not be in the exercise of judicial power. Resolutions of Government might be amenable to writs under Articles 32 and 226 in appropriate cases but might not be subject to a direct appeal under Article 136 as the decisions of a tribunal. The position, however, changed when Government embarked upon curial functions and proceeded to exercise judicial power and decide disputes. In these circumstances, it was legitimate to regard the officer who dealt with the matter and even Government itself as a tribunal. The word "tribunal" was a word of wide import and the words "court" and "tribunal" embraced within them the exercise of judicial power in all its forms. The decision of the Central Government thus fell within the powers of the Supreme Court under Article 136."*

For the purposes of determining the issue in hand in the context of Special Court (Trial of Offences Relating to Transactions in Securities) Amendment Ordinance, 1994, Hon'ble Supreme Court held that the word "court" must be read in the context in which it is used in a statute. *"It is permissible, given the context, to read it as comprehending the courts of civil judicature and courts or some tribunals exercising curial, or judicial, powers. In the context in which the word "court" is used in Section 9A of the Special Court Act, it is intended to encompass all curial or judicial bodies which have the jurisdiction to decide matters or claims, inter alia, arising out of transactions in securities entered into between the stated dates in which a person notified is involved."*

Supreme Court also held that it is proper to attribute to the word "court" in Section 9A(1) of the Special Court Act, not the narrower meaning of a court of civil judicature which is part of the ordinary hierarchy of courts, but the broader meaning of a curial body, a body acting judicially to deal with matters and claims arising out of transactions in securities entered into between the stated dates in which a person notified is involved. An interpretation that suppresses the mischief and advances the remedy must, plainly, be given.

Accordingly, Hon'ble Supreme Court held that the application of the Canara Bank pending before the CLB shall stand transferred to the Special Court constituted under the provisions of the Special Court (Trial of Offences Relating to Transactions in Securities) Act, 1992.

In view of the aforesaid judgment of the Hon'ble Supreme Court, it is clear that the CLB will not have jurisdiction to decide the application filed by Canara Bank seeking relief against Nuclear Power Corporation of India Ltd. and the pending application before CLB will stand transferred to the Special Court constituted under Special Court Act. Hence, the stand of the Canara Bank and Nuclear Power Corporation that the application of the Canara Bank stood transferred to the Special Court by virtue of the provisions of section 9A(2) of the Special Courts Act is correct and CLB has no jurisdiction.

Answer 2(b)

It is a fundamental principle of law that proof of an allegation levelled against a person may be in the form direct of substantive evidence or, as in many cases, such proof may have to be inferred by a logical process of reasoning from the totality of the attending facts and circumstances surrounding the allegations/charges made and levelled. While direct evidence is a more certain basis to come to a conclusion, yet, in the absence thereof the Courts cannot be helpless. It is the judicial duty to take note of the immediate and proximate facts and circumstances surrounding the events on which the charges/allegations are founded and to reach what would appear to the Court to be a reasonable conclusion therefrom. The test would always be that what inferential process that a reasonable/prudent man would adopt to arrive at a conclusion.

The degree of proof required to hold brokers/sub-brokers liable for fraudulent/ manipulative practices under the SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations inter alia includes:

- volume of the trade effected;
- the period of persistence in trading in the particular scrip;
- the particulars of the buy and sell orders, i.e., the volume ;
- the proximity of time between the two and
- such other relevant factors.

In *SEBI* Vs. *Kishore R. Ajmera* case, the proved facts are as follows:

(i) Both clients are known to each other and were related entities;

(ii) This fact was also known to the sub-broker the respondent-broker;

(iii) The clients through the sub-broker had engaged in mutual buy and sell trade the scrip in question, volume of which trade was significant, keeping in mind that the scrip was an illiquid scrip.

Apart from the above, there is no other material to hold either lack of vigilance or bona fides on the part of sub-broker so as to make respondent-broker liable. An irresistible or irreversible inference of negligence/ lack of due care etc., in our considered view, is not established even on proof of the primary facts alleged so as to make respondent-broker liable under the Conduct Regulations, 1992 as has been held in the order of the Whole Time Member, SEBI which, according to us, was rightly reversed in appeal by the Securities Appellate Tribunal.

Note : Any of the below cases or any other relevant case may be briefly mentioned

- *SEBI vs. M/s Ess Ess Intermediaries Pvt. Ltd.;*

- *SEBI vs. M/s Rajesh N. Jhaveri and M/s Rajendra Jayantilal Shah and;*
- *SEBI vs. M/s Monarch Networth Capital Limited (earlier known as Networth Stock Broking Limited).*

Question 3

(a) *The appellant was arrested on 25th March, 2015 in relation to an offence alleged to have been committed under Section-3 of the Prevention of Money Laundering Act 2002. (hereinafter Referred to as "PMLA"). The appellant is the Chairman of XYZ Real Estate Construction Ltd. a public company incorporated in the year 1999 and registered under the Companies Act, 1956. Certain non-convertible debentures were issued by the XYZ by 'Private Placement method.' No advertisements etc. were issued to the public. The said debentures were issued to the employees of the company and to their friends and associates after fulfilling the formalities for private placement of debentures. Thus the appellant collected money by issuing secured debentures by way of private placement in compliance with the guidelines issued by the Securities and Exchange Board of India from time to time. Further the appellant had floated as much as 27 companies and routed the monies collected by his front companies through these companies. Whether appellant entitled for bail? (6 marks)*

(b) *The appellant awarded the work order for transportation to Respondent on 28th July, 1992 and an agreement was entered into between the appellant and respondent No. 1 on 24th February, 1993 which was to expire on 31st March, 1993. But owing to circumstances, the work was extended several times and the contract was finally completed on 23rd October, 1997. Issues arose as to the rate of escalation based on the base year 1992 or 1994. Respondent submitted final bill having three annexures out of which first two were admitted, however, the appellant rejected the third one which was as to deciding the base year for calculating escalation. Analyse the problem. (6 marks)*

Answer 3(a)

For the purposes of deciding the issue whether Appellant, Chairman of XYZ Real Estate Construction Ltd. arrested in relation to offence alleged to have been committed under section 3 of the Prevention of Money Laundering Act (PMLA), 2002, is entitled for Bail, following decision of the Hon'ble Supreme Court in *Gautam Kundu* vs. *Manoj Kumar Assistant Director, DOE, Criminal Appeal No. 1706 of 2015* is relevant. In the aforesaid case of Gautam Kundu, bail was sought under section 439 of the Criminal Procedure Code, 1973 on behalf of the Appellant for floating as many as 27 companies and monies collected through front company was routed through these companies. Hon'ble Supreme Court dismissed the Appeal and rejected the bail application for the following reasons.

We have heard the learned counsel for the parties. At this stage we refrained ourselves from deciding the questions tried to be raised at this stage since it is nothing but a bail application. We cannot forget that this case is relating to "Money Laundering" which we feel is a serious threat to the national economy and national interest. We cannot brush aside the fact that the schemes have been prepared in a calculative manner with a deliberative design and motive of personal gain, regardless of the consequence to the members of the society.

We note that admittedly the complaint is filed against the appellant on the allegations of committing the offence punishable under Section 4 of the PMLA. The contention raised on behalf of the appellant that no offence under Section 24 of the SEBI Act is made out against the appellant, which is a scheduled offence under the PMLA, needs to be considered from the materials collected during the investigation by the respondents. There is no order as yet passed by a competent court of law, holding that no offence is made out against the appellant under Section 24 of the SEBI Act and it would be noteworthy that a criminal revision praying for quashing the proceedings initiated against the appellant under Section 24 of SEBI Act is still pending for hearing before the High Court. We have noted that Section 45 of the PMLA will have overriding effect on the general provisions of the Code of Criminal Procedure in case of conflict between them. As mentioned earlier, Section 45 of the PMLA imposes two conditions for grant of bail, specified under the said Act. We have not missed the proviso to Section 45 of the said Act which indicates that the legislature has carved out an exception for grant of bail by a Special Court when any person is under the age of 16 years or is a woman or is a sick or infirm. Therefore, there is no doubt that the conditions laid down under Section 45A of the PMLA, would bind the High Court as the provisions of special law having overriding effect on the provisions of Section 439 of the Code of Criminal Procedure for grant of bail to any person accused of committing offence punishable under Section 4 of the PMLA, even when the application for bail is considered under Section 439 of the Code of Criminal Procedure.

We cannot brush aside the fact that the appellant floated as many as 27 companies to allure the investors to invest in their different companies on a promise of high returns and funds were collected from the public at large which were subsequently laundered in associated companies of Rose Valley Group and were used for purchasing moveable and immoveable properties. We have further noted that the High Court at the time of refusing the bail application, duly considered this fact and further considered the statement of the Assistant General Manager of RBI, Kolkata, seizure list, statements of directors of Rose Valley, statements of officer bearers of Rose Valley, statements of debenture trustees of Rose Valley, statements of debenture holders of Rose Valley, statements of AGM of Accounts of Rose Valley and statements of Regional Managers of Rose Valley for formation of opinion whether the appellant is involved in the offence of money laundering. In these circumstances, we do not find that the High Court has exercised its discretion capriciously or arbitrarily in the facts and circumstances of this case. We further note that the High Court has called for all the relevant papers and duly taken note of that and thereafter after satisfying its conscience, refused the bail. Therefore, we do not find that the High Court has committed any wrong in refusing bail in the given circumstances. Accordingly, we do not find any reason to interfere with the impugned order so passed by the High Court and the bail, as prayed before us, challenging the said order is refused. Consequently the appeal is dismissed.

Accordingly, in view of the aforesaid decision of the Hon'ble Supreme Court in *Gautam Kundu* vs. *Manoj Kumar Assistant Director, DOE*, it appears that the Appellant being Chairman of XYZ Real Estate Construction Ltd. will not be entitled for Bail.

Answer 3(b)

For the purposes of analysis of the problem in hand, it is important to take note of the following decision of the Hon'ble Supreme Court of India in *Rashtriya Ispat Nigam*

Ltd. vs. *M/S. Prathyusha Resources & Infra, Civil Appeal No. 3699 of 2006*, wherein Supreme Court considered settled law on the cause of action and observed that the cause of action arises when the real dispute arises i.e. when one party asserts and the other party denied any right. In the said case, Supreme Court noted that the cause of action was the claim of the respondent/claimant to the determination of base year for the purposes of escalation and the calculation made thereon, and the refusal of the appellant to pay as per the calculations.

When disputes arose, the Arbitration Tribunal decided the five issues framed in favour of the respondent/claimant whereby the base year was adjudged as 1992, the bar of limitation was negated and the calculations made by the Claimant were upheld. Thereafter, the appellant challenged the said award under Section 34 of the Arbitration Act, 1996 before the Ld. District Court which set aside the award as the relief was barred by limitation. Upon appeal under Section 37 of the Arbitration Act, 1996 by the respondent/ claimant, the High Court set aside the order of the District Judge and upheld the award of the Arbitrator.

In the aforesaid case, Appellant submitted that the High Court has arrived at a wrong conclusion by invoking Article 137 of the Limitation Act, 1963, and since the contract was in the nature of work contract, Article 18 would apply which provided that the right to sue accrued when the contract was completed i.e. 23.10.1997 and hence notice for arbitration was beyond the period of limitation. The respondent/claimant also argued that the dispute as to determination of base year for calculating escalation arose vide letter dated 15.7.1996 and hence the notice for arbitration was issued beyond the period of limitation.

Hon'ble Supreme Court held that the view taken by the High Court was correct as to when the real dispute arose between the parties to be adjudicated by the Arbitrator. In this regard, Supreme Court noted that the difference on determination of base year first arose in the letter dated 15.7.1996 and the said letter was already controverted as the service of the same was seriously contested before in Arbitration. However, the said letter was there even before completion of the work and prior to that the respondent/ claimant had reserved right to claim money later since the contract was still subsisting then.

Supreme Court also noted that *"In light of the above reservation by the respondent/ claimant, bills were raised in 1998 vide letter dated 4.9.1998, which actually resulted into exchange of letters which formed the base of dispute between the parties."*

Finally, Hon'ble Supreme Court observed that the findings of the learned Arbitrator and concurrently affirmed by the High Court were correct on the point that the cause of action arose on or after 4.9.1998. Hence, the said letter by the respondent claimant to the appellant to initiate arbitration was not barred by the law of limitation.

Accordingly, claims of the Respondent including the issue relating to the determination of the base year for calculating escalation can be considered in the light of aforesaid Supreme Court decision in Rashtriya Ispat Nigam Ltd case.

Question 4

(a) The appellant was the successful bidder in a work contract which was cahllenged by the respondent. In the proceedings, the appellant filed an affidavit to the

effect that nearly 85% of the work had been completed. However, the High Court found the statement made in the affidavit to be false after causing an inspection by an advocate. Then the High Court imposed a cost of ₹10 lakh on the appellant for filing a false affidavit.

Analyze the case whether the court was correct in imposing fine on appellant.

(b) A company having registered office at Aurangabad and the workman appointed in Aurangabad transferred to Pondicherry. Pondicherry establishment was closed and the workman was terminated. The workman raised dispute and filed complaint at Aurangabad but it was rejected on the ground of lack of Jurisdiction.

Whether it was correct? (6 marks each)

Answer 4(a)

Hon'ble Supreme Court in *M/s Sciemed Overseas Inc* vs. *Boc India Limited & Ors, Special Leave Petition (C) No. 29125 of 2008* considered the issue related to imposition of cost of 10 lakhs on the petitioner by the High Court for filing a false or misleading affidavit in the Court.

Briefly stated, Supreme Court noted that, in the proceedings relating to works contracts, which was awarded to the Appellant and which was challenged by the Respondent, the appellant filed an affidavit to the effect that nearly 85% of the work had been completed. However, the High court found the statement made in the affidavit to be false after causing an inspection by an advocate. Then the High court imposed a cost of 10 lacs on the appellant for filing a false affidavit.

Supreme Court noted as follows. *"In our opinion, the imposition of costs, although somewhat steep, was fully justified given that the High Court also held that the contract in favour of the petitioner was awarded improperly and was of a commercial nature, the last two findings not being under challenge."*

Supreme Court also took note of the global developments regarding filing of false affidavit and observed that a global search of cases pertaining to the filing of a false affidavit indicates that the number of such cases that are reported has shown an alarming increase in the last fifteen years as compared to the number of such cases prior to that. This is illustrative of the malaise that is slowly but surely creeping in. This 'trend' is certainly an unhealthy one that should be strongly discouraged, well before the filing of false affidavits gets to be treated as a routine and normal affair.

Supreme Court rejected the contention submitted by Sciemed that the statement made in the affidavit filed in this Court was not a false statement but was bona fide and not a deliberate attempt to mislead this Court. Supreme Court also rejected the contention submitted by Sciemed that the allegedly false or misleading statement had no impact on the decision taken by this Court and should, therefore, be ignored.

Hon'ble Supreme Court observed that the correctness of the statement made by Sciemed was examined threadbare not only by the learned Single Judge but also by the Division Bench and it was found that a considerable amount of work had still to be completed by Sciemed and it was not as if the work was nearing completion as represented to this Court. Additionally, the Report independently given by the learned advocate appointed to make an assessment, also clearly indicated that a considerable amount of work had still to be performed by Sciemed. The Report was not ex parte but was carefully

prepared after an inspection of the site and discussing the matter with Shailendra Prasad Singh the proprietor of Sciemed and an engineer of Sciemed.

Supreme Court observed that in the first instance, the work order was issued to Sciemed on 25th July, 2007 but this was not disclosed to the High Court when it disposed of W.P. (C) No.4203 of 2007 on 31st July, 2007. Had the factual position been disclosed to the High Court, perhaps the outcome of the writ petition filed by BOC would have been different and the issue might not have even travelled up to this Court. Furthermore, apparently to ensure that work order goes through, a false or misleading statement was made before this Court on affidavit when the matter was taken up on 14th March, 2008 to the effect that the work was nearing completion. It is not possible to accept the view canvassed by learned counsel that the false or misleading statement had no impact on the decision rendered by this Court on 14th March, 2008. We cannot hypothesize on what transpired in the proceedings before this Court nor can we imagine what could or could not have weighed with this Court when it rendered its decision on 14th March, 2008. The fact of the matter is that a false or misleading statement was made before this Court and that by itself is enough to invite an adverse reaction.

Hon'ble Supreme Court considered its earlier decision in *Muthu Karuppan* v. *Parithi Ilamvazhuthi (2001) 5 SCC 289* wherein Supreme Court expressed the view that the filing of a false affidavit should be effectively curbed with a strong hand. It is true that the observation was made in the context of contempt of Court proceedings, but the view expressed must be generally endorsed to preserve the purity of judicial proceedings. Hon'ble Supreme Court noted following from its earlier judgment in Muthu Karuppan case "Giving false evidence by filing false affidavit is an evil which must be effectively curbed with a strong hand. Prosecution should be ordered when it is considered expedient in the interest of justice to punish the delinquent, but there must be a prima facie case of "deliberate falsehood" on a matter of substance and the court should be satisfied that there is a reasonable foundation for the charge."

Accordingly, Hon'ble Supreme Court held that on the material before us and the material considered by the High Court, we are satisfied that the imposition of costs by the High Court was justified.

In view of the aforesaid decision of the Hon'ble Supreme Court in the M/s Sciemed Overseas Inc, it can be stated that the High Court was correct in imposing fine on the Appellant.

Answer 4(b)

Hon'ble Supreme Court in *Nandram* vs. *Garware Polyster Ltd., Civil Appeal No. 1409 of 2016* considered the issue of jurisdiction of Labour Court in almost same facts. Briefly stated, in this case, a workman raised industrial dispute and filed the complaint before Labour Court at Aurangabad i.e. where the registered office of the Company was situated. It may be noted that in the aforesaid case, the appointment of the workman was initially made at Aurangabad and later he was transferred to Pondicherry. Thereafter, owing to closure of Pondicherry establishment, services of workman was terminated.

Hon'ble Supreme Court after considering all the material and contention of the parties observed that *"In the background of the factual matrix, the undisputed position is that the appellant was employed by the Company in Aurangabad, he was only transferred to*

Pondicherry, the decision to close down the unit at Pondicherry was taken by the Company at Aurangabad and consequent upon that decision only the appellant was terminated. Therefore, it cannot be said that there is no cause of action at all in Aurangabad. The decision to terminate the appellant having been taken at Aurangabad necessarily part of the cause of action has arisen at Aurangabad. We have no quarrel that Labour Court, Pondicherry is within its jurisdiction to consider the case of the appellant, since he has been terminated while he was working at Pondicherry. But that does not mean that Labour Court in Aurangabad within whose jurisdiction the Management is situated and where the Management has taken the decision to close down the unit at Pondicherry and pursuant to which the appellant was terminated from service also does not have the jurisdiction. In the facts of this case both the Labour Courts have the jurisdiction to deal with the matter. Hence, the Labour Court at Aurangabad is well within its jurisdiction to consider the complaint filed by the appellant. Therefore, we set aside the order passed by the High Court and the Industrial Court at Aurangabad and restore the order passed by the Labour Court, Aurangabad though for different reasons."

In view of the aforesaid decision of Hon'ble Supreme Court in Nandram vs. Garware Polyster Ltd, it can be stated that both the Labour Courts at Aurangabad and Pondicherry will have jurisdiction to entertain the complaint by the workman.

It can be stated that as part of the cause of action has arisen at Aurangabad *(since appellant was employed by the Company in Aurangabad; he was only transferred to Pondicherry; the decision to close down the unit at Pondicherry was taken by the Company at Aurangabad and consequent upon that decision only the appellant was terminated.)*, hence, hence it was not correct to reject the complaint on the ground of lack of jurisdiction.

Question 5

(a) *'No recovery under section 31, sub-section (10) of the SARFAESI Act shall be enforced by an other of the Bank authorised in this behalf certifying that the person in default has failed to pay the recoverable sum.' Explain the non-applicability of the provisions of SARFAESI Act,*

(b) *Every company including its holding or subsidiary and a foreign company defined under clause (42) of section 2 of the Companies (Corporate Social Responsibility Policy), Rules, 2014 shall comply with the provisions of section 135 of this Act. Describe the various activities to be undertaken by a company under this Act.*

(c) *'Corporate Governance failures manifested in Ranbaxy Laboratories Board's failure to Check fraud, absence of the adequate risk management system and unethical practices.' Discuss how the above factors have affected company's status.*

(d) *A Bank clerk fraudulently withdraws money from customer's account. The management dismisses the employee from services of Bank and withholds retirement benefits and adjusts agaisnt the loss caused. Net amount is paid to the employee after adjustment. Examine whether Bank's action is correct.*

(3 marks each)

Answer 5(a)

Section 30D of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI) relates to recovery of penalties.

Section 30D (10) of the SARFAESI provides that the Reserve Bank may enforce recovery of recoverable sum through the principal civil court having jurisdiction in the area where the registered office or the head office or the principal place of business of the person in default or the usual place of residence of such person is situated as if the notice issued by the Reserve Bank were a decree of the Court.

Further, Section 30D (11) of the SARFAESI provides that no recovery under sub-section (10) shall be enforced, except on an application made to the principal civil court by an officer of the Reserve Bank authorised in this behalf certifying that the person in default has failed to pay the recoverable sum.

However, Section 31 of the SARFAESI provides that provisions of this Act not to apply in certain cases. In terms of Section 31 of the SARFAESI, the provisions of this Act shall not apply to—

(i) a lien on any goods, money or security given by or under the Indian Contract Act, 1872 or the Sale of Goods Act, 1930 or any other law for the time being in force;

(ii) a pledge of movables within the meaning of section 172 of the Indian Contract Act, 1872;

(iii) creation of any security in any aircraft as defined in clause (1) of section 2 of the Aircraft Act, 1934;

(iv) creation of security interest in any vessel as defined in clause (55) of section 3 of the Merchant Shipping Act, 1958 ;

(v) any rights of unpaid seller under section 47 of the Sale of Goods Act, 1930 ;

(vi) any properties not liable to attachment (excluding the properties specifically charged with the debt recoverable under this Act)]or sale under the first proviso to sub-section (1) of section 60 of the Code of Civil Procedure, 1908 ;

(vii) any security interest for securing repayment of any financial asset not exceeding one lakh rupees;

(viii) any security interest created in agricultural land;

(ix) any case in which the amount due is less than twenty per cent of the principal amount and interest thereon.

Answer 5(b)

Rule 3 of the Companies (Corporate Social Responsibility Policy) Rules, 2014 relates to Corporate Social Responsibility Policy. In terms of Rule 3 (1) of the Companies (Corporate Social Responsibility Policy) Rules, 2014, every company including its holding or subsidiary, and a foreign company defined under clause (42) of section 2 of the Act having its branch office or project office in India, which fulfils the criteria specified in sub-section (1) of section 135 of the Act shall comply with the provisions of section 135 of the Act and Companies (Corporate Social Responsibility Policy) Rules, 2014.

In terms of Rule 4 (1) of the Companies (Corporate Social Responsibility Policy) Rules, 2014 , the CSR activities shall be undertaken by the company, as per its stated

CSR Policy, as projects or programs or activities (either new or ongoing), excluding activities undertaken in pursuance of its normal course of business.

Further, in terms of Section 135 of the Companies Act, 2013, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII.

Accordingly, it may be noted that Schedule VII to the Companies Act, 2013 provides following Activities which may be included by companies in their Corporate Social Responsibility Policies Activities relating to:—

(i) Eradicating hunger, poverty and malnutrition, ''promoting health care including preventive health care'' and sanitation including contribution to the Swach Bharat Kosh set-up by the Central Government for the promotion of sanitation] and making available safe drinking water.

(ii) promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly and the differently abled and livelihood enhancement projects.

(iii) promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups.

(iv) ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources and maintaining quality of soil, air and water including contribution to the Clean Ganga Fund set-up by the Central Government for rejuvenation of river Ganga.

(v) protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional art and handicrafts;

(vi) measures for the benefit of armed forces veterans, war widows and their dependents, Central Armed Police Forces (CAPF) and Central Para Military Forces (CPMF) veterans, and their dependents including widows;

(vii) training to promote rural sports, nationally recognised sports, paralympic sports and olympic sports

(viii) contribution to the prime minister's national relief fund or Prime Minister's Citizen Assistance and Relief in Emergency Situations Fund (PM CARES Fund) or any other fund set up by the central govt. for socio economic development and relief and welfare of the schedule caste, tribes, other backward classes, minorities and women;

(ix) (a) Contribution to incubators or research and development projects in the field of science, technology, engineering and medicine, funded by the Central Government or State Government or Public Sector Undertaking or any agency of the Central Government or State Government; and (b) Contributions to public funded Universities; Indian Institute of Technology (IITs); National Laboratories and autonomous bodies established under Department of Atomic Energy (DAE);

Department of Biotechnology (DBT); Department of Science and Technology (DST); Department of Pharmaceuticals; Ministry of Ayurveda, Yoga and Naturopathy, Unani, Siddha and Homoeopathy (AYUSH); Ministry of Electronics and Information Technology and other bodies, namely Defense Research and Development Organisation (DRDO); Indian Council of Agricultural Research (ICAR); Indian Council of Medical Research (ICMR) and Council of Scientific and Industrial Research (CSIR), engaged in conducting research in science, technology, engineering and medicine aimed at promoting Sustainable Development Goals (SDGs).

(x) rural development projects.

(xi) slum area development.

(xii) disaster management, including relief, rehabilitation and reconstruction activities.

Further, in terms of Rule 4 (5) of the Companies (Corporate Social Responsibility Policy) Rules, 2014, the CSR projects or programs or activities that benefit only the employees of the company and their families shall not be considered as CSR activities in accordance with section 135 of the Act.

That said, in terms of proviso to Section 135 of the Companies Act, company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities.

Answer 5(c)

Ranbaxy Laboratories (Ranbaxy), had gone from a rising star to troubled company as a result of corporate governance failure manifested in its Board's failure to check fraud, absence of risk management system and unethical practices.

As per reports, "Ranbaxy had been on a fast track when it started supplying generic drugs to the developed countries. Issues with FDA in the U.S. came to light in 2006, but Ranbaxy's compliance and quality problems had remained under the surface for several years."

As per reports, "Ranbaxy also perpetrated fraud on shareholders by exposing their investment to huge reputation and compliance risks by fuzzing data submitted to regulators." Further, as reported, "Ranbaxy, also committed fraud on consumers, hospitals, value chain partners and common people who took pride that Ranbaxy had emerged as the first Indian multinational in the pharmaceutical sector. "

If reports are to be believed, "disputes flared between the company and the US Food and Drug Administration, and evidence emerged that Ranbaxy had been systematically gaming tests and failing to meet health standards." Thereafter, in 2013, the Ranbaxy settled with the US Justice Department and pled guilty to felony charges and had to shell out $500 million in fines."

In one of the article, an author noted following important facts, "Everyone expected corporate governance of highest order with the illustrious Board and significant foreign and institutional shareholding, however the reality was different. The company was fined $500 million. The US department of justice said the company had "pleaded guilty today to felony charges relating to the manufacture of certain adulterated drugs". Felony is a

serious criminal charge. By accepting to pay a criminal fine and forfeiture and agreeing to settle civil claims, Ranbaxy may have succeeded in effecting damage control. That does not, however, mitigate the seriousness of its actions."

In 2008, Japanese pharmaceutical giant, Daiichi Sankyo, bought the jewel of India's generic medicines industry, Ranbaxy Laboratories. However, as per reports, in 2013, "Daiichi Sankyo declared that information about the US investigations had been withheld from it when it bought the company and took the Singh brothers to arbitration in Singapore". Later in 2014, Daiichi Sankyo sold Ranbaxy to Sun Pharmaceuticals.

It has been stated that adverse ruling by Courts, compounded the problems, resulting in severe liquidity pressures, triggered unanticipated defaults with banks and lenders. As reported in news reports, Bottle of Lies by Katherine Eban, reveals, Ranbaxy's "success" was based on deceit. "In its race for profit, Ranbaxy had lied to regulators, falsified data and endangered patient safety in every country where it sold drugs".

In one of the reports, an author stated that there is a "similarity in the fraud at Satyam and the same at Ranbaxy. In both cases, the top management overrode the internal control system." Highlighting the role of Independent Directors, it has been noted that "Independent director's responsibility is limited to ensuring that he/she understands the business model, best corporate governances practices (e.g. board process, risk management system, internal audit and statutory audit, whistle-blower policy, and transparency within and outside the Board) are in place and operating effectively, analysing information available through the Board processes or otherwise and acting proactively based on that analysis for the benefit of the company as a whole. If independent directors are held responsible for frauds perpetrated by or with the support of the top management, which has the ability to override internal controls, it will be difficult to induce professionals to join Boards of companies as independent directors."

Answer 5(d)

For the purposes of examining Bank's action of dismissal of Bank Clerk (employee) from the services of Bank, withholding retirement benefits and payment of net amount to the employee after adjustment against loss caused for fraudulent withdrawal of money from customer account following decision of Hon'ble Supreme Court in *Canara Bank & Anr* vs. *Lalit Popli (Through LRs)*, Civil Appeal No. 9666 of 2010 may be looked into.

In this case, Respondent who was a clerk, and two other persons i.e. manager and special assistant, all bank employees, were found guilty of fraudulently withdrawing an amount of 1,07,000/- from the saving account of a customer. The manager and special assistant were censured for their negligence and some recovery were made from them while the respondent was dismissed from service.

Supreme Court noted that vide judgment dated 18.02.2003 a categorical finding that it was the respondent who committed forgery which ultimately led to the loss caused to the bank.

Supreme Court further noted that the Respondent case stood on a different footing from the other three employees. Since the amount recovered from the other three employees, who were imposed penalty of 'censure', is refunded to them, the bank had to recover the amount of loss caused to it from the person who was the author of the forgery.

Looking to the material on record, Supreme Court found that the other three officials were held to be negligent in their duty and as held by this Court in its judgment dated 18.02.2003, that it was the respondent, who committed forgery of the signature of the account holder, consequent upon which the bank had suffered loss to the tune of ₹1,07,000/- .Accordingly, Supreme court observed that *"Therefore, the bank has taken an equitable decision to recover the entire amount from the respondent and to refund the amount already recovered from the other three officials, because they were only found to be negligent in their duty."*

Hon'ble Supreme Court also noted that Rule 12 of the Canara Bank Employees' Gratuity Fund Rules (for short, 'Gratuity Rules'), Clause 19 of the Canara Bank Staff Provident Fund Regulations, 1994 (for short, Provident Fund Regulations) and Rule 3(4) of Chapter VIII of the General Conduct Rules, governing the services of the employees fully support the action taken by the bank against the respondent in withholding the amount of gratuity and employer's contribution towards provident fund.

Hon'ble Supreme Court further noted that Special Rules relating to gratuity, makes it amply clear that the employee who has been dismissed for his misconduct and if such misconduct has caused financial loss to the bank, he shall not be eligible to receive the gratuity to the extent of financial loss caused to the bank. So also, Clause 19 of the Provident Fund Regulations permits the bank to deduct the payment of provident fund to the extent of financial loss caused to the bank from the bank's contribution. Both the aforementioned Clauses are plain and simple. They are unambiguous. Since Rule 12 of the Gratuity Rules and Clause 19 of the Provident Fund Regulations permit the bank to withhold gratuity and deduct the bank's contribution towards provident fund, in such matters, the bank was justified in recovering the amount of financial loss sustained by it, which was caused by the respondent, from out of the gratuity and employer's contribution towards provident fund payable to the respondent/employee.

Accordingly, in view of the aforesaid decision of the Hon'ble Supreme Court in Canara Bank & Anr vs. Lalit Popli, if fraudulent withdrawal of money from Customer's account also includes act of forgery on behalf of Bank Clerk which led to the loss caused to the bank then Bank's action needs to be judged in terms of Employees' Gratuity Fund Rules of the Bank, Provident Fund Regulations of the Bank, General Conduct Rules of the Bank governing the services of the employees. Also, a proper departmental enquiry needs to be conducted for ascertaining the role of Bank Clerk and any other person involved including their role etc. Accordingly, in case, Bank Clerk role does not relate to forgery of customer signature etc., then he may be censured for negligence and the amount may be recovered as penalty subject to aforesaid Conduct rules, Provident Fund and Gratuity Rules.

Question 6

For preparing a strategy for success a business needs to be clear about what it wants to achieve. Kellogg also prepared successful strategy by setting aims and objectives. Among these aims and objectives Kellogg's objective was to sponsors swimming programmes, involve in community programmes and have effective external communication.

Analyze the Kellogg's strategic focus behind it and long-term benefit to be achieved by implementing this strategy. (12 marks)

Answer 6

Kellogg's prepared a successful strategy by setting aims and objectives linked to its unique brand. Aims and objectives have been used to create a strategy which gives Kellogg's a unique position in the minds of its consumers.

Developing an Aim for business :

Research undertaken for Kellogg's, as well as comprehensive news coverage and growing public awareness, helped its decision-takers to understand the concerns of its consumers. In order to meet these concerns, managers realised it was essential that Kellogg's was part of the debate about health and lifestyle. It needed to promote the message 'Get the Balance Right'.

Decision-takers also wanted to demonstrate Corporate Responsibility (CR). This means that they wanted to develop the business responsibly and in a way that was sensitive to all of Kellogg's consumers' needs, particularly with regard to health issues. This is more than the law relating to food issues requires. It shows how Kellogg's informs and supports its consumers fully about lifestyle issues.

An aim also helps those outside the organisation to understand the beliefs and principles of that business. Kellogg's aim was to reinforce the importance of a balanced lifestyle so its consumers understand how a balanced diet and exercise can improve their lives.

Setting business objectives :

Kellogg's objectives were to: Encourage and support physical activity among all sectors of the population; Use resources to sponsor activities and run physical activity focused community programmes for its consumers and the public in general; Increase the association between Kellogg's and physical activity.

Each of the objectives set by Kellogg's was clear, specific and measurable. This meant Kellogg's would know whether each objective had been achieved. By setting these objectives Kellogg's set a direction that would take the business to where it wanted to be three years into the future.

Having created an aim and set objectives, Kellogg's put in place a process of planning to develop a strategy and a series of actions. These activities were designed to meet the stated aim and range of business objectives.

Sponsoring swimming programmes :

For many years Kellogg's has been working to encourage people to take part in more physical activity. The company started working with the Amateur Swimming Association (ASA) as far back as 1997, with whom it set some longer term objectives. More than twelve million people in the UK swim regularly.

Swimming is inclusive as it is something that whole families can do together and it is also a life-long skill. The ASA tries to ensure that 'everyone has the opportunity to enjoy swimming as part of a healthy lifestyle'. As a lead body for swimming, the ASA has been a good organisation for Kellogg's to work with, as its objectives match closely those of the company. Kellogg's became the main sponsor of swimming in Britain. This

ensured that Kellogg's sponsorship reached all swimming associations so that swimmers receive the best possible support.

Kellogg's sponsors the ASA Awards Scheme with more than 1.8 million awards presented to swimmers each year. This relationship with the ASA has helped Kellogg's contribute in a recognisable way to how individuals achieve an active healthy balanced lifestyle. This reinforces its brand position.

Kellogg's in the community :

Kellogg's has also delivered a wide range of community programmes over the last 20 years. For example, the Kellogg's Active Living Fund encourages voluntary groups to run physical activity projects for their members. The fund helps organisations like the St John's Centre in Old Trafford which runs keep-fit classes, badminton and table tennis.

Since 1998 Kellogg's has invested more than £500,000 to help national learning charity ContinYou to develop nationwide breakfast club initiatives. These include start-up grants for new clubs, the Breakfast Club Plus website, the Kellogg's National Breakfast Club Awards and the Breakfast Movers essential guide.

Breakfast clubs are important in schools because they improve attendance and punctuality. They help to ensure that children are fed and ready to learn when the bell goes. Kellogg's promotes breakfast via these clubs, not Kellogg's breakfast cereals. Together Kellogg's and ContinYou have set up hundreds of breakfast clubs across the UK, serving well over 500,000 breakfasts each year.

Communicating the strategy :

Kellogg's success is due to how well it communicated its objectives to consumers to help them consider how to 'Get the Balance Right'. It developed One of the most important means of communication adopted by Kellogs's was effective external communication to convey the message 'eat to be fit' to all its customers.

External communication takes place between an organisation and the outside world. As a large organisation, Kellogg's uses many different forms of communication with its customers.

For example, it uses the cartoon characters of Jack & Aimee to communicate a message that emphasises the need to 'Get the Balance Right'. By using Jack & Aimee, Kellogg's is able to advise parents and children about the importance of exercise. These characters can be found on the back of cereal packets. The company has also produced a series of leaflets for its customers on topics such as eating for health and calcium for strong bones. These are available on its website.

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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 case below carefully and answer the questions given at the end :

A Negotiable Instrument (NI) means a promissory note, bill of exchange or cheque payable either to order or to bearer. Negotiable Instrument may be made payable to two or more payees jointly, or in the alternative to one of the two, or one or some of several payees.

A Promissory Note is an instrument in writing containing an unconditional undertaking, signed by the maker to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument.

A Bill of Exchange is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument.

A Cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form.

The maker of a bill of exchange or cheque is called the drawer, the person thereby directed to pay is called drawee, when in the bill or in any endorsement there on the name of any person is given in addition to the drawee to be resorted to in case of need after the drawee of a bill has signed his assent upon the bill, or if there are more parts thereof than one, one of such parts and delivered the same, or given notice of such. Signing to the holder or to some person on his behalf, he is called the acceptor. The person name in the instrument, to whom or to whose order the money is to be paid is called payee. The 'holder' of Negotiable Instrument means any person entitled in his own name to possession thereof and to receive or recover the amount due thereon from the parties thereto. The 'Holder in due course' mean any person who for consideration became the possessor of Negotiable Instrument, if payable to bearer or the payee or endorsee thereof if payable to order, before the amount mentioned in it became payable and without having sufficient cause to believe his title of the person from whom he derived his title. When banker dishonour a cheque of a customer, appropriate reason in writing, duly singed by its official must be given. Such cheque may either be returned across the counter or through clearing.

(a) What are the Negotiable Instruments in the banking ? Explain types and presumptions of Negotiable Instruments. *(10 marks)*

(b) Define holder and holder in due course with their rights. Explain difference between them. *(10 marks)*

(c) Mr. Kunal draws a bill of exchange on ABC Ltd. in consideration of sale of goods of ₹1,00,000 directing to pay on demand to M/s Bhagwan Das Ramlal. From above Bill of Exchange explain who is drawee, drawer and payee. Define the parties to a bill of exchange. (10 marks)

(d) X has issued a cheque of ₹1,00,000 in favour of Y, but when Y deposited the cheque in bank, it gets bounced. What are the common reasons behind the bouncing of a cheque ? (10 marks)

Answer 1(a)

Negotiable Instruments (NI) has not been defined directly in the NI Act, 1881 but as per Section 13, a NI means and includes A Promissory Note, A Bill of Exchange, and A Cheque payable to order or Bearer. In this regard the following are the forms of Negotiable Instruments:

- Promissory Note (PN) is an instrument in writing, containing an unconditional undertaking (or promise), signed by the maker, to pay a certain sum of money, to or to the order of a certain person or to the bearer of the instrument.
- Bill of Exchange (BOE) is an instrument in writing, containing an unconditional order, signed by maker, directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument.
- Cheque is a bill of exchange drawn on a specified bank and not expressed to be payable otherwise than on demand. It includes electronic image of a truncated cheque and also an electronic cheque.
- Though directly not defined under Section 13 of the NI Act, 1881, Demand Drafts are also considered for practical purposes included as a part of Negotiable Instruments by virtue of Section 85(A) and Section 131 (A) of the NI Act, 1881.

It is to be noted that as per section 21 of the Indian Currency Act, 1861, a Currency Note is not a negotiable instrument.

Negotiable instruments under section 137 of the Transfer of Property Act, 1882, documents of title to goods such as Bill of lading, Dock warrant, GRs approved by IBA, Railway Receipts, Warehouse Receipt, Wharfinger Certificate. All the above examples are also the document of title to goods under Sale of Goods Act, 1930.

Presumption with regards to Negotiable Instruments:

Section 118 of the NI Act, 1881 provides certain presumptions regarding to NIs, until the contrary is provided:

i. NI was made, drawn, accepted, endorsed and negotiated or transferred for consideration.

ii. It bears the date on which it was made or drawn.

iii. It was accepted within a reasonable time after it's date and before maturity.

iv. Every transfer of NI was made before maturity.

v. Endorsements appearing on NI were made in the order in which they appear thereon.

vi. It was duly stamped and stamp duly cancelled, when the NI stands lost.

vii. Holder is holder in due course.

The burden of proof that the instrument is contrary to all/any of the above presumptions is with the person who challenges such presumptions.

Answer 1(b)

Holder : As per section 8 of the Negotiable Instrument Act, 1881 the holder is a person who is entitled in his own name to the possession thereof (legal right to possess is also sufficient), to receive or recover the amount due thereon from the parties thereto. Finder of an instrument lying somewhere or a thief, cannot become holder by mere possession. Consideration is not compulsory to become a holder.

Rights of a holder

i. He can obtain a duplicate of the lost instrument.

ii. He can cross the cheque if not already crossed, convert a general crossing to a special crossing and endorse and can negotiate, if the negotiation is not restricted.

iii. He can sue in his own name in relation to the instrument.

iv. He can complete an inchoate instrument.

v. He can give proper discharge to the person making the payment.

Holder in due course : As per section 9 of the Negotiable Instrument Act, 1881 a holder in due course is a person (a bearer or endorsee or a payee) who must have instrument in his possession. He must obtain possession of it for valuable and lawful consideration before its maturity. He must obtain it in good faith without any sufficient reason to believe that any defect existed in the title of the person from whom he obtained it. He gets a defect free title even when the transferor had defective title, provided transferee has no notice of defect in title of the transferor.

Right of Holder in due course

i. If any inchoate/incomplete instrument has been handed over for a sum greater than what it was intended by maker, the maker cannot challenge the right of holder in due course to recover the amount mentioned.

ii. If a bill is drawn payable to the drawer's order in a fictitious name, the acceptor is not relieved from liability to any holder in due course, provided endorsement and the drawer's signatures are in the same handwriting.

iii. A person, liable on a NI, cannot be relieved from his liability towards the holder in due course on the ground that the bill was lost or obtained by fraud or for unlawful consideration.

iv. Every prior party to a NI is liable thereon to a holder in due course until the instrument is duly satisfied.

Difference between the holder and holder in due course:

Transaction	*Holder*	*Holder and holder in due course*
Right of Possession	Compulsory	Compulsory
Consideration	Not Essential	Essential
Possession of Instruments	Not Essential	Essential
Nature of Title	Gets the same title as that of thetransferor. Defective when defective.	Gets good title even if transferor was having defective title.
Authority	Can sue in his own name.	Can sue in his own name.

Answer 1(c)

Drawer Mr. Kunal

Drawee ABC Ltd.

Payee M/s Bhagwan Das Ramlal

i. The maker of a bill of exchange or cheque is called the "drawer".

ii. The person thereby directed to pay is called “Drawee". When in the bill or in any endorsement thereon the name of any person is given in addition to the drawee to the resorted to in case of need. Such a person is called "drawee in case of need". In case of a cheque, drawee is always a branch of a bank on whom the cheque is drawn.

iii. After the drawee of a bill has signed his assent upon the bill or if there are more parts thereof than one, on one of such parts and delivered the same or given notice of such signing to the holder or to some person on his behalf. He is called "Acceptor".

iv. The person named in the instrument to whom or to whose order the money is to be to be paid is called "Payee”.

Answer 1(d)

Following are the common reasons for which the cheque are returned:

i. *Refer to drawer* : In the past, banks used to returned cheques with this reason. When there was no sufficient balance in drawer's account to honour the cheque. However after addition of section 138 of the NI Act, 1881, it is now expected that no such reason for insufficiency of funds be given. When the drawer of the cheque becomes insane the cheque signed by him should be returned with the reason 'refer to drawer'. Except this situation, the reason should not be used.

ii. *Not arranged for* : Basically it means the drawer has not arranged funds in the account to honour the cheque.

iii. *Effects not cleared, present again* : Where drawer has deposited cheque which is sent for the clearing but not yet realised.

iv. *Funds expected, present again* : Where the drawer has submitted some bills for collection, the payment of which is expected to be received.

v. *Exceed arrangements* : When the overdraft/Cash Credit facility sanctioned to the drawer will exceed the limit if the cheque is honoured.

vi. Payments countermanded (stopped) by the drawer.

vii. Drawer signature differs/required.

viii. Cheque is outdated (stale)/Post dated.

ix. Amount in words and figures differs. Although in such cases NI Act says that amount stated in words should be honoured, the general practice fallowed amongst bankers is to return such cheques.

x. Cheque crossed to two banks (unless the presenting bank is acting as an agent for another bank whose crossing appears on the cheque). Alteration is not authenticated by the drawer (In CTS cheques with alteration are not accepted).

xi. Cheque mutilated.

Question 2

(a) What are the additional verification methods available for the verification of authenticity of a document submitted for KYC by a prospective customer at branch level ? (6 marks)

(b) Read the following statements carefully. Write True/False with the reasons :

(i) The Commercial Bank has the currency issue authority

(ii) CRR and SLR work opposite to each other.

(iii) Repo Rate is the rate of interest charged by the bank on corporate loans.

(iv) The Commercial Banks are the controller of the money supply.

(v) The Central bank is a lender of last resort.

(vi) RBI provides licence to banking company under Banking Regulation Act, 1949. (6 marks)

Answer 2(a)

The verification of authentication of a document submitted by a prospective customer must be based on the original documents submitted by such customers, however there are following few additional verification methods available:

1. Income tax department has made available PAN verification facility to a few reputed agencies in India. Therefore, if a customer submits a PAN card it can

be verified from the verification facility through the accredited agencies. All banks have a link with such agencies and through such arrangements PAN verification can be done.

2. Authentication, of Aadhar Number already available with the Bank can also done with explicit consent of the customer in applicable cases through the Aadhar data base and biometric data available with Central Identities Data Repository (CIDR).

3. In the case of Electricity Bills/Telephone bills these can also be verified through the service providers by mentioning the consumer number/telephone number as well as through verification software available on online.

4. In case of Companies and Directors, the data submitted by such customers can be verified through the website data of department of Corporate Affairs.

5. In case of certain banks, they employ field personnel who make a visit to the address provided by the prospective customers and physically verify the details provided by such customers.

6. At the time opening a new account/establishing a new relationship the customer will be checked against watch lists provided by international/National/Local authorities including Central banks and Anti Terrorist Organizations. If the names of such customers match with any of such names in the list, a thorough screening will take place to ensure such accounts are not opened. If such names are detected it must be reported to concerned agencies including RBI.

Answer 2(b)

(i) **False** : Commercial banks do not have the authority to issue currency in India. The Reserve Bank of India (Central Bank of our country) is the sole currency issuing authority in the Country in terms of powers vested in it through Section 22 of the RBI Act, 1934. It has the exclusive right of currency issuing.

(ii) **False** : CRR and SLR are complimentary to each other. A rise in these ratios curbs the creation of credit and vice versa. It is a statutory requirement and default on adherence to CRR/SLR requirements attracts penalty. Banks do not get interest on CRR (balance maintained in current account with RBI) but interest is earned on securities approved for the purpose of SLR (Investments of Bank in RBI approved securities from time to time).

(iii) **False** : Repo rate is that rate at which the RBI (Central bank of our country) offers short term loans to commercial Banks.

(iv) **False** : The Reserve Bank of India (Central Bank of our country) controls the money supply in the economy. The commercial banks only contribute to the money supply by way of credit creation.

(v) **True** : Central Bank provides loans to a commercial banks when the latter fail to get financial accommodation from anywhere against approved securities.

(vi) **True** : Under section 22 of the Banking Regulation Act, 1949, Reserve Bank of India grants licence to a Banking Company.

Question 3

(a) What do you mean by Corporate Governance and explain how it plays an important role in banks ?

(b) Dishonour of a cheque is a criminal offence. Explain the relevant sections/ provisions of Negotiable Instrument Act, 1881. (6 marks each)

Answer 3(a)

Corporate Governance (CG) means the system by which Companies are controlled. Corporate Governance in the context of banking denotes, managing the affairs of Banking Company by adopting the global best practices so as to protect the interest of all stakeholders such as depositors, other customers, investors, employees, regulatory authorities and society at large. Therefore the gamut of Corporate Governance is quite large and encompasses numerous aspects namely regulatory market, stakeholder and internal governance aspects. For a balanced performance of an economy, the country's economic and financial systems have to be stable. If any of these factors is found wanting there could be destabilization of the economy.

Banks are back bone of the economy. Any failure of the governance factors will have its chain reaction on other sectors of the economy. Therefore banks must follow best governance practices that goes a long way in instilling confidence among all its stake holders. Hence good corporate governance practices are a pre-requisite for a robust banking system in the economy. On the contrary poor governance in the banking system can lead to bank failures and consequently erode the confidence of depositors and other stakeholders leading to run on banks thereby creating negative impact on the financial system both at national as well as international levels.

In light of the aforesaid discussion and for the following reasons Corporate Governance becomes a crucial component for the banking sector:

1. Any financial mishap be detrimental to the economy and to get back to normalcy it would take a long time which may impede growth plans.
2. Banks are highly leveraged and this make them vulnerable to any adverse developments in the economy.
3. Banks are highly trusted organizations that deal with funds of the public at large. Anything missed in their functions will result in loss of trust, leading eventually to the collapse of such institutions and also will have its contagion effect on the economy.
4. Banks act as agents for transmission of the benefits of monetary policies to the public. They also play a vital role in payment and settlement system in an economy. Any weaknesses arising out of poor or inadequate monitoring can be set right with robust internal controls which are an essential part of governance.

Therefor corporate governance in the banks is beneficial both for the banking sector as well as the economy.

Answer 3(b)

Under section 138 of the Negotiable Instrument Act, 1881, dishonour of a cheque is a criminal offence liable to be punished with 2 year's imprisonment or with the fine up to twice the amount of the cheque or both.

The following are required to be satisfied to make the dishonour an offence under the provisions of the NI Act, 1881:

i. Existence of a legally enforceable debt or other liability by the drawer of the cheque towards another person (will be payee or holder of the cheque, as the case may be) and a cheque is drawn to discharge the debt or liability.

ii. Cheque is returned due to insufficient funds or exceeds the amount agreed upon to be paid by the bank. Cheque should be presented within its validity (i.e. 3 months from the date of issue).

iii. Notice in writing is sent within 30 days to the drawer along with the receipt of information form bank about failure of payment of cheque.

iv. The payee or holder does not receive the payment within 15 days of the receipt of the notice to the drawer.

v. The complaint to be made within one month from the cause of action arising.

vi. Only payee or holder can lodge a complaint.

vii. The offence will be tried in Metropolitan magistrate court or judicial Magistrate of 1st class court.

Cheques issued towards payment of debt will only attract the provisions of Section 138 of the NI Act, 1881. Cheque given for donation or post dated cheques for security purposes or undated cheques will not be covered under this section.

Question 4

(a) Which scheme provides refinance support to banks for lending to micro units having loan requirement upto ? 10 lakh and explain its type of funding support under the scheme? (6 marks)

(b) Match the following Securities (A) with the nature of charges over Securities (B):

Securities under Charge of Bank (A)	*Nature of Charge to be created on Securities (B)*
(1) Land and Building	*(a) Pledge/Hypothecation*
(2) Life Policies	*(b) Mortgage*
(3) Stock	*(c) Lien*
(4) Shares	*(d) Assignment*
(5) Residential House/Flat	*(e) Assignment*
(6) FDR	*(f) Mortgage*

(6 marks)

Answer 4(a)

MUDRA provides refinance support to Banks/Micro Finance Institutions (MFIs) for lending to Mircro Units having loans requirement upto 10 lakh.

Type of funding support from MUDRA:

1. *Micro Credit Scheme* : It is offered mainly through MFIs, which deliver the credit

upto 1 lakh, for various micro enterprise activities. Although, the mode of delivery may be through groups like SHGs/JLGs, the loans are given to the individuals for specific income generating micro enterprise activity. The MFIs who are availing financial support, need to enrol with MUDRA by complying to some of the requirements as notified by MUDA, from time to time.

2. *Refinance Scheme for Banks* : Different banks like Commercial Banks, Regional Rural Banks and Scheduled Cooperative Banks are eligible to avail of refinance support from MUDRA for financing micro enterprise activities. The Refinance is available for term loan and working capital loans, upto an amount of Rs 10 lakh per unit. The eligible banks, who have enrolled with MUDRA by complying to the requirements as notified, can avail refinance from MUDRA for the loan issued under Shishu (up to 50,000), Kishore (above 50,000 up to 5 lakh) and Tarun (above 5 lakh to 10 lakh) Categories.

3. *Women Enterprise Programme* : To encourage women entrepreneurs, the financing. banks/MFIs may consider extending additional facilities, including interest reduction on their loan. At present, MUDRA extends a reduction of 25 bps in its interest rates to MFIS/NBFCs, who are providing loans to women entrepreneurs.

4. *Securitization of Loan Portfolio* : MUDRA also supports Banks/NBFCs/MFIs for raising funds for financing micro enterprises by participating in securitization of their loan assets against micro enterprise portfolio, by providing second loss default guarantee, for credit enhancement and participating in investment of Pass Through Certificate (PTCs) either as Senior or Junior investor.

Answer 4(b)

	Securities under Charge of Banks (A)	*Nature of Charges to be created on Securities (B)*
1)	Land and building	Mortgage
2)	Life policies	Assignments
3)	Stock	Pledge/Hypothecation
4)	Shares	Lien/ pledge (since possession with bank)
5)	Residential house/Flat	Mortgage
6)	FDR	Lien/and Set-off

Question 5

(a) On 20th March, 2019 in the interbank market the US Dollar is quoted as under:

Spot	*US Dollar 1 = ₹ 42.4000/4200*
Spot/April	*2000/2100*
Spot/May	*3500/3600*

Your Exporter Customer wants to know the Selling and Buying rates for:

(a) Spot Delivery

(b) Forward delivery April 2019

(c) Forward delivery May 2019.

(b) What is an Operational Risk? Explain type of Operational Risk which having the potential to result in substantial losses. (6 marks each)

Answer 5(a)

The buying and selling rates will be as under:

		Buying Rate	*Selling Rate*
a)	Spot Delivery	US Dollar 1= Rs. 42.4000	Rs. 42.4200
b)	Forward Delivery April, 2019	Rs. 42.6000	Rs. 42.6300
c)	Forward Delivery May, 2019	Rs. 42.7500	Rs. 42.7800

Working Note:

	Buying Rate		*Selling Rate*	
	April	*May*	*April*	*May*
Spot Rate	42.4000	42.4000	42.4200	42.4200
Add : Premium	0.2000	0.3500	0.2100	0.3600
Forward rates	42.6000	42.7500	42.6300	42.7800

Answer 5(b)

It is the risk of loss resulting from inadequate or failed internal processes of an organisation, in human actions, systems or due to external events. Problems related to operation risks arise because of inadequate attention given to the processes and systems, or because people fail in their performance, or their functions are poorly defined.

Operational risks are difficult to define because of the broad spectrum or potential loss events, it covers. According to the segment where the company acts, this may be subject to various operational risks inherent to the business. Operational risks varies from one business to another depending upon the segment in which it operates.

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. It includes legal risk, but excludes strategic and reputational risk.

Operational risk identifies why a loss happened and at the broadest level includes the breakdown by four causes i.e. People, Processes, Systems and External factors.

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

i. Internal Fraud. Examples: employee theft etc.

ii. External Fraud. Examples: robbery, forgery etc.

iii. Employment practices and workplace safety. Examples: violation of employee health and safety rules.

iv. Clients, products and business practices. Examples: misuse of confidential customer information, Fiduciary breaches etc.

v. Damage to physical assets. Examples: Vandalism by disgruntled employees, Earthquakes, Fires and floods etc.

vi. Business disruption and system failure. Examples: Computer hardware and software failures etc.

vii. Execution, delivery and process management. Examples: incomplete legal documentation.

Question 6

Prepare the Profit and Loss account of The Modern Bank Ltd. for the year ended 31st March, 2019, from the following :

	(Amount in ₹)
Interest on Fixed Deposits	*1,62,410*
Rebate on Bills Discounted	*29,000*
Interest on Loans	*45,000*
Commission Charged to Customers	*62,500*
Establishment	*15,000*
Discount on Bills Discounted	*89,000*
Interest on Cash Credit	*24,000*
Amount Charged against Current Account	*71,500*
Directors' Fee	*10,000*
Audit Fee	*20,000*
Postage and Telegram	*2,000*
Printing and Stationery	*4,000*
Rent and Taxes	*22,500*
Interest on Overdrafts	*71,000*
Sundry Charges	*1,500*
Interest on Saving Bank Deposits	*57,780*

(12 marks)

Answer 6

Profit & Loss Account of Modern Bank Ltd.

For the Year ended 31st March 2019

Particulars	*Schedule No.*	*Amount (Rs.)*
I. Income		
Interest Earned	13	271500
Other Income	14	62500
Total		**334000**
II. Expenditure		
Interest Expanded	15	220190
Operating Expenses	16	75000
Provision for Contingencies		0
Total		**295190**
III. Profit		
Net Profit for the Year		**38810**

Schedule to be annexed with Profit & Loss Account

Schedule 13 : Interest Earned *(Amount in Rs.)*

Interest on		
Loan	45000	
Cash Credit	24000	
Overdraft	71000	140000
Discount on Bills Discounted	89000	
Less : Rebate on Bills Discounted	29000	60000
Amount charged against Current accounts		71500
Total		**271500**

Schedule 14: Other Income *(Amount in Rs.)*

Commission Charged to Customer	62500
Total	**62500**

Schedule 15: Interest Expanded *(Amount in Rs.)*

Interest Paid on	
Fixed Deposits	162410
Saving Bank Deposits	57780
Total	220190

Schedule 16 : Operating Expenses *(Amount in Rs.)*

Establishment Expenses	15000
Director's Fees	10000
Audit Fees	20000
Rent and Taxes	22500
Postage and Telegrams	2000
Printing and Stationery	4000
Sundry Expenses	1500
Total	75000

***

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

Sanjay an individual, wanted to insure his household goods against fire, theft and burglary. He approached a general insurance company for a policy. The insurance company officer had detailed discussions with him and the following values of the assets were agreed for fire and burglary insurance.

	(₹ In lakh)
Value of flat to be covered	*75*
Flat's contents	
Jewellery	*10*
Paintings and art features	*20*
Furniture & Fittings	*5*
Other miscellaneous assets	*10*
TOTAL	*120*

The insurer quoted premium of ½% on the premises, 2% on jewellery, 5% on art features and paintings and 1% on other items.

Sanjay felt that the premium rates were too high. He also thought that the likelihood of a fire accident at his flat was very minimal. However he wanted to have a cover and decided to take an insurance cover for the following values:

	(₹ In lakh)
Value of flat to be covered	*50*
Flat's contents	
Jewellery	*5*
Paintings and art features	*15*
Furniture & Fittings	*1*
Other miscellaneous assets	*4*
TOTAL	*75*

The premium was paid to the insurance company based on the above values. The insurance company accepted the proposal and a policy was issued accordingly.

A fire accident took place during the currency of the policy and the flat was damaged. The fire fighting force was able to control the fire and retrieve some of the assets. Sanjay lodged a claim of ₹ 75 lakh with the insurance company. The insurer appointed a qualified surveyor to inspect the damages and submit a report. The surveyor in his report mentioned that the flat did not suffer any material and substantial damage and with an expenditure of ₹20 lakh, it could be restored to its original position. As regards other assets insured, he reported that jewellery was kept in safety boxes and was intact and did not suffer any damage at all. Paintings and artefacts had suffered extensive damages along with furniture and other miscellaneous assets.

The surveyor raised question on admissibility of claim under the policy by stating that the fire was caused due to overhanging electrical wires which was due to the negligence of the insured.

Sanjay got the copy of the survey report and represented to the insurance company that there was no negligence on his part and the electrical wire was left hanging by the builder. He also stated that the paintings and artefacts were total loss and they cannot be repaired or set right. The other items affected by the fire and salvaged by the fire fighters were sold for ₹ 40,000 with the concurrence of the insurance company. Sanjay wanted the insurance company to pay him the full insured value.

On the basis of the above facts provide your answers/observations to the following issues:

(a) Who is a surveyor and in what circumstances does an insurer appoint him? Is the surveyor report binding on the insurer and the insured? (8 marks)

(b) Is the opinion of the surveyour that the accident was due to the negligence of the insured and hence no claim was payable under the policy sustainable ? (6 marks)

(c) If the insurer were to accept the claim under the policy, what would be the amount payable to Sanjay? Indicate in your answer the methodology of settlement that could be suggested by the insurance company. (16 marks)

(d) In case Sanjay was not in a position to accept the insurer's settlement, what course of action is open to him to establish his claim? (10 marks)

Answer 1(a)

A surveyor or a loss assessor is relevant for general insurance business, where assessment of the loss of the subject matter insured is very important for deciding the claim amount. The job of the Surveyor or Loss assessor is to arrive at the exact amount of loss incurred and his role is critical to general insurer.

Every person who is a student member of the Institute of Surveyors and Loss Assessors intending to act as a Surveyor or Loss Assessors is required to be licensed by IRDA to start functioning as surveyor for general insurance. The IRDA license for Surveyor is valid for a period of 5 years and has to be renewed after every 5 years.

A surveyor is appointed in cases of claims of loss exceeding ₹ 20000.

A surveyor examines the claim, takes note of the claims of the insured and reports to the insurance company. Prior to submitting his report to the insurer, the surveyor discusses the claim with the insured and a copy of the report is also sent to the insured. The surveyor is a technical expert well versed in the area of the claim. He also discusses in his report the contents of the policy, whether any policy restrictions are attracted, the concept of negligence if any and suggests what according to him will be a reasonable amount of claim to be paid. Such a report is not final and based on the report the insurer will negotiate with the insured and settle the claim. A surveyor shall submit his report within 30 days of his appointment. In exceptional case, the surveyor may seek extension of time up to six months from the insurer, under intimation to the insured. Generally the surveyor will cite some rules etc. and would suggest that the claim is mala fide and amount not payable. However these are only observations and don't have any legal authority.

A survey report is a help in settling the claim and is not legally binding on the insurer and the insured. The National Consumer Commission held that the surveyor's assessment need not be the final word while settling a claim.

Answer 1(b)

The report from the surveyor is a procedure in the process of settlement of claim. The policy is a fire insurance policy. It becomes payable in case of an accident caused by fire. Here the cause to be looked into is only the proximate cause and not the contributory cause.

In the present case, the surveyor had apparently at the time of inspection notices some loose wires in the premises and felt that the fire emanated from them and caused the loss reported. It can however not be denied that the articles insured were not damaged due to fire in the premises. The proximate cause being fire which is insured under the policy. The insurance company cannot repudiate the claim on the basis of the survey report only. The report by the surveyor that the accident was due to the negligence of the insured is not sustainable in this case. The proximate cause as discussed above is fire and hence no negligence on the part of the insured can be found.

Answer 1(c)

The following are the market values and the insured values of the various assets under the policy.

	Market/Fair value *₹ In lakhs*	*Insured Value* *₹ In lakhs*
Value of flat to be covered	75	50
Flat's content		
Jewellery	10	5
Paintings and art features	20	15
Furniture & Fittings	5	1
Other miscellaneous artefacts	10	4

TOTAL	120	75

The reduction in the values of the assets is a deliberate decision by the insured who thinks that the chances of the fire accident occurring in the flat were very minimal. However subsequent to the taking of the policy he has been proved wrong. Thus there exists a feature of under insurance of the values of assets for the policy. Second feature of the fire policy is that it is an indemnity policy only. Further the total values of assets which was ₹ 120 lakhs at market value has been insured only for ₹ 75 lakhs. Moreover these goods are into different categories for insurance on which different rates of insurance premium ranging from ½ % to 5% are applicable.

Since the insured has under insured the assets the average clause would be applicable for settlement of the claim. The claims work out as under:

Flat 50/75 x 20,00,000 = 2/3x20,00,000 = 13,33,333

Painting s and features 15/20x15,00,000 = 3/4x15,00,000 = 11,25,000

Furniture &Fittings = 1/5x1,00,000 = 20,000

Other miscellaneous assets = 4/10x4,00,000 = 1,60,000

Thus total claim works out to

1333333+1125000+20000+160000 = 2638333

Less salvage value = 40000

Net claim payable as per insurance company = 2598333.

No claim has been calculated on jewellery as there was no loss in jewellery. Sanjay, the insured has the option to accept the claim as settled above by the insurance company based on the policy conditions and the survey report submitted.

Answer 1(d)

Sanjay has the option to accept the claim as settled above by the insurance company. In case he is not satisfied he can file his grievances with the Grievances settlement Commission of the insurance company. He could have gone to the insurance ombudsman but in that case the claim limit is up to ₹ 20 lakhs only. In this case he cannot us the option of Insurance Ombudsman due to the claim amount being higher than ₹ 20 lakhs.

He can file a case with the consumer courts and as necessary can go higher courts to seek a higher claim than offered by the insurance company.

Question 2

(a) What are the participating policies in life insurance business ? Can a life insurance company declare a bonus to the policyholders when participating fund is in deficit? Discuss.

(b) A, an individual, has taken a life insurance policy for ₹ 5 lakh on his own life and nominated C as the nominee under the policy. Subsequently A assigned interest under the policy to S from whom he had borrowed ₹ 2 lakh. Both the assignment and the nomination were duly reported to the insurer.

A died after about 2 years of taking the policy. The amount borrowed from S had remained unpaid on the date of his death. Who will get the insured amount on A's death? Decide. *(6 marks each)*

Answer 2(a)

Participating policies are the policies issued by an insurance company that participate in the periodical bonus declared by the insurance company. The periodical premium payable for a participating policy will be higher than the premium payable on non-participating policy.

Policyholders who take Life insurance policies which are eligible for participating in the surplus arising out of the Participating business are eligible for bonus, if and when declared by the Life Insurance Company. These Policies which are eligible for bonus are also called "With Profits" Policies or "Participating" Policies. Policyholders' Bonus is not guaranteed and is subject to availability of surplus arising in the Participating segment of the Life insurance business.

An insurer where participating fund is in deficit is generally not allowed to declare bonus. However IRDAI has permitted declaration of bonus if the insurer strictly satisfies the following conditions:

(i) It should make good the accumulated deficit in the policyholders' account and transfer adequate assets to cover the cost of bonus, prior to declaration of bonus. Such an transfer from the shareholder's account can be out of profit & loss account balance or reserves in the shareholders account and/or by drawing upon the paid up capital of the insurer. By implication there shall be no deficit in the policyholders' account in case of the insurer opting for declaration of bonus under these circumstances.

(ii) Any transfer as aforesaid shall be by a debit to the Profit & Loss (Shareholder's) account and a credit to the Revenue (Policyholders') Account.

(iii) The funds so transferred to the Policyholder's Account shall be irreversible in nature i.e at no point of time can they be recouped to the Shareholders' Fund.

(iv) The transfer to the Policyholders' Account must be fully backed by transfer of assets / investments to the Policyholders' funds and should be adequate to meet the Policyholders' liabilities including the cost of bonus.

(v) The proposed rates of bonus should be capable of being sustained in the future.

(vi) The transfer of the funds to the Policyholders' account should be supported by a special resolution of the shareholders at the general meeting of the insurer. Further the insurer should appropriately increase the paid-up equity capital within six months from the date of transfer of funds, or such longer period as may be approved by the authority, with a view to aligning the paid-up equity capital, such as to make up the deficiency (including the cost of bonus) in the life fund as aforesaid and is backed up and represented by Policyholder's assets/investments.

The above provisions, for the purpose of meeting the requirement of declaration of bonus are available to the insurers only during the first twelve financial years commencing from the year in which the life insurance business operations were started. Thereafter, it is expected that the declaration of the bonus will be supported by surplus within the life fund without recourse to the contribution from the shareholders.

Answer 2(b)

As per Section 39(4) of Insurance Act, 1938, as a rule assignment of an Insurance Policy automatically cancels nomination subject to the exceptions given below:

Where policy loan is taken from the Life insurer who issues the policy, as a pre-condition of sanction of loan, the policy has to be assigned in favour of the Life insurer. Under such circumstances, such assignment in favour of Life insurer does not automatically cancel subsisting nomination. But in the event of death while the loan subsists, the rights of Nominee is subject to satisfaction of the outstanding loan and interest and only the balance amount if any, can be paid to the Nominee.

Similarly where the Policy is assigned by a Debtor (policyholder/Borrower/Assignor to Creditor (Lender/Assignee) as collateral security for the loan taken by the policyholder from the assignee the Nomination is not cancelled. Nominee get the residual amount if any, after satisfaction of the outstanding amount on death to the Assignee.

Thus in the cited case C will get the residual amount (as he has been appointed as Nominee after the death of Mr. S) after payment to Mr. S of the outstanding debt of ₹ 2 lakhs with interest if any.

Question 3

(a) X is a director of an insurance broking company. C, a general insurance company, wants to induct him on the Board of the company as an independent director. You are the company secretary of the company C. How will you proceed for the appointment of X as an independent director? What is the procedure to be complied with by a person who wishes to be appointed as a director on the board of an insurance company? (6 marks)

(b) S is a limited liability company carrying on a business in manufacture and sale of hazardous products. It has insured its risks under a general insurance contract with one of the Indian insurer. In course of the currency of the policy, an explosion occurs in the factory and 20 members of the public are killed while 40 suffer from permanent total disability. Amongst the injured were 5 minors who were hospitalized and then discharged.

Calculate the amount of relief that members of the public will be entitled under the policy taken with the insurer. (6 marks)

Answer 3(a)

The rule and regulation of corporate governance are applicable to insurance companies. The IRDAI has adopted the principle and notified them to be followed by all insurers, insurance intermediaries, auditors, directors, actuaries and other key managerial personnel connected with the industry are prohibited from holding positions which are conflicting with each other. This is to ensure that the business decisions are taken without any bias. For example, the Appointed Actuary cannot be undertaking claims settlement functions, an appointed actuary is required to evaluate the impact of the variance between with actual and expected claims and the impact on the insurers.

Section 48A of Insurance Act, 1938, prohibits interlocking directorships between an insurance company and Insurance intermediary, without prior approval of IRDAI. The

term Insurance intermediary includes distributors of insurance products such as agents, brokers, web aggregators, Insurance Marketing Firms etc. Approval may be granted by IRDAI, subject to conditions being imposed to avoid conflicts of interest or to protect interests of Policyholders. For example, if the Director of the Insurance Company is an Independent director and wishes to be appointed as an independent director on the board of an intermediary, IRDAI may grant its approval as the chances of conflicts of interest is low in such cases

IRDAI views such situation in two manners. For auditor or officer who becomes aware of a material conflict of interest two options are open viz, to eliminating the conflict or to reassign within 30 days. Common directorship among insurance firms, insurance company and its promoters, insurance company and its intermediaries will be subject to certain conditions. IRDAI may positively feel that its pre sanction/ pre approval is not needed when the common director /official is an independent director in both the organization under the same group and where the annual remuneration does not exceed ₹10 lakhs.

Let us apply these principles to the facts given in the question. The individual director is an independent director in one insurance broking company undoubtedly an insurance intermediary. The individual wants to be appointed as an independent director in general insurance company.

The role of an insurance broker is mostly manifest in general insurance business where he acts as an independent professional and advises on the policy contents. He also apprises the products offered by different insurers and advise to the customers on the type of cover that will best suit the requirement of the customers. The broker also do liasoning between the insurers and insured on settlement of the claims. Hence the connection between an insurance broker and a general insurance company is very strong.

By becoming an independent director in the general insurance company, there is a distinct possibility of developing a bias to his brokerage home which will lead to unwanted complications. The independence of the director will be completely lost in the development of the broking business.

In the circumstances it is felt that under the corporate governance rules, this selection will be frowned upon by the regulator.

Answer 3(b)

This case is covered under the Public Liability Insurance Act, 1991. Very often we notice members of the public being affected by major accidents in establishments. This Act provides for mandatory public liability insurance for installations handling hazardous substances to provide minimum relief to victims of accidents, other than the employees. The Act imposes no fault liability, i.e. irrespective of any wrongful act, neglect or default on the owner to pay the relief in the event of a death of or injury to any person (other than workman) or damage to property of any person arising out of an accident while handling any hazardous substance. No fault liability means that 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. The Act itself under a schedule attached to it lays down the scale of relief/ compensation due in various situations:

Fatal accident: 25,000 per person Permanent total disability : 25,000 per person; There are certain other prescription to meet allied situation based on the schedule to the Act the amount of relief due in the present case, will work to:-

No. of death 20 at the rate of ₹25,000/person	₹ 5,00,000
No. suffering from permanent total disability 40 @ 25000/person	₹10,00,000
	₹15,00,000

The question of compensating for medical expenses and the minority age of the affected are relevant factor only for determining permanent partial disability which is not

Question 4

(a) Under what conditions imposed by IRDAI, can insurance products be marketed by web aggregators ? Discuss.

(b) What is the role of a "with profits committee" of a life insurance company? How is it constituted? (6 marks each)

Answer 4(a)

A Web Aggregator is an online seller of insurance products – allowed to sell insurance products of multiple insurance companies. *Example* : Policy Bazaar. They are permitted to do only online sales, though telephonic solicitation is also allowed. Since the Web Aggregator aggregates the insurance products of multiple insurance companies through internet (Web), they are called Web Aggregators.

Web Aggregator is a company registered under the Companies Act and approved by IRDAI which maintains or owns a website and provides information on insurance products of different insurers.

Following are some of the conditions imposed by IRDAI on the Web Aggregators for marketing of insurance products:

- A Web Aggregator is a Company having its own website and providing insurance products.
- Product information of various insurers with price comparisons.
- leads to Insurers from customers who access the website.
- No ranking, rating or endorsement of any insurer allowed.
- Minimum capital & Net worth of ₹25 lakhs and cannot act as agent, broker, TPA surveyor or be their related party.
- All Web Aggregators shall get approval from IRDA valid for 3 years.
- An insurance broker who provides product comparisons in his website shall also follow the web aggregator guidelines pertaining to display of product comparisons on website.
- Telemarketing by Web Aggregators through Authorised Verifiers who have to undergo IRDAI training and examination – telephone solicitations allowed only

for leads generated on the Web aggregator site. Product restriction over telemarketing mode – not more than ₹1,50,000 of annualised premium.

- Customer visits the website of the aggregator selects the product category, e.g. Endowment, Whole Life, Term, ULIPs etc.
- Once the visitor selects the product category, the website will ask for his basic details such as age, health and personal details, term, sum assured required etc.
- Once the visitor gives the details, the product comparison chart is displayed, along with the default underwriting requirements such as medical examinations required, exclusions, limits and other conditions and key features of the product chosen.
- Visitor may select the insurer with whom his information can be shared as a lead, else the Web Aggregator can transmit the lead to not more than 3 insurers (life or non-life as the case may be).
- Insurer can in turn pass on the lead to a Corporate Agent or an Authorised Person of a Telemarketer or an Insurance Broker or to their own employees or Web Aggregator can use distance marketing for closure of sale.
- Visitor is either called over phone or visited by person closing the sale (either authorised employee of Web Aggregator or Insurer or Broker) and the solicitation is completed.
- Policies procured by Web Aggregators to be commensurate with their resources and number of Authorised verifiers.
- A Web Aggregator is allowed to provide product comparisons as well as solicit insurance business – entity licensed cannot do any other business, including corporate agency, broking. Company or a partnership firm can act as Web Aggregator after procuring IRDA licence with a networth of ₹25 lakhs to be maintained at all times – foreign equity restricted to 26%
- Principal Officer and the Employees who solicit insurance business should have undergone 50 hours training and passed the examination conducted by National Insurance Academy, Pune.
- Professional indemnity insurance 3 times the remuneration subject to a minimum of ₹ 10 lakhs mandatory. I Web Aggregator shall ensure that their systems comply with the generally accepted information security standards.
- Ratings or rankings or endorsements of products prohibited while doing product comparisons.
- Customer's lead shall be shared with the insurer of customer's choice. If customer has no choice of a specific insurer, the lead can be shared with up to 3 insurers by the Web Aggregator.
- Once a policy is sold out of the lead provided by insurer, it shall be fed into the Lead management system ('LMS') by the concerned insurer – yearly audit of the LMS prescribed.
- Board approved policy for comparison and distribution of products

Answer 4(b)

'With Profits' Committee is unique to Life insurance companies. Under Participating line of business for Life insurance companies, Policyholders are entitled to a Bonus which may be declared depending on the surplus that emerges from this line of business. Out of the surplus, not less than 90% shall be distributed to Policyholders as bonus and the balance 10% goes to Shareholders. In order to ensure transparency and governance over the distribution of surplus, Regulation 45(d) of IRDAI (Non-linked Products) Regulations, 2013 have prescribed constitution of a 'With Profits' Committee comprising of the following members:

(a) CEO

(b) Appointed actuary

(c) 1 Independent Director

(d) 1 Independent Actuary

The Committee is responsible for the following:

(a) Examining detailed working of the asset share (share of assets for participating business) at eh Policy level

(b) Expenses allocated to Participating business

(c) Investment income earned in Participating business

Question 5

Is a health insurance policy taken by an individual from a health insurer 'A' transferrable to another health insurer 'B'? Discuss the modalities of such a transfer if it were to be possible. *(12 marks)*

Answer 5

Portability is the right accorded to the Policyholder to transfer the credit gained for pre-existing conditions and time-bound exclusions from one insurer to another insurer or from one plan to another plan of the same insurer.

In simple words, it is the right conferred on a Policyholder who decides to move from one General or Health insurer to another or to another plan of the same General or Health insurer. Portability is not applicable to fixed benefits payable under Health insurance policies issued by a Life insurer. The advantage of portability is the carry forward of the credits accrued on account of having a Policy with the previous Insurer.

Portability form shall be submitted to the old insurer who shall send it through a portal to the new Insurer. New insurer may request the claims history and other details from the previous insurer who shall submit the required details within a period of 7 days from the date of receipt of request.

An insurer may reject the request for portability if the Policyholder approaches 60 days before or within 45 days of the date of expiry of the insurance policy. However, an insurer may at their option consider the request for renewal even outside the above period.

New insurer is under obligation to accept or reject within a period of 15 days from the date of receipt of the Portability form. If the New insurer does not convey any decision with the aforesaid 15 days, the New insurer is deemed to have accepted the request for portability. No charges for portability can be levied either by the Previous insurer of the New insurer.

No commission shall be paid to any Agent or Intermediary for the policy which is ported from one insurer to another insurer.

The insurance regulator added the terms portability and migration in its health insurance guidelines. By doing this, the Insurance Regulatory and Development Authority of India (IRDAI) has given clarity with regards to transfer of credit gained for pre-existing conditions (PED) and time-bound exclusions, from one insurer to another insurer, while migrating or porting policies. It also added the definition of migration specifically.

These changes were included in the guidelines on standardisation in health insurance released by IRDAI on January 1, 2020, with respect to the Standard Definitions for 42 commonly used terms in health insurance policies as defined under Guidelines on Standardization in Health Insurance.

IRDAI said, "The definition of 'Portability' and 'Migration' shall be applicable in respect of all health insurance products (both Individual and Group) filed immediately. Break in policy clause "occurs when the premium due on a given policy is not paid on or before the premium renewal date or within 30 days thereof" as per the earlier guidelines.

Here is the latest definition: "Portability" means, the right accorded to individual health insurance policyholders (including all members under family cover), to transfer the credit gained for pre-existing conditions and time-bound exclusions, from one insurer to another insurer, as per the circular.

On the other hand, the latest definition of Migration means, "the right accorded to health insurance policyholders (including all members under family cover and members of group health insurance policy), to transfer the credit gained for pre-existing conditions and time-bound exclusions,

Question 6

R Insurance Inc. is a life insurance company having its headquarters in the USA. It has many subsidiaries and associates that are engaged in the financial sector.

R entered into the Indian insurance market in 2004 by taking a 26% equity interest in an Indian insurance company. On liberalisation of the rules, its equity participation was increased to the permitted level of 49%.

Sensing that it could contribute to the growth of the Indian insurance market, R wanted a further participation in the equity of another Indian insurance company either in its name or any one of its US subsidiaries. It carried on negotiations with an Indian company proposing to set up a new life insurance company in India and agreed to take equity in the new life insurance company to the extent of 26% in the first stage.

Can R hold equity in two different insurance companies in India? Discuss.

(12 marks)

Answer 6

In 1993, the Government set up a committee under the chairmanship of RN Malhotra, former Governor of RBI, to propose recommendations for reforms in the insurance sector. The objective was to complement the reforms initiated in the financial sector. The committee submitted its report in 1994 wherein, among other things, it recommended that the private sector be permitted to enter the insurance industry. They stated that foreign companies be allowed to enter by floating Indian companies, preferably a joint venture with Indian partners. Following the recommendations of the Malhotra Committee report, in 1999, the Insurance Regulatory and Development Authority (IRDA) was constituted as an autonomous body to regulate and develop the insurance industry. The IRDA was incorporated as a statutory body in April, 2000. The key objectives of the IRDA include promotion of competition so as to enhance customer satisfaction through increased consumer choice and lower premiums, while ensuring the financial security of the insurance market. The IRDA opened up the market in August 2000 with the invitation for application for registrations. Foreign companies were allowed ownership of up to 26% in the equity share capital of the Insurer. This limit was later raised to 49% during the year 2016. The limit of foreign investments in intermediaries has increased from 49% to 100% in year 2019.

The IRDAI issued the Insurance Regulatory and Development Authority of India (Investment by Private Equity Fund or Alternative Investment Fund in Indian Insurance Companies) Guidelines, 2017 on 05 December, 2017 (IRDAI Guidelines). The IRDAI Guidelines are effective from the above date.

In addition to the above, the private equity funds (PEFs) would be required to comply with the IRDAI (Transfer of Equity Shares) Regulations, 2015 (Transfer Regulations 2015) and other applicable IRDAI, exchange control and SEBI regulations.

The IRDAI Guidelines are applicable to unlisted Indian insurance companies and the PE funds that have invested in unlisted Indian insurance companies either as an "investor" or as a "promoter". A PEF has been defined to include an Alternative Investment Fund registered under the Securities and Exchange Board of India (Alternative Investment Fund) Regulations, 2012 and/ or a Fund specifically formed for investment in one/ more entities by one/ more persons. It appears that only onshore PEFs are sought to be governed by the IRDAI Guidelines.

The key conditions emanating from the IRDAI Guidelines are summarised below.

(A) *Key conditions applicable to PEFs investing in Indian insurance companies as an "investor"*

1. A PEF may invest in an Indian insurance company as an "investor" directly or through a Special Purpose Vehicle (SPV) i.e. an onshore company or limited liability partnership incorporated in India;
2. Investment to be as per the PEF's strategy reflected in its placement memorandum;
3. The PEF shall hold maximum 10% of the paid up equity share capital of the insurance company;
4. All Indian investors along with the PEFs to jointly hold maximum 25% of the paid-up equity share capital of the insurance company;

5. Minimum shareholding by the promoters/ promoter group to be 50% of the paid up equity share capital of the insurance company at all times. However, if the present holding by the promoters is below 50%, such lower holding would be the minimum holding;
6. Investment to be subject to the prescribed "Fit and Proper" criteria as annexed to the IRDAI Guidelines;
7. PEFs to provide a specific undertaking that it will not create any encumbrance on or leverage the investment;
8. Upfront disclosure by the PEF if the investment is one time.

(B) *Key conditions applicable to PEFs investing in Indian insurance companies as a "Promoter"*

1. A PEF can invest in an Indian insurance company as a "promoter" only through an SPV and not directly;
2. A PEF through an SPV shall not be a promoter for more than one life insurer, one general insurer, one health insurer and one reinsurer;
3. Schemes to be filed with SEBI in accordance with the provisions of relevant SEBI regulations;
4. Investment to be as per the PEF's strategy reflected in its placement memorandum;
5. Investment to be made entirely out of own funds and not borrowed funds;
6. Investment memorandum or charter documents of the investor/ investing vehicle to permit investment up to the permitted limits including any future capital requirements;
7. Investment to be subject to the prescribed "Fit and Proper" criteria. One of the key criteria is "whether the applicant is a widely held entity, publicly listed and a well established regulated financial entity in good standing in the financial community";
8. PEFs to provide a specific undertaking that it will not create any encumbrance on or leverage the investment;
9. Lock-in period of five years for the (i) SPV; and (ii) shareholders of the SPV holding atleast 10% capital of the SPV;
10. Any new shareholders in the SPV through issue of fresh shares beyond 25% would require prior IRDAI approval;
11. Minimum shareholding by the promoters/ promoter group to be 50% of the paid up equity share capital of the insurance company at all times. However, if the present holding by the promoters is below 50%, such lower holding would be the minimum holding;
12. The Indian insurance company to comply with IRDAI guidelines on "Indian owned and controlled" and Indian Insurance Companies (Foreign Investment) Rules, 2015;

13. Either the Chairman of the Indian insurance company to be an independent director or its Chief Executive Officer/ Managing Director/ Whole-time director to be a professional and not a nominee of a promoter;

14. Atleast one-third of the board of the insurance company to comprise of independent directors;

15. An undertaking to subscribe to the rights issue of the Indian insurance company to be provided to ensure that the Indian insurance company is not cash strapped;

16. An undertaking of the post lock in period divestment plan (preferably through an Initial Public Offer) in accordance with the relevant regulations to be provided.

Thus, R Insurance Inc. can be promoter in one life insurer, one general insurer, one health insurer and one reinsurer and can hold maximum 10% of the paid up equity share capital of the insurance company.

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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

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

RELMO S.A. (RELMO) is an Argentinean seed company belonging to the Ferrarotti family. The origins of RELMO are to be found in the Ferrarotti Countryside Organization (OFPEC) which was established in the 1960s as the first company in Argentina to devote itself to the genetic improvement of soybean. OFPEC was responsible for the program that led to the registration of the first Argentinean soybean "variety" (a plant grouping within a single botanical taxon of the lowest rank) in 1980.

RELMOs business strategy concentrates on the production and sale of plant seeds of mainstay crops : soybean, wheat and maize. Its activities are conducted throughout the Argentinean agricultural and livestock industry. Its central offices are in Rosario, Santa Fe, a major grain marketing, soybean grinding center and seed export zone. In fact, the most important soybean producing-exporting center in the world is to be found in an area within a radius of 200 kilometers around Rosario.

Despite its traditional approach in certain areas (e.g. the company's main experimental field remains the Ferrarotti family farm), RELMO has dramatically changed its way of doing business and has managed to prosper following some of the important changes that took place in the Argentinean seed industry since the mid-1990s. One of the main reasons for RELMO's success has been its ability to manage its intellectual property (IP) successfully and to establish partnerships with foreign and domestic companies and research institutes.

The Argentinean Law No. 20.247 on Seeds and Phytogenetic Creations, guarantees ownership of plant varieties, and the Argentinean Association of Protection for Plant Breeds (ARPOV) deals with the defense of rights and provides the possibility for collecting royalties for IP rights holders. Additionally, Argentina's accession to the 1978 Act of the International Union for the Protection of New Varieties Convention (UPOV Convention) plays an important role in the development of companies such as RELMO.

One of RELMO's major areas of work is the genetic improvement of soybean. The company's market position, however, was seriously challenged when Monsanto, a multinational agricultural biotechnology corporation, started commercializing the Round-up Ready (RR) gene (RR technology allows for the use of herbicide without any adverse effect on the crops) in Argentina during the mid-1990s. The RR gene-based plant varieties soon became popular among farmers. RELMÓ was quick to realize that to retain its market position, they would have to market RR varieties too.

Therefore RELMÓ reached an agreement with Monsanto Argentina that authorized its use of the RR gene. This agreement also allowed RELMO to place its soybean varieties in other countries.

As far as maize is concerned, due to the high degree of adoption of transgenic (genetically engineered) forms of maize in Argentina, RELMO signed a testing agreement with Monsanto in order to work with MON 810, a maize variety based on the Bt gene (gene of a naturally occurring bacteria that produces a protein toxic to certain types of insects. The Bt gene can be transferred to crops, thereby making them more resistant to the corresponding insect).

RELMO has registered over a dozen trademarks. Among them, the most important ones are RELMÓ, TECNOSOJA, TECNOTRIGO and TECNOMAIZ. The company has also registered the name with which it identifies its lines of products, such as CANAI. Trademark registrations are done primarily for the domestic market with Argentina's National Institute for Industrial Property (INPI), as varieties that are licensed to foreign companies, for example American companies, are generally sold under the licensee's trademarks.

The growth of RELMO in recent years is essentially based on license agreements linked to IP. It has been capable of negotiating licenses for its own varieties and those created by third parties to other companies in Argentina and abroad.

Agreement with the National Institute of Agriculture Technology (INTA) of Argentina: In 2002, RELMÓ concluded an agreement on technology transfer with INTA for the genetic improvement of subtropical germplasm of maize. Under the Agreement, INTA provides the germplasm, installations and technical staff, and RELMO covers the operating expenditures. The hybrids obtained are marketed exclusively by RELMO while INTA receives a percentage royalty as the owner of the germplasms. This unique public-private agreement also allows RELMÓ to produce the hybrids with its own trademark and also to license them out to third parties.

Licensing Agreement with the National Livestock Research Institute (INIA) of Uruguay: INIA and RELMÓ have a special deal under which INIA has granted RELMÓ exclusive rights over the licenses for INIA's wheat varieties in Argentina. In return, RELMÓ has authorized similar rights to INIA for soybean varieties from RELMÓ. This license agreement allows RELMÓ to enter the wheat seed market with adapted varieties at a cost roughly equivalent to that of developing its own crops, however at a much quicker pace. INIA benefits from the expansion of the market for its wheat varieties. For RELMÓ, this is a very good commercial opportunity; RELMÓ has typically focused on soybean sown in summer, but the incorporation of the seeds of winter crops from INIA allows them to expand their sales structure and to generate more revenue. The scheme of licenses for soybean varieties to INIA, with a view to market them in Uruguay, has similar results for both parties.

Licensing-out to South African companies : In the past, RELMO had granted licenses for conventional varieties in South Africa, and, more recently, it has done so for RR varieties, thereby contributing to the development of the crop in that country. As in previous agreements, RELMÓ is the owner of the varieties and a South African company exploits them commercially.

Partnership with Delley Semences et Plantes (Seeds and Plants) S.A. (DSP) of Switzerland : RELMÓ established a commercial relationship with DSP in Switzerland, which includes licenses for varieties of wheat for the whole of South America and technical collaboration, including the training of RELMÓ staff in Switzerland. Like in the Agreement with INIA, the varieties here are also owned by DSP, and RELMÓ is responsible for commercial exploitation. The agreement allowed RELMO to access the Argentinean markets with high quality wheat varieties.

Argentina constitute a major market for the production of soybean in the world. FMT provides important technical support for the crop in Brazil, where approximately 16 million hectares are cultivated. RELMÓ has established a program of work which includes the joint launch of varieties of soybean, which is carried out in both countries. This joint project does not involve any licenses but an ambitious joint development of varieties and research on discease resistance, as well as cultivation technology. Integration with Sursem S.A. : In April 2009, RELMÓ reached an agreement with Sursem S.A., another Argentinean seed company. Based on this agreement, Sursem has taken over the responsibility of the distribution of seeds for RELMÓ in Argentina. Sursem will build upon the existing marketing structure of RELMÓ and improve its services to customers and distributors. For its part, RELMÓ will be integrated into Sursem and will focus on research programs and improvement of soybean and wheat to meet Argentinean requirements. It will at the same time continue its technology exports to neighboring countries.

Starting as a small family business, RELMO has come a long way to establish itself as a pioneer in the genetic improvement of soybean in Argentina. The partnership strategy that RELMÓ pursued not only enabled it to retain its market position in Argentina, but also provided it with improved plant varieties, access to foreign markets and consequently higher revenue. The integration with Sursem allows RELMÓ to concentrate more in research and development while at the same time assuring it of the much-needed market access at home and abroad.

A strategic partnership approach through licensing and intelligent use of IP was the key factor behind RELMÓ's success. While the national and international legal framework facilitated the task of ensuring the ownership of phytogenetic creations (varieties or lines), the partnerships helped RELMÓ move forward quickly and very actively in retaining and extending its domestic and foreign market positions.

Questions:

(a) Assess the RELMO's ability in managing its Intellectual Property (IP) successfully.

(b) How the Argentina's accession to the 1978 Act of the International Union for the Protection of New Varieties Convention (UPOV Convention) plays an important role in the development of companies such as RELMO?

(c) Although the RELMO's major areas of work is the genetic improvement of soybean then why company's market position seriously challenged by Monsanto.

(d) How the licensing agreement with National Institute of Agriculture Technology (INTA) and National Livestock Research Institute (INIA) helpful for RELMO?

(10 marks each)

Answer 1(a)

RELMO's ability in managing its Intellectual Property (IP) successfully can be assessed from the following:

(i) Agreement with Monsanto Argentina: During the mid-1990s when Monsanto commercialised RR gene in Argentina and RR gene-based plant varieties became popular among farmers, RELMO quickly realised that to retain its market position, they would have to market RR varieties too. Therefore RELMO reached an agreement with Monsanto Argentina that authorized its use of the RR gene. This agreement also allowed RELMO to place its soybean varieties in other countries. As far as maize is concerned, due to the high degree of adoption of transgenic (genetically engineered) forms of maize in Argentina, RELM signed a testing agreement with Monsanto in order to work with MON 810, a maize variety based on the Bi gene (gene of a naturally occurring bacteria that produces a protein toxic to certain types of insects.

(ii) Registration of trademarks: RELMO has registered over a dozen trademarks. Among them, the most important ones are RELMO, TECNOSOJA, TECNOTRIGO and TECNOMAIZ. The company has also registered the name with which it identifies its lines of products, such as CANAI. This trademark registration enabled foreign companies like American Companies to sell the varieties under licensee's trademarks. So, Telco did not limit itself to Argentina but also targeted the foreign countries for its registered varieties.

(iii) Entering into Licensing Agreements linked to IP: The growth of RELMO in recent years is essentially based on license agreements linked to IP. RELMO has been capable of negotiating licenses for its own varieties and those created by third parties to other companies in Argentina and abroad e.g.

  (a) Agreement with the National Institute of Agriculture Technology (INTA) of Argentina: This unique public-private arrangement allows RELMO to market exclusively hybrids of maize developed by INTA, to produce hybrids with its own trademark and also to license them out to third parties.

  (b) Licensing Agreement with the National Livestock Research Institute (INIA) of Uruguay: This was a special deal between INIA and RELMO which enables RELMO to enter into exclusive rights over the licenses for INIA's wheat varieties in Argentina on a reciprocal basis for giving the similar rights to INIA for it's soyabean varieties. This license agreement allowed RELMO to enter into wheat seed market with adapted varieties at a cost roughly equivalent to that of developing its own crops however at a much quicker pace. By this agreement, RELMO expanded its sale structure and generated more revenue.

  (c) Licensing-out to South African companies: RELMO granted licenses in South Africa not only for its conventional varieties but also for RR varieties which enables the commercial exploitation of its varieties in South Africa.

  (d) Partnership with Delley Semenceset Plantes (Seeds and Plants) S.A. (DSP) of Switzerland: This agreement allowed RELMO to access the Argentinean markets with high quality wheat varieties.

(e) Integration with Suresam S.A.: This partnership strategy enabled small family business RELMO to retain not only its market position in Argentina, but also provided it with improved plant varieties, access to foreign markets and consequently higher revenue. The integration with Sursem allowed RELMO to concentrate more in research and development along with ensuring much- needed market access at home and abroad.

RELMO started as a small family business, became the first Argentinean Company to devote itself to the genetic improvement of soyabean in 1960s. RELMO dramatically changed its way of doing business and adopted changes that took place in the Argentinean seed industry since the mid-1990s. One of the main reasons for RELMO's success has been its ability to manage its intellectual property (IP) success and to establish partnership with foreign and domestic companies and research institutes. A strategic partnership approach through licensing and intelligent use of IP was the key factor behind RELMO's success. While the national and international legal framework facilitated the task of ensuring the ownership of phytogenetic creations, the partnership helped RELMO move forward quickly and very actively in retaining and extending its domestic and foreign market positions.

Answer 1(b)

The Argentinean Law No.20.247 on Seeds and Phytogenetic Creations, guarantees ownership of plant varieties, and the Argentinean Association of Protection for Plant Breeds (ARPOV) deals with the defense of rights and provides the possibility for collecting royalties for IP rights holders. Additionally, Argentina's accession to the 1978 Act of the International Union for the Protection of New Varieties Convention (UPOV Convention) plays an important role in the development of companies such as RELMO.

The International Union for the Protection of New Varieties of Plants (UPOV) is an intergovernmental organization with headquarters in Geneva (Switzerland). UPOV was established by the International Convention for the Protection of New Varieties of Plants. The Convention was adopted in Paris in 1961 and it was revised in 1972, 1978 and 1991. UPOV's mission is to provide and promote an effective system of plant variety protection, with the aim of encouraging the development of new varieties of plants, for the benefit of society.

Introducing the UPOV system leads to increased availability of new varieties, and that accession to the UPOV Convention means greater availability of foreign new varieties. For example, in 1991, when the Argentina PVP law incorporated provisions of the UPOV Convention, the number of titles of protection immediately tripled. With Argentina's accession to the UPOV Convention in 1994, titles of protection granted to foreign breeders substantially increased as their varieties began to be introduced into the country. Argentinean farmers therefore gained access to, for example, varieties of wheat from abroad with superior baking qualities.

One of RELMO's major areas of work is the genetic improvement of soybean. The company's market position, however, was seriously challenged when Monsanto, a multinational agricultural biotechnology corporation, started commercializing the Round-up Ready (RR) gene (RR technology allows for the use of herbicide without any adverse effect on the crops) in Argentina during the mid-1990s. The RR gene-based plant varieties soon became popular among farmers. RELMO was quick to realize that to retain its

market position, they would have to market RR varieties too. Therefore RELMO reached an agreement with Monsanto Argentina that authorized its use of the RR gene. This agreement also allowed RELMO to place its soybean varieties in other countries.

Answer 1(c)

RELMO S.A. is an Argentinean seed company belonging to Ferrarotti family. RELMO was established in 1960s as the first company in Argentina to devote itself to the genetic improvement of soyabean. RELMOs business strategy concentrates on the production and sale of plant seeds of mainstay crops: soyabean, wheat and maize.

Although the RELMO's major area of work is the genetic improvement of soyabean but the company's market position, however, was seriously challenged when Monsanto, a multinational agricultural biotechnology corporation, started commercializing the Round-up Ready (RR) gene (RR technology allows for the use of herbicide without any adverse effect on the crops) in Argentina during the mid-1990s. The RR gene-based plant varieties soon became popular among farmers. RELMO was quick to realize that to retain its market position, they would have to market RR varieties too. Therefore RELMO reached an agreement with Monsanto Argentina that authorized its use of the RR gene. This agreement also allowed RELMO to place its soybean varieties in other countries. The apprehension of acquiring market dominance in the the commercial market of RR varieties by Monsanto derives the RELMO to comprehend the requirement of commercial collaboration where authorised usage can give them more economic opportunities to breed soybean varieties in the same market and different places conducive to local specification, geographical area to such products.

As far as maize is concerned, due to the high degree of adoption of transgenic (genetically engineered) forms of maize in Argentina, RELMO signed a testing agreement with Monsanto in order to work with MON 810, a maize variety based on the Bt gene (gene of a naturally occurring bacteria that produces a protein toxic to certain types of insects. The Bt gene can be transferred to crops, thereby making them more resistant to the corresponding insect).

Answer 1(d)

Agreement with the National Institute of Agriculture Technology (INTA) of Argentina: In 2002, RELMO concluded an agreement on technology transfer with INTA for the genetic improvement of subtropical germplasm of maize. Under the Agreement. INTA provides the germplasm, installations and technical staff, and RELMO covers the operating expenditures. The hybrids obtained are marketed exclusively by RELMO while INTA receives a percentage royalty as the owner of the germplasms. This unique public-private agreement also allows RELMO to produce the hybrids with its own trademark and also to license them out to third parties.

Licensing Agreement with the Notional Livestock Research Institute (INIA) of Uruguay: INIA and RELMO have a special deal under which INIA has granted RELMO exclusive rights over the licenses for INIA's wheat varieties in Argentina. In return, RELMO has authorized similar rights to INIA for soybean varieties from RELMO. This license agreement allows RELMO to enter the wheat seed market with adapted varieties at a cost roughly equivalent to that of developing its own crops, however at a much quicker pace. INIA benefits from the expansion of the market for its wheat varieties. For RELMO,

this is a very good commercial opportunity; RELMO has typically focused on soybean sown in summer, but the incorporation of the seeds of winter crops from INIA allows them to expand their sales structure and to generate more revenue. The scheme of licenses for soybean varieties to INIA, with a view to market them in Uruguay, has similar results for both parties.

Variety licensing allows breeding companies or institutions to commercialize their products (plant varieties) and is also an efficient tool for technology transfer. New technology in a variety, represented by improved genetics and expressed mostly through improved agricultural performance, can be transferred to farmers by licensing out seed production and distribution rights to seed companies. The variety license itself consists of an agreement between the owners of the varieties, or an authorized representative, and a legally eligible person who wishes to commercialize the variety. Access to new varieties requires proper handling of intellectual property (IP). This can be accomplished through variety license agreements, which also provide a strategy for developing and introducing new varieties. In-licensing plant varieties can raise market share or offer competitive advantages by increasing the ability to meet customer demands. The most obvious reason for in-licensing varieties is to enhance or complete a company's variety portfolio. This applies both to companies with their own breeding programs and to companies working exclusively with in-licensed varieties. Those species for which a company has existing breeding programs—or other species that may be of interest to the market—are potentially subject to in-licensing. Demand for certain products from farmers, the processing industry, or consumers could be met by a company obtaining a license from the variety owner to supply the market with seed of that variety. The most common reason for a company to out-license its varieties is to maximize the return on its investment by allowing others to produce and sell its varieties in markets that the company cannot reach. Exclusive licenses are preferred because breeders believe that the mutual commitment will be stronger when working exclusively. A good variety provides a competitive advantage and will thus create revenue for the company with the exclusive rights. It is in the best interest of both parties to make the variety as profitable as possible, and the commitment resulting from exclusive rights is considered to lead to the best market coverage possible.

Question 2

(a) Give your interpretation about the "Proviso" that a person may legitimately acquire property rights by making his labor with resources held "in common" only if, after the acquisition, "there is enough" and as good left in common for others.

(b) The Universal Copyright Convention (UCC) was developed by United Nations Educational, Scientific and Cultural Organization (UNESCO) as an alternative to the Berne Convention for those states which disagreed with aspects of the Berne Convention, but still wished to participate in some form of multilateral copyright protection. Identify the limitation of Berne Convention and why the Berne Convention states also became party to the UCC. (6 marks each)

Answer 2(a)

The Natural Right Theory emanates from the proposition that "a person who labors upon resources that are either un-owned or "held in common" has a natural property right to the fruits of his or her efforts and that the state has a duty to respect and enforce that

natural right". This idea has been elaborated in the writings of John Locke and is also applicable to the subject of intellectual property, wherein the raw materials in the form of facts and concepts do seem in some sense to be "held in common" and where labor contributes substantially to the value of the finished product. Lockean property entitlements.

i) Right to use without harm

ii) Right to transfer the property

iii) Right of exclusive usage of the property

Personality theory finding place in the writings of Kant and Hegel is that private property rights are crucial to the satisfaction of some fundamental human needs. The law makers thus must create and allocate entitlements to resources in a way that best enables people to satisfy such needs. From this perspective, Intellectual Property Rights may be justified either on the ground that they shield from appropriation or modification artifacts through which authors and artists have expressed their "wills" (an activity thought central to "personhood").

Justin Hughes, taking inspiration from Hegel's Philosophy of Right, laid down following guidelines concerning the proper shape of an Intellectual Property regime:

(i) We should be more willing to accord legal protection to the fruits of highly expressive intellectual activities, such as the writing of novels, than to the fruits of less expressive activities, such as genetic research.

(ii) Because a person's "persona"-- his "public image, including his physical features, mannerisms, and history" -- is an important "receptacle for personality." it deserves generous legal protection, despite the fact that ordinarily it does not result from labor.

(iii) Authors and inventors should be permitted to earn respect, honor, admiration, and money from the public by selling or giving away copies of their works, but should not be permitted to surrender their right to prevent others from mutilating or misattributing their works.

Intellectual property rights afford authors and inventors a measure of control over this risk. To put the point a different way, it is the moral claims that attach to personality, reputation, and the physical embodiments of these individual goods that justify legal rules covering damage to reputation and certain sorts of economic losses.

Moreover, personality-based theories of intellectual property often appeal to other moral considerations. Hegel's personality-based justification of intellectual property rights included an incentive-based component as well—he asserts that protecting the sciences promotes them, benefiting society. Perhaps the best way to protect these intuitively attractive personality-based claims to intangible works is to adopt a more comprehensive system designed to promote progress and social utility.

Answer 2(b)

The first multilateral agreement on copyright is the Berne Convention which was concluded in 1886 and was meant for providing protection to literary and artistic works.

A country joining the Convention has to provide copyright protection to literary and artistic works of member countries in its own territory and also entitled for enjoying reciprocal protection from others. Ninety countries are at present member of the Berne Convention. The post Second World War era saw the emergence of the need for protecting copyright on a universal basis. Till then countries in the North America were not party to the Berne Convention and copyright protection in these countries were governed by various national and regional agreements.

The Universal Copyright Convention (UCC), adopted in Geneva, Switzerland, in 1952, is one of the two principal international conventions protecting copyright; the other is the Berne Convention. The UCC was developed by United Nations Educational, Scientific and Cultural Organization (UNESCO) as an alternative to the Berne Convention for those states which disagreed with aspects of the Berne Convention, but still wished to participate in some form of multilateral copyright protection. These states included developing countries as well as the United States and most of Latin America. The former thought that the strong copyright protections granted by the Berne Convention overly benefited Western, developed, copyright-exporting nations, whereas the latter two were already members of the Buenos Aires Convention, a Pan-American copyright convention that was weaker than the Berne Convention. The Berne Convention states also became party to the UCC, so that their copyrights would exist in non-Berne convention states. In 1973, the Soviet Union joined the UCC. The United States only provided copyright protection for a fixed, renewable term, and required that in order for a work to be copyrighted it must contain a copyright notice and be registered at the Copyright Office. The Berne Convention, on the other hand, provided for copyright protection for a single term based on the life of the author, and did not require registration or the inclusion of a copyright notice for copyright to exist. Thus the United States would have to make several major modifications to its copyright law in order to become a party to it. At the time the United States was unwilling to do so. The UCC thus permits those states which had a system of protection similar to the United States for fixed terms at the time of signature to retain them. Eventually the United States became willing to participate in the Berne convention, and change its national copyright law as required. In 1989 it became a party to the Berne Convention as a result of the Berne Convention Implementation Act of 1988.

Question 3

(a) *Company XYZ Ltd. has made invention on new water purifier technology and company has filed application for patent. The company fear about the PriorPublic use of that invention before the date of filing of application destroy the novelty of the invention. Convince the company XYZ Ltd. why they should not fear by illustrating cases in India.*

(b) *Recently a program broadcasted by a foreign television channel in India whose content was highly critical and certain segment of the society is criticizing this program. Can Indian government take action against this foreign television company based in India under Chapter VIII? (6 marks each)*

Answer 3(a)

Prior public use of the invention before the date of filing of application destroys the novelty of the invention. However, there is an exception to this general rule. The Act

provides that if an invention has been publicly worked in India within one year before the priority date by the patentee or applicant for the patent or by any third person from whom he derives the title or by the person who has obtained a consent to work the invention and such working of invention was only for the purpose of reasonable trial and it was necessary to effect such trial or working in public in view of the nature of the invention then such working of invention does not anticipate the invention The Indian patent law takes middle way and provides for grace periods in some conditions to evaluate anticipation.

The Indian Patents Act mentions what are not anticipations in Sections 29 to 34, rather than defining anticipation. Exceptions are mentioned in the Indian Patent Act under which the patent application can be filed despite public disclosure, and such public disclosure will not be considered to have been anticipated.

To conclude, one should file a patent application ideally prior to publicly disclosing the invention. However, in light of the provisions discussed above one can still contemplate patent application filing.

Lack of novelty is usually referred to as 'anticipation and is determined by factors such as prior publication, public knowledge and public use. Commercialised products and selection inventions. While anticipation is not expressly defined in the Patent Act, Sections 29 to 34 identify what anticipation is not. When testing for anticipation, if a prior art exists (i.e. if the prior art describes something falling within the scope of an alleged claim) then, if by studying the prior art the claimed invention can be performed, the claim would be considered to be anticipated. It may be unnecessary to repeat the prior art test, but expert opinion may be considered in order to identify anticipation better using relevant expertise. It can also be identified by showing the predictable result as the outcome of what is described in the prior art, regardless of whether it would be a product or process falling within the scope of the claim. In India, a patent application is considered to be anticipated if the invention is disclosed in a patent or any other document which is published before the priority date of the application. However, if the inventor proves that the matter published was obtained fraudulently and was published without his or her consent, then it may not be considered to be anticipated. The concept for identifying prior publication was established in Farbewerke Hoechst Aktiengesellschuft Vormuls. *Meister Lucius* v. *Unichem Laboratories*, wherein the court held as follows:

"To anticipate a patent, a prior publication or activity must contain the whole of the invention impugned; i.e., all the features by which the particular claim attacked is limited. In other words, the anticipation must be such us to describe, or be an infringement of the claim attacked."

Likewise, in *Lallubhai Chakubhai Jariwala* v. *Chimanlal Chunilal and Co.* the court observed that:

"the two features necessary to the validity of a patent are novelty and utility, but the real test is the novelty of the invention. Novelty is essential, for otherwise there would be no benefit given to the public and consequently no consideration moving from the patentee [while interpreting the factor related to public knowledge and public use."

The court further held that "the next question is, whether the plaintiff's invention has been anticipated by prior public user. Has it been publicly used by the plaintiff and/or by

others before the date of the application? Public user does not mean a user or exercise of the invention by the public, but a user or exercise in a public manner; and it is in every case a question of fact, If the invention is being put into practice before and at the date of the grant, the grant will not be for a new invention or manufacture, and this applies equally whether the invention is being practised by the patentee himself or by others. A use of the invention for the purposes of trade may constitute a prior user which invalidates the patent, and it has been held that the prior public sale of goods or articles treated according to the invention is a public user of the invention, for the sale is strong evidence that the user was really commercial and not experimental".

In *Monsanto Co.* v. *Coromandel Indag Products (P) Ltd.* 1986 A.I.R. 712, it was held that "to satisfy the requirement of being publicly known as used in clauses (e) and (f) of section 64(1), it is not necessary that it should widely be used to the knowledge of the consumer public. It is sufficient if it is known to the persons who are engaged in the pursuit of knowledge of the patented product or process either as men of science or men of commerce or consumers."

Answer 3(b)

Section 40A of the Copyright Act, 1957 provides that subject to the satisfaction of Central Government that a foreign country (other than a country with which India has entered into a treaty or which is a party to a Convention relating to rights of broadcasting organisations and performers to which India is a party) has made or has undertaken to make such provisions, if any, as it appears to the Central Government expedient to require, for the protection in that foreign country, of the rights of broadcasting organizations and performers as is available under this Act, it may, by order, published in the Official Gazette, direct that the provisions of Chapter VII shall apply:

(i) to broadcasting organizations whose headquarters is situated in a country to which the order relates or, the broadcast was transmitted from a transmitter situated in a country to which the order relates as if the headquarters of such organisation were situated in India or such broadcast were made from India;

(ii) to performances that took place outside India to which the order relates in like manner as if they took place in India;

(iii) to performances that are incorporated in a sound recording published in a country to which the order relates as if it were published in India;

(iv) to performances not fixed on a sound recording broadcast by a broadcasting organisation the headquarters of which is located in a country to which the order relates or where the broadcast is transmitted from a transmitter which is situated in a country to which the order relates as if the headquarters of such organisation were situated in India or such broadcast were made from India.

Section 40A (2) of the Copyright Act also provides that the order so made by the Central Government may provide that:

(i) the provisions of Chapter VII shall apply either generally or in relation to such class or classes of broadcasts or performance or such other class or classes of cases as may be specified in the order;

(ii) the term of the rights of broadcasting organisations and performers in India shall

not exceed such tern as is conferred by the law of the country to which the order relates;

(iii) the enjoyment of the rights conferred by Chapter VIII shall be subject to the accomplishment of such conditions and formalities, if any, as may be specified in that order;

(iv) chapter VIII or any part thereof shall not apply to broadcast and performances made before the commencement of the order or that Chapter VIII or any part thereof shall not apply to broadcasts and performances broadcast or performed before the commencement of the order;

(v) In case of ownership of rights of broadcasting organisations and performers, the provisions of Chapter VIII shall apply with such exceptions and modifications as the Central Government, may having regard to the law of the foreign country, consider necessary.

Similarly, under Section 42A of the Copyright Act has strictly ascertained that the Central Government has the power to restrict rights of foreign broadcasting organizations if it thinks that a foreign country hasn't provided adequate protection of rights to a broadcasting organization or the citizens of such country are not incorporated or domiciled in India under such provision.

In view of the above, Indian Government shall have the right to suspend the permission of one or more permission holders in the public interest or for the sake of national security in order to prevent the misuse of their respective channels. The permission holders shall be obliged to immediately comply with the directives of the Government.

Question 4

(a) Company A has got registration for its new design of bottles for soft drink but after substantive examination it was found that the design not new or original. Can the registration of a design be cancelled?

(b) In North-East state the tribal people are producing a special type of beverage from time immemorial which is extracted from a special type of flower found only in that region. Now the state government is interested to get this product in Geographical Indication category. With your expert knowledge explain how the product will be recognized as Geographical Indication product and how the state government can apply to bring this product under Geographical Indication.

(6 marks each)

Answer 4(a)

(a) The registered proprietor of design is given exclusive rights to his/her registered Designs. One such right is the right of the Cancellation of Design Registration. The registered proprietor or any other person interested can file for a petition of Cancellation of Registration of Design on the grounds mentioned in the Design Act, 2000 read with the Design Rules, 2001. The procedure for Cancellation is also provided in the Act and the Rules regarding the Design Law of India.The registration of a design may be cancelled at any time after the registration of the design on a petition for cancellation in Form 8, along with the prescribed fee.

(b) Such petition may be filed at any of the four Patent Offices. Such petitions filed in offices other than Kolkata, are transmitted to the Kolkata Patent Office. However, at present, all further proceedings of cancellation take place only at Patent Office, Kolkata and hence all communications relating to cancellation petitions are required to be communicated to that office.

(c) The petition for cancellation of registration of a design may be filed on any of the following grounds:

(i) that the design has been previously registered in India;

(ii) that it has been published in India or in any other country prior to the date of registration;

(iii) that the design is not a new or original;

(iv) that the design is not registerable under the Designs Act;

(v) that it is not a design as defined under Section 2(d) of the Designs Act .

For a design to be called new or original there should be some original mental application involved. The novelty or originality of even a particular part of the article may be sufficient to call the design as a whole “novel or original”, but this part must be a significant one and it must be potent enough to impart to the whole design a distinct identity.

In view of the above, registration of design of Company A’s soft drinks bottles can be cancelled on the ground the design is not new or original.

Answer 4(b)

According to the Section 2(1)(e) of the Geographical Indication of Goods (Registration and Protection) Act, 1999,"geographical indication” in relation to goods means an indication which identifies such goods as agricultural goods, natural goods or manufactured goods as originating, or manufactured in the territory of a country, or a region or locality in that territory, where a given quality, reputation or other characteristic of such goods is essentially attributable to its geographical origin and in case where such goods are manufactured goods one of the activities of either the production or of processing preparation of the goods concerned takes place in such territory, region or locality, as the case may be.

It may be noted that any name which is not the name of a country, region or locality of that country shall also be considered as the geographical indication is it relates to a specific geographical area and is used upon or in relation to particular goods originating from that country, region or locality, as the case may be.

According to the Geographical Indication of Goods (Registration and Protection) Act, 1999, the organizations or companies who register their geographical indications enjoy various advantages from the registration, including:

1. Registered geographical indications have the exclusive right to access or use G.I.’s products during the business.

2. Authorized users enjoy the right to sue for infringement.

3. It provides legal protection to geographical signs in India.
4. Prevents unauthorized use of registered geographical indications by others.
5. It provides legal protection to Indian geographical signals which in turn promotes exports.
6. It promotes the economic prosperity of producers of goods produced in a geographical area.
7. A registered owner can also approach for legal protection in other WTO member countries.
8. It provides legal protection to the respective goods in domestic as well as in international markets.

"Producer in relation to goods, means any person who,

(i) if such goods are agricultural goods, produces the goods and includes the person who processes or packages such goods;

(ii) if such goods are natural goods, exploits the goods;

(iii) if such goods are handicraft or industrial goods, makes or manufactures the goods;

(iv) and includes any person who trades or deals in such production, exploitation, making or manufacturing, as the case may be, of the goods. [Section 2(1)(k)]

For the registration of a geographical indication, any association of persons, producers, organisation or authority established by or under the law can apply. The applicant must represent the interest of the producers and the application should be in writing in the prescribed form. The application should be addressed to the Registrar of Geographical Indications along with prescribed fee.

Section 8 of the Act provides that a geographical indication may be registered in respect of any or all of the goods, comprised in such class of goods as may be classified by the Registrar and in respect of a definite territory of a country, or a region or locality in that territory, as the case may be. The Registrar may also classify the goods under in accordance with the International classification of goods for the purposes of registration of geographical indications and publish in the prescribed manner in an alphabetical index of classification of goods.

Question 5

(a) A German company signed agreement with an Indian company to use its patented technology and trademark to manufacture and market the product in European market. Suggest how the Indian company assign the Intellectual Property Rights Patent and Trademark to German company.

(b) Why some experts suggest that it may be prudent for the companies to conduct an intellectual audit to identify the protectable business information? What are the measures taken by Japan, Brazil, China and Israel for International Protection of Trade Secrets? (6 marks each)

Answer 5(a)

An assignment of a trademark must be in writing and with the consent of the Registrar under the Trademarks Act, 1999. A registered/unregistered proprietor can assign a trademark with or without goodwill. An assignment is usually required to be made for a consideration. The application, which is in a prescribed format, can be submitted by either the Assignee or together with the Assignor, before the Registrar of Trademarks for registering the title of a person who becomes entitled by assignment to a registered trademark. The Assignee, after the assignment is complete, must apply to the Registrar of Trademarks to register his/her title and the Registrar enters the name and details of the Assignee in the Register on proof of title, to his satisfaction. However, under certain circumstances an assignment cannot be enforced, namely (a) if an assignment will create multiple exclusive rights in more than one person: (b) if an assignment will create multiple exclusive rights in different parts of India.

Sections 37 and 38 of the Trade Marks Act govern assignment of trademarks. When a trademark is assigned, the assignee acquires the right to use the trademark and steps into the shoes of the erstwhile proprietor or owner.

A patentee may assign the whole or any part of the patent rights to the whole of India or any part thereof. There are three kinds of assignments: legal assignment, equitable assignment and mortgages. An assignment (or an agreement to assign) of an existing patent is a legal assignment, where the assignee may enter his name as the patent owner. A certain share given to another person is called an equitable assignment and a mortgage is when the patent rights are wholly or partly transferred to obtain money.

A valid assignment under the Patents Act requires the assignment to be in writing, to be contained in a document that embodies all terms and conditions and must be submitted within six months from the commencement of the Act or the execution of the document whichever is later.

Under Section 68 of the Patents Act, an assignment is valid and enforceable only when it is in writing and is duly signed by the assignor or any person authorized to do so. The written agreement must contain all the terms, conditions, rights and obligations of the parties thereto.

Answer 5(b)

Intellectual Property (IP) Audit is a tool which is mostly used by the companies to take into account the intangible assets which they have generated / developed in the certain span of time. Thought the IP is intangible in nature, but it contributes to a very crucial core value of the company, i.e. the goodwill which they brand has in the market. Tentatively speaking the goodwill of the IP is one of the crucial reasons for which the industries acquire protection. This goodwill thus generated is then represented as the consumer preference and the acceptability of the brand in the market which is now a major reason for generating revenue.

Through various embodiments the IP Audit affective provides an assessment over the following concerns:

1. To identify the scope of the present and to create a future profile for the tangible assets of the company.

2. To reinforce the IP protection mechanism and device secure portfolio to avoid legal conflicts.
3. To identify the idle IP and to set them in process and to harness them as a potential.
4. To assess the financial equivalent of the assets and to be able to use them as leverage or guarantee with other financial institutions.
5. To foresee and steer clear of any risks or unwanted litigation which may evolve or affect the functioning and profile of the applicant in the market.
6. To reduce unnecessary cost and legal expenses.

Measure taken by Japan

Effective June 15, 1991, Japan enacted a national trade secrets law. Trade secrets include any "technical or business information that has commercial value, is not in the public domain, and which has been "administered "as a trade secret. Infringement occurs when a person procures a trade secret, by theft, fraud, or extortion or when there is an unauthorized use or disclosure of a lawfully acquired trade secret for unfair competition. An injured party may obtain injunctive relief and damages. The trade secret holder may also request destruction of any articles that have been manufactured as a result of the illegally obtained trade secret. The statute has similarities to the Uniform Trade Secrets Act. For sample, there is a 3-year statute of limitations after discovery of the trade secret violation. There are no criminal penalties in the statute.

Measure taken by Brazil

In 1996, Brazil revamped its intellectual properly laws. Trade secrets are protected under the rubric of “unfair competition. “ Borrowing from U.S. law, a variant of the Section 757 (6-Factor) test is used to determine whether a particular piece of information qualifies as a trade secret, Common knowledge, knowledge in the public domain, or knowledge that is apparent to an expert in the field cannot qualify for protection as trade secrets. The trade secret owner must take positive steps to safeguard the secrecy of the information.

The full panoply of relief is available--compensatory damages, punitive damages and injunctions. There are also criminal sanctions available against anyone who releases, exploits, or uses without authorization a trade secret to which he or she had access by virtue of a contractual or employment relationship.

Measure taken by China

The Law of the People's Republic of China (PRC) against Unfair Competition (Unfair Competition Law) was promulgated by the State Council in September 1993 and became effective on December 1, 1993. This is China's first trade secret law. The term "trade secrets" is defined as technical and management information that is unknown to the public, can bring economic benefits, is of practical value, and for which the rightful party has adopted measures to maintain its confidentiality. Article 10 of The Unfair Competition Law prohibits business operations from engaging in certain acts and the law also provides for the remedies in case of infringement of trade secrets.

Measure taken by Israel

Israel has a criminal statute (Penal Law 1977 Section 496) prohibiting the disclosure of trade secrets by an employee. Employee contracts enjoin employees from using trade secrets and industrial know-how. There is an implied obligation of confidentiality between employers and employees.

Question 6

A European company in the dental instruments sector was selling their product in China through a Chinese distributor. They discovered a competitor in China was offering a similar product, but built to lower-specifications that used an identical exterior design, colour scheme and control interface. The technical manual, diagrams and parts of their sales brochure appeared to be directly copied from the European dental instruments company. Overall, the competitor's product gave the appearance of being similar in function to that of the European company, although its performance level and price were much lower.

The European company's representatives had previously approached the company at a trade fair to complain about the infringement of the company's IP but had not received a positive response. The European company then proceeded to seek legal advice on what could be done. The company did not have a design patent to protect the overall appearance of their product, nor were there any patents covering the product's function, so trying to claim the Chinese company committed patent infringement was legally possible but extremely difficult to do. The only legal recourse the company had was to argue copyright infringement of the technical manual.

Instead of taking the legal route, the company decided to send a warning letter through their local lawyers that alleged infringement of the product's shape—even though they were not on strong legal ground—and copyright. The letter implied that the company would take the matter to court. The law firm, and representatives from the European company, followed up the letter and met with the Chinese company. The European company argued that a lawsuit would be waste of time for both parties and that even if they were not successful in court, the Chinese competitor's imitation of the European product would harm their corporate image in the long run. As a result, the infringing company decided to change a number of exterior features of the product and produce new manuals and brochures which greatly reduced the similarities to the European product.

(a) If the company decided to send a warning letter through their local lawyers that alleged infringement of the product's shape will they able to prevent the Chinese company.

(b) The technical manual, diagrams and parts of their sales brochure appeared to be directly copied from the European dental instruments company. Can the European company file for copyright violation against the Chinese company?

(6 marks each)

Answer 6(a)

Registration of a Design helps in protecting the products which can be distinguished by their mere novel shape or pattern. However, the requirement for registration is that

such design itself must be new and thus the element of novelty is of the essence for design registration. Design is registrable both nationally as well as under the EU-wide single registration. Such a right can also be protected through the copyright.

Unlike many other Intellectual Property Rights, Copyright is not necessarily registrable and it arises automatically upon creation of the work itself. Further, Copyright can be enforced through the court of law.

Today, industrial design has become an integral part of consumer culture where rival articles compete for consumer's attention. It has become important, therefore, to grant adequate protection to an original industrial design. It is not always easy to separate aesthetics of a finished article from its function. Law, however, requires that it is only the aesthetics or the design element which can be registered and protected. For example, while designing furniture whether for export or otherwise, when one copies designs from a catalogue, one has to ascertain that somebody else does not have a design right in that particular design.

In the given case, the company did not have a design patent to protect the overall appearance of their product, nor were there any patents covering the product's function, so trying to claim the Chinese company committed patent infringement was legally possible but extremely difficult to do. The only legal recourse the company had was to argue copyright infringement of the technical manual. Though company decided to send a warning letter through their local lawyers that alleged infringement of the product's shape but they were not on strong legal ground and copyright. The letter implied that the company would take the matter to court.

Answer 6(b)

International instruments do not usually constitute a directly applicable source of rights to private parties. An international treaty rather imposes obligations on the states, parties to the convention, to adapt their domestic legislation according to its provisions. In the field of copyright and related rights, the relevant conventions establish a certain level of protection in the contracting states through the principle of national treatment and the guaranteeing of a number of minimum standards.

International copyright law is complex in its detail and in its relationship with national laws. These complexities include national laws giving effect to the internationally agreed minimum standards and where national law allows for exceptions to those standards that they comply with the internationally agreed frameworks for exceptions. An important aspect of understanding and dealing with the international complexity is the interpretation of international law at both international and domestic levels.

According to the national treatment principle, works originating in a contracting state are protected in every other contracting state in the same manner as these states protect works originating in their own territory. For example, a textbook first published in contracting State A will be protected in contracting State B in the same manner as State B protects a school text originating in its own territory. The guaranteed minimum standards ensure that the protection provided by national laws of states parties and notably scope of rights, possible exceptions and limitations, as well as terms of protection and does not fall below the level agreed in the respective international instrument.

Often there are several possible ways for national legislations to comply with international prescriptions. In order to find out how copyright and related rights are protected abroad, one has therefore always to consult the laws of the respective country in which protection is sought.

The central feature of the Berne Convention is that it prohibits member countries from imposing "formalities" on copyright protection, in the sense that the enjoyment and exercise of copyright cannot be subject to any formality except in the country of origin. Likewise, foreign jurisdictions cannot impose similar formality requirements on U.S. copyright owners as a condition to filing suit in their national courts, even though they can impose those requirements on their own nationals.

The other main characteristics of the Berne Convention are the concepts of "minimum standards" and "national treatment." "Minimum standards" are the baseline that all nations must provide to non-domestic claimants. The "national treatment" principle in copyright law states that authors should enjoy the same protection for their works in other countries as those countries accord their own authors. Therefore, a country that is a member of the Berne Union must afford copyright protection to foreign nationals without a requirement of any formalities (like use of a copyright notice or a registration requirement). Foreign nationals must be afforded the same rights and treatment that a domestic copyright holder would receive.

European company can file for copyright violation against the Chinese company under Berne Convention or the Universal Copyright Convention.

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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

(a) Noble Insurance Company has received two claims about which the company has grave suspicions about their genuineness and admissibility under the terms of the insurance policy.

To help them in the aspect of the genuineness of the two claims, it appoints a forensic auditor (FA). The claim is not payable where there has been negligence on the part of the insured. The FA was to also look into this aspect and report to the insurer.

(i) Bank cyber crime

The first claim has been reported by a bank about the fraud committed in the account of one of its customers. The customer had a bank account in Chennai branch. According to the bank, the customer, a resident of India, was then living in New York. He used to periodically transfer amounts to some foreign accounts, i.e. accounts of other persons, who were outside India. He would send intimation through his email (Gmail account) and sign in the necessary forms, as may be required.

The customer's Gmail account was hacked by a miscreant. The said miscreant sent an email from the customer's Gmail id (which was the official email id given to the bank), asking for transfer of funds to a bank account in Hong Kong. Since the bank had done such transfers in the past, it did the same during the said time also. A sum of ₹12 lakhs was transferred.

Later on, when the customer saw his bank account, he found to his dismay that his account was debited with ₹12 lakhs. He alerted the bank and when enquiry was conducted, it turned out that his Gmail id had been hacked and that a fraudster had dome the said fraud. The bank had to pay this amount since the customer was a valuable customer. As the bank had taken policy with the insurance company covering such losses, it lodged the claim and hence the present situation.

How can the FA help the insurer in the given situation? (10 marks)

(ii) Fidelity guarantee claim

Doomsday Garments Ltd., had lodged a fidelity guarantee claim which insures the perils caused due to act of infidelity of any of the permanent employees of the insured.

The insured's business model was that advance payment was required from any buyer before goods are delivered from the insured's warehouse to them. In the given case, the insured's claim was misappropriation of sum of ₹22 lakhs misappropriated by Sakuni, one of its employees. Goods worth ₹24 lakhs had been invoiced for ₹2 lakhs only, to one Kumbakarna Tex.

The event happened on January 31st, 2019 evening when everyone was under Severe targets pressures and hence the officer superior to Sakuni could not find out the alleged mistake or fraud in the invoicing of goods.

When the warehouse keeper was enquired, it turned out that he did receive written memo from the sales team, as per usual practice, to release the goods. The warehouse keeper was not aware of the issue relating to short payment, the same not being in his domain.

The FA conducted the investigation in the above situation to help the insurance company and came to their rescue. You are required to imagine and narrate how the FA had helped the insurer in this regard. (10 marks)

(b) Purchase department in an organisation plays a vital role and it has to be handled honestly in the interest of the company. In an instant case, HR department observed that a certain officer of the purchase department was resented by his colleagues and juniors as being arrogant. Upon enquiries, it was revealed that some vendors whose business with the company was low, were frequently visiting the concerned purchase officer with gifts and sweets, and some time distributed them to the entire department also. HR department in its routine annual review, elicited that the said purchase officer has been leading a very luxurious life which made the HR department to suspect the bonafides of this officer. Enquiry revealed that there was a disproportinate increase in his wealth and that he always selected non-competitive contractors for placing purchase orders.

If you have to conduct a forensic audit, how would you proceed to investigate this case? (10 marks)

(c) Two brothers allegedly took help of SMS technology and launched the first of its kind SMS fraud in India.

The alleged masterminds behind a ₹400 million SMS fraud have duped at least 50,000 people. As part of the attractive scheme, the duo brothers messaged random numbers asking people interested in "earning ₹10,000 per month" to contact them.

(i) Describe the facts of the case.

(ii) What was the modus operandi of the SMS fraud? (10 marks)

Answer 1(a)(i)

Bank Cyber Crime

The Forensic Auditor first looked into the procedures required at the bank for transfer of funds to an account abroad. The main aspects involved were:

(a) Written request was to be received from the customer, if not so, through a digitally signed document.

(b) For any transfer of funds abroad, FEMA requirements are to be completed, including submission of Form 15CB under the Income-tax Act, 1961. Either a self-declaration of the customer was sufficient or a Chartered Accountant's certificate is required.

(c) Funds have to be transferred through electronic mode like SWIFT.

(d) When the Forensic Auditor tracked the funds which had been sent to an account in Hong Kong, it was found that the fraudster had closed the account and the Hong Kong bank disowned any liability, since it was not at fault.

In the given case,

– The banker had not received any written request from the customer for transfer of funds abroad.

– The Forms required under the Income-tax law had not been submitted.

– The compliances required under the Foreign Exchange Management Act 'FEMA' had not been complied with.

– The bank did not ascertain the identity of the customer.

Therefore, it is clear from fact of the case that the banker was negligent in his duties. The insurance policy excludes payability of the insurance claim, where the loss is caused to the negligence of the insured.

The Forensic Auditor was thus able to help Noble Insurance Company which repudiated the claim, as a consequence.

Answer 1(a)(ii)

Fidelity Guarantee Claim

The Forensic Auditor should conduct the investigation in the following manner:

(a) Whether Sakuni is a permanent employee of the insured should be ascertained.

(b) This can be seen with the help of several documents, some of them being appointment letter, salary slips, bank transfers of salary to the bank account of Sakuni, PF remittance, HR record of employee etc.

The Forensic Auditor first ascertained that Sakuni was a permanent employee of the insured.

The Forensic Auditor then looked into the internal controls and Standard Operating Procedure 'SOP' to be followed in case of sale to a customer. The important sequences of events were as under:

(a) Purchase requisition from buyer was to be first received;

(b) Purchase requisition was to be approved by a senior officer.

(c) Where the goods worth Rs 20 lakhs or above are dispatched, the approval of the Sales Manager was required, who was to check the rates as well as quantities involved.

(d) Approval matrix to be checked and whether the same was adhered.

The Forensic Auditor found out that in the given case, the Sales manager had not given approval at all. The transaction was authorised only by the supervisor above Sakuni, who coaxed him to believe that he would get it ratified by the sales manager. Such ratifications has been done in the past, but this time it was not done.

Since the SOPs have not been followed, it was a clear case of negligence on the part of the insured, consequent to which there will be no liability on the part of Noble Insurance Company.

Answer 1(b)

Forensic Audit Investigation Methodology

Forensic investigation is the utilization of specialized investigative skills in carrying out an inquiry conducted in such a manner that the outcome will have an application in a court of law or in legal proceedings.

The person to whom forensic audit has been entrusted should follow some methods by which he will be in a position to assert the case properly. Once the case has been handed over to him, he should analyze data which is available and create a hypothesis based on such data and test the hypothesis.

In the present case, there are more avenues available to pin point the culprit. They are:

1. *Data collection from IT Department* : Email backups, company mobile devices as per the company policy and applicable law, electronic data from the computer device of the suspect.
2. *Paper based Data collection* : Suppliers documentation since pre-vendor creation stage, quotes, bids, invoices, payments, delivery acknowledgements, revisions to contracts, etc. for the alleged suspects tenure with the company.
3. Identification of significant increase in business through statistical analysis: Significant increase indicate most likely vendors who could have received business by paying kickbacks.
4. Reviewing transactions thoroughly including bidding documents, order placements, contractual agreements, per unit prices, quality of goods and services, etc.
5. Background search on suspect vendors for their existence, location, publicly available financial information via MCA or Financial database software's like Prowess or Capitalline, litigations against them, ownership structure, and overall market reputation.
6. Background search on the suspected procurement officer about his reputation in the department, increase in his assets, changes in his lifestyle, etc.
7. If significant indicators point towards fraud by the employee, asset trace investigation can be conducted to help recover the loss.
8. From data analytics, identification of vendors whose business has suddenly decreased or were removed from the approved list during his tenure needs to 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.

9. 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.

10. Enquire the employees of the purchase department about the concerned officer about the various visits of the vendor receiving low order vis-à-vis business model of the organisation.

11. Market Intelligence is one of the techniques that we use in vendor related frauds. Wherein cover agent will visit to the suspected persons residence area to get an understanding his lifestyle, discreetly enquire about him with the few people in the area etc.

12. A detailed enquiry as to whether the concerned officer followed the purchase policy of the department like competitive bidding etc.

A conclusive analysis on the facts and evidence collected so that it can be used either in the court of law or in legal proceedings.

Answer 1(c)

Jayanand Nadal, 30 years, Jayraj Nadal and Ramesh Gala, 26 years allegedly took help of SMS technology and launched the first of its kind SMS fraud in India.

According, to EOW sources, in August, 2006 the duo launched an aggressive and catchy advertisement campaign in the print media that read: “Nothing is impossible. The word itself is, Impossible”.

As part of attractive scheme, the Nadal brothers messaged random numbers, asking people interested in “earning Rs. 10,000 per month” to contact them.

“The modus operandi adopted by the brothers was alluring”. An EOW official said “interested subscribers” were asked to deposit Rs. 500 each.

The common duo claimed to be working with a U.S. based company named Aropis Advertising Company, which wanted to market its client’s products through SMS. The brothers even put up a website (www.getpaid4sms.com) to promote their scheme. Subscribers who registered with them received about 10 SMS every day about various products and were promised handsome commissions if they managed to rope in more subscribers by forwarding the messages.

In return, the Nadals promised to pay Rs. 10,000 over 16 months to the inventors. The amount was to be paid in instalments of Rs. 1,000 every few months.

The duo invited people to become agents and get more members for the scheme. Gala reportedly looked after the accounts.

Initially the brothers paid up small amounts. But when cheques and pay orders of larger sums issued by the duo were not honoured, the agents got worried. The SMSes too suddenly stopped.

Finally, they were arrested from a hotel in Mine Road in western suburbs.

Question 2

A bank suspects that the stock statements furnished for the 12 months during the FY 2018-19 by Ravana Handlooms, one of its borrowers, do not reflect the true position and that they have been systematically furnishing statements showing higher quantities of various items of stock as compared to the actual quantity present in their godowns, and also that the values have been overstated. The borrower is a registered supplier under the GST law. Their turnover for the year ended 31st March, 2019 is ₹3.4 crores and they have filed their return of income on 12th October, 2019.

As a forensic auditor appointed by the bank, how will you go about gathering evidence and what are the documents, statements, returns, etc., you will go through to check the veracity of the stock statements furnished by the borrower? (12 marks)

Answer 2

Gathering of Audit Evidence

In forensic auditing specific procedures are carried out in order to produce evidence. Audit techniques and procedures are used to identify and to gather evidence to prove, for example, how long have fraudulent activities existed and carried out in the organization, and how it was conducted and concealed by the perpetrators. In order to continue, it is pertinent that the planning stage has been thoroughly understood by the investigating team, who are skilled in collecting the necessary evidence.

The investigators can use the following techniques to gather evidence:

— Testing controls to gather evidence which identifies the weaknesses, which allowed the fraud to be perpetrated.

— Using analytical procedures to compare trends over time or to provide comparatives between different segments of the business.

— Applying computer-assisted audit techniques, for example, to identify the timing and location of relevant details being altered in the computer system.

— Discussions and interviews with employees.

— Substantive technique such as reconciliations, cash counts and review of documentation.

Documents / Papers etc., to be seen by Forensic Auditor

The Forensic Auditor should verify the following statements/papers/ documents:

1. Analyse the stock held on various dates during the FY 2018-19 and FY 2017-18. The stock statements submitted to the bank themselves may be seen in this regard.

2. Trend analysis of the two years may be carried out from above.

3. The borrower has filed the Income tax return for the AY 2019-20. Since its turnover exceeds Rs 2 crores, it will be subject to tax audit. Form 3CD should be verified to see the comments of the auditor about valuation of stock. In case, there is any adverse comment or qualification, this will be helpful for further probe.

4. Form 3CD also furnishes quantitative details of stock, which are to be verified by the forensic auditor.

5. Forensic auditor should check whether the quantity as well as value as furnished to the banker tally with those disclosed in the Income-tax return. In case the difference is material, the same justifies strong further action.

6. GST returns filed for each month may be verified. Thus will give an idea of the selling prices of the borrower for various items. By deducting rough Gross Profit margin, the cost of goods sold can be ascertained. The Forensic Auditor can compare the said rates with the rates adopted by the borrower in the Stock statements of various months.

7. Forensic Auditor could conduct a surprise visit of the godown where the stocks are held and undertake a stock verification.

Question 3

Vishnu Mobiles Ltd., is a domestic company dealing in mobiles of famous international brands. During August, 2018, the company suspects that its sales volume has come down, thanks to the red flag raised by the Sales Manager.

Two persons L and M are handling sales of two famous brands viz., Orange (Costly mobiles) and Bamfung (economy model mobiles).

Anonymous letters have come to the company about sudden spurt in the lifestyles of L and M.

The company, suspecting acts of collusion and corruption, entrusts the job to you as forensic auditor. What are the types of corruption you will look for ?

What will be your course of action as forensic auditor to unearth the misdeeds, if any, committed against the company ? *(12 marks)*

Answer 3

Forensic Audit of Corruption Fraud

There are three types of Corruption Fraud : Conflicts of Interest, Bribery, and Extortion. Research shows that corruption is involved in around one third of all frauds.

— In a conflict of interest fraud, the fraudster exerts the influence to achieve a personal gain which detrimentally affects the company. The fraudster may not benefit financially, but rather receives an undisclosed personal benefit as a result of the situation. For example, a manager may approve the expenses of an employee who is also a personal friend in order to maintain that friendship, even if the expenses are inaccurate.

— Bribery is when money (or something else of value) is offered in order to influence a situation.

— Extortion is the opposite of bribery, and happens when money is demanded (rather than offered) in order to secure a particular outcome.

Methodology to be adopted

The following methodology may be adopted by the Forensic Auditor, singly or in combination:

(i) Conducting interviews with the employees of the company, especially in the sales division.

(ii) Encourage the employees to post their views about L and M, in suggestion boxes anonymously kept in this regard.

(iii) Where the company policy permits, check the email history of L and M for the past one year.

(iv) Buyers of the two mobile products are to be interviewed to ascertain whether there is any collusion between any of them and L (or M).

(v) Forensic auditor may obtain SOP for sake for these two mobiles and check whether they have been adhered to by L and M.

(vi) It is possible that L and M have colluded with each other, along with some buyer. Costly products of Orange might have been billed as the other product.

(vii) Confirmation of balances should be obtained from various buyers and cross checked with company records.

(viii) GST returns for the month should be scrupulously checked and any fraud pattern visible therein must be looked into.

(ix) Look for red flags. Were L and M too sincere in their work, without even taking sick leave or going for vacation, even though they were entitled to?

(x) Market Intelligence techniques can be adopted wherein cover agent will visit the suspected person's residence area to get an understanding his lifestyle, discreetly enquire about him with the few people in the area adjoining etc.

Question 4

Department of Foreign Trade (DFT) have received complaints from several quarters about one exporter who is alleged to have indulged in book exports (actual exports have not taken place, only the books show as if exports have taken place), against one Duryodhana Jewellers, Surat (DJS).

DFT appointed a forensic auditor (FA) to probe into the matter. The FA came out with a report proving that the complaints received were true. Discuss how the FA would have gone about in the course of his audit to prove the misdeeds of DJS.

(12 marks)

Answer 4

Forensic Audit of alleged book exports fraud

The Forensic Auditor (FA) will go about examining various aspects connected with the alleged exports of Duryodhana Jewellers, Surat (DJS). Various aspects the Forensic Auditor would have looked into, the documents and records which the Forensic Auditor would have verified and related aspects involved are as under:

(a) Compare the track record of DJS for the past 5 years to see whether there is any alarming increase in the quantum of exports during the current year, as compared to the earlier / previous years.

(b) Verify the details of the alleged buyers for the exported product, to see whether such buyers are located in notified jurisdictional areas for Income tax purposes. In case there are notified jurisdictional areas buyers, deeper scrutiny is required.

(c) Bank records are to be thoroughly scrutinised to see whether there are actual remittances in foreign exchange from the alleged buyers.

(d) Investigate the origin and the manner of utilisation of the alleged remittances received from abroad for the exports. This will help to see whether the same are funnelled out of India for remittances again into India.

(e) Compare the rates shown in the various export invoices with the rates of sellers of similar products who also export.

(f) Production /stock records of DJS to be seen to examine the flow of production. Sales is possible only if stock is held and stock can arise only of they are produced or purchased.

(g) In case the inflow of stock is due to purchases, all the purchase invoices are to be verified.

(h) Related party transactions, if any, should be looked into and in case of any, deeper scrutiny is required.

(i) Form 3CD to be verified to look into transactions with related parties or with persons specified in section 40A (2) of the Income-tax Act, 1961.

(j) GST returns to be checked thoroughly to see how DJS has claimed the refund for GST paid on exports.

Question 5

Vishnu Polymers Ltd., (VPL) have been dealing with one A Pvt. Ltd., (APL), which is a one person company (OPC). Directors of VPL feel that the promoter of APL, Mr. G, is also a nominee of another company, GGL and that he is a resident of Singapore. They suspect some foul play against VPL in the form of falsification of records given for proving the financial stability of the OPC.

You are appointed as the forensic auditor (FA) by VPL.

You are required to give a note to VPL about OPC and as to how you would proceed to clear the suspicion in their minds. *(12 marks)*

Answer 5

Forensic Audit of OPC

OPC under the Companies Act, 2013 : Section 2(62) of the Companies Act, 2013 defines "One Person Company" as a company which has only one person as member. OPC is a type of Private Company as per Section 2(68) and Section 3(1)(c) of the Companies Act, 2013. Rule 3 of the Companies (Incorporation) Rules 2014 say, only a natural person who is an Indian citizen and resident in India:

(a) shall be eligible to incorporate a One Person Company;

(b) shall be a nominee for the sole member of a One Person Company.

Resident in India means a person who has stayed in India for a period of not less than one hundred and eighty two days during the immediately preceding financial year.

A person can incorporate only one "One Person Company", at any point of time and the said person shall not be a nominee of more than a One Person Company.

The subscriber to the memorandum of a One Person Company shall nominate a person, after obtaining prior written consent of such person, who shall, in the event of the subscriber's death or his incapacity to contract, become the member of that One Person Company. The name of the person nominated shall be mentioned in the memorandum of One Person Company and such nomination in Form INC-32 (SPICe), Single Application for Incorporation of Company, along with consent of such nominee obtained in Form INC – 3 and fee as provided in the Companies (Registration offices and fees) Rules, 2014 shall be filed with the Registrar at the time of incorporation of the company along with its memorandum and articles.

Methodology adopted by Forensic Auditor

From the above, it is clear that person who is a resident in India only can be nominee of OPC and that he can be nominee of only one OPC.

Thus there are enough safeguards under the Companies Act, 2013 in this regard. The Forensic Auditor can verify the records available in the office of the ROC and see who Mr. G is. It is inconceivable that he is not a resident of India, at least at the time of formation of the OPC. These records can be submitted to the directors of VPL.

If G has become a resident of Singapore, subsequent to the formation, he should have informed it to the ROC.

The Forensic Auditor can track it from the VISA of G (available in the files of the ROC), whether he has left India subsequent to formation. A systematic tracking of the flight manifest in the airports and similar manifests in ship ports will help to prove the same.

Further, the Forensic Auditor try to check with the individual's Bankers if the individual is having an Non Resident status. Bank records may dispel all doubts on the residency.

Question 6

Recently, BG Ltd., an existing Indian Company, was taken over by a new set of shareholders, who acquired majority stake in the company. They have taken steps to change Mr. E, the existing auditor, following the procedures laid down in the Companies Act, 2013.

They opine that two years back, a major fraud had been committed against the company and that Mr. E was aware of it, but he had not reported the same. The fraud is in the area of inflated purchases of products and services relating to the company construction project (factory building). You are appointed as the forensic auditor (FA) to carry out a forensic audit to look into the fraud.

You are required to advise the present management on these aspects:

(a) Is there any duty on the part of auditor of a company to report the fraud, if any, which he has come across? (6 marks)

(b) What are the aspects to be seen to determine/judge/ascertain whether fraud has taken place in the areas suspected? (6 marks)

Answer 6(a)

Duty of the Auditor to report Fraud

Section 143(12) of the Companies Act, 2013 read with the Companies (Audit and Auditors) Amendment Rules, 2015 provides 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 which involves or is expected to involve individually an amount of rupees one crore or above, is being or has been committed against the company by its officers, the auditor shall report the matter to the Central Government.

The auditor shall report the matter to the Central Government as under:

i. the auditor to report the matter to the Board/ Audit Committee, as the case may be, immediately but not later than 2 days of his knowledge of the fraud, seeking their reply or observations within 45 days;

ii. on receipt of such reply, the auditor to forward his report and the reply of the Board/Audit Committee along with his comments to the Central Government within 15 days from the date of receipt of such reply or observations;

iii. in case the auditor fails to get any reply or observations from the Board/ Audit Committee within 45 days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;

iv. the report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same.

v. the report shall be in the form of a statement as specified in Form ADT-4.

In case of a fraud involving lesser than rupees one crore, the auditor shall report the matter to Audit Committee or to the Board immediately but not later than 2 days of his knowledge of the fraud and he shall report the matter specifying the following:

i. Nature of Fraud with description;

ii. Approximate amount involved; and

iii. Parties involved.

The following details of each of the frauds reported to the Audit Committee or the Board during the year to be disclosed in the Board's Report:

i. Nature of Fraud with description;

ii. Approximate Amount involved;

iii. Parties involved, if remedial action not taken; and

iv. Remedial actions taken.

Answer 6(b)

Probe into suspected fraud

The fraud is suspected in the area of purchase of building materials for company construction project, say factory building. The Forensic Auditor will look into the following areas:

(i) Collect complete details about the factory which has been constructed including type of construction, area, furnishing, lighting, etc.;

(ii) Scrutinise quotations received from engineers. In case of labour contract only, there is need for further probe, since it is the company which has to procure the materials /services.

(iii) Make out a list of parties from whom goods have been purchased and services have been procured.

(iv) Where such purchases are from related parties, the same requires disclosure under the Companies Act.

(v) Form 3CD may be checked to see whether there is any transaction between the company and persons specified in section 40A(2) of the Income-tax Act, 1961.

(vi) The help of a registered valuer may be obtained to ascertain, the approximate cost of construction for the factory may be thus obtained and the same can be compared with the amount debited in the books of the company. Significant difference would clearly indicate that a fraud has taken place in this area.

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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 2020-21, unless stated otherwise.

3. Working notes should form part of the answer.

Question 1

ABC LLP having office located at NOIDA, constituted by a team of professionals comprising of Company Secretaries, Chartered Accountants and Others engaged in providing services for diversified activities in the field of Secretarial matters, Audit matters, Accounts and Taxation related matters to different constituents. The firm is known for the expertise services, best guidelines and for providing consultation in the field of taxation related matters. The Taxation division of the firm is being acknowledged for providing the best consultation on the issues and matters under the Income Tax Act, 1961 and relating to International taxation and on Transfer Pricing. The firm has been contacted for seeking their expert opinion on the issues and matters relating to Taxation by the various constituents/entities including the small professional firms located in the nearby areas. Some of the matters/issues referred by different entities/ constituents/professionals for obtaining their expert opinion are being compiled and being listed hereunder :

(A) Matter/Issue referred by Ding Dong Ltd -Mumbai

Ding Dong Ltd engaged in the manufacture of textile goods since 01.04.2009 is preparing to file its tax return for the A.Y. 2020-21 and for ascertaining to have a correct computation of income provides various particulars and details. Its Statement of Profit& Loss as on 31.03.2020 shows a net profit of ₹700 lakhs after debit/credit of the following items :

(i) Depreciation calculated on the basis of useful life of assets as per provisions of the Companies Act, 2013 of ₹50 lakhs.

(ii) Both Employee's contribution to EPF of ₹2 lakhs and Employer's contribution of ₹2 lakhs for the month of March, 2020 were remitted on 18th May, 2020.

(iii) The company had provided amount of ₹20 lakhs being sum estimated as payable to workers based on agreement entered with the workers union towards periodical wage revision once in three years. The provision is based on a fair estimation on wage and reasonable certainty of revision.

(iv) The company had made a provision of 10% of its debtors towards bad and doubtful debts. Total sundry debtors of the company as on 31.03.2020 were of ₹300 lakhs.

(v) *A debtor who owed the company an amount of ₹30 lakhs was declared insolvent by Court and hence the amount was written off in total by debit to profit & loss account.*

(vi) *The opening and closing stocks for the year were ₹200 lakhs and ₹255 lakhs respectively. These were overvalued by 10%.*

(vii) *Provision for gratuity based on actuarial valuation was ₹500 lakhs. Actual gratuity paid during the year and debited to gratuity provision account was of ₹300 lakhs.*

(viii) *Commission of ₹1 lakh paid to a recovery agent for realization of a debt. Tax was neither deducted nor remitted as per Chapter XVII-B of the Act on such amount of payment.*

(ix) *The company has purchased 500 tons of packing material at a price of ₹30,000 per ton from Ping Pong a firm in which majority of the directors is partners. The normal selling price charged by Ping Pong for the same material when sold to others is ₹28,000 per ton.*

Additional Information :

(i) *There was an addition to Plant & Machinery for ₹50 lakhs on 10.06.2019 but the machinery was put to use on 10.8.2019. Additional deprecation on such machinery has not been charged or adjusted in the books.*

(ii) *Normal depreciation calculated as per income-tax is ₹80 lakhs.*

(iii) *The company had collected in past ₹7 lakhs as sales tax from its customers and paid the same on the due dates to the government. However, on an appeal made, the High Court directed the Sales Tax Department to refund ₹ 3 lakhs to the company. The company in turn refunded ₹2 lakhs to the customers from whom the amount was collected and the balance of ₹1 lakh is still lying under the head "Current Liabilities".*

(B) *Matters referred by ABC Professional Services :*

The partner of the firm have sought opinion in respect of the matters of their clients for filing reply with the tax authorities relating to the show cause notices issued indicating to tax the income in India in each of the following cases under the provisions of Income-tax Act, 1961 :

(i) *Tech Engineering a German foreign Company entered into an agreement for the execution of Electrical Work in India for Raj Thermal Power Ltd. Separate payment was made towards drawings & designs by Raj Thermal Power Ltd to the German Company which termed as payment for "Engineering Fee". The German Company is not having any permanent establishment (PE) in India for doing the business and operates from Germany only.*

(ii) *Engineers and Engineers of UK a non-resident foreign company entered into a collaboration agreement on 25.06.2019 with Tony (India) Ltd an Indian Company. The UK Company was issued debentures by Tony (India) Ltd of ' 100 lacs on 1.7.2019 bearing interest @ 12% p.a. in consideration of providing*

the technical know-how to Tony (India) Ltd by the UK Company. Tony (India) Ltd had also paid the interest on the debentures to Engineers and Engineers which was due for the relevant period ended on 31.3.2020.

(iii) PQR Ltd. is an Indian Company manufacturing T-shirts located at Jaipur in Special Economic Zone (SEZ) in which Joly Inc. a US Company is holding 32% shares and voting power. Following transactions were effected between these two companies during the year 2019-20 :

(a) PQR Ltd sold 1,50,000 pieces of T-shirts at $ 3 per T-shirt to Joly Inc. The identical T-shirts were sold by PQR Ltd to the unrelated party namely Konny Inc at $ 4 per T-shirt.

(b) PQR Ltd borrowed a loan of $5,00,000 from a foreign lender on the strength of guarantee given by Joly Inc and for the purpose of giving guarantee, PQR Ltd paid $20,000 as guarantee fee to Joly Inc. However, for the same amount of loan taken by an unrelated party, Joly Inc had charged the guarantee fees of an amount of $15,000.

(c) PQR Ltd paid $20,000 to Joly Inc for getting the details of various potential customer to improve its business outside India in global market. Joly Inc provided the same services and details to an unrelated party for $15,000.

(C) Matter referred by Monika Steel Balls :

Monika Steel Balls manufacturing Steel Balls had ordered advanced technology machine to Punjab Machine Tools Ltd and paid an advance of ₹ 5 lacs. The machine was to be supplied by Punjab Machine Tools Ltd before the end of August, 2019. However, they could not supply the machine till January, 2020 and therefore, Monika Steels Balls after negotiation with them received back the advanced amount of ₹ 5 lacs in February, 2020 and against their claim for liquidated damages received an amount of ₹ 3 lacs in the month of March, 2020. Monika Steel Balls, had shown the amount of liquidated damages as a capital receipt in the return filed for A.Y. 2020-21. However the tax authorities had issued a notice stating that the liquidated damages are in the nature of revenue receipt and thus are subject to tax.

(D) Matter referred by Nargis Agro Ltd - Jaipur :

Nargis Agro Ltd, Jaipur engaged in manufacturing of Vegetable Oils wants to offer Voluntary Retirement Scheme (VRS) to its employees to cut down its pay roll cost. The company is desirous to offer such scheme of voluntary separation to its employees so that the amount received by the employees under the scheme would qualify for tax exemption under section 10(10C) of the Income Tax Act, 1961 in their hands and also the company be allowed to claim the deduction of the amount so paid to the employees under the scheme.

(E) Matter referred by Siddharth Hospitals Pvt. Ltd :

Siddharth Hospitals Pvt. Ltd has recently been accorded recognition by several insurance companies to admit and treat patients in the hospital on cashless hospitalization basis. Payments are to be made by Third Party Administrators

(TPA) who will process the claims of the patients admitted and be making payments to the various hospitals including the payments to Siddharth Hospital. All TPAs are the corporate entities. In the backdrop of the aforesaid compiled matters referred to ABC LLP which are being entrusted to you, provide your expert opinion/views and workings wherever required in the context of provisions contained under the Income Tax Act, 1961 supported with reasons on the following:

(a) Compute the total income of Ding Dong Ltd Mumbai for the year ended 31.3.2020 from the particulars/information and details given by them as compiled under 'A'. Give brief reasons for the treatment given to each of the items in the computation. (13 marks)

(b) Provide the expert opinion/advice on the matters referred by ABC Professional Services as compiled under 'B' as to :

(i) Whether the payment made towards drawings and designing by Raj Thermal Power Ltd to Tech Engineering be subject to tax in India and if so, then why ? (3 marks)

(ii) What treatment shall be given for the purpose of taxation to the debentures of ₹ 100 lacs issued by Tony (India) Ltd to Engineers and Engineers of UK on 1.7.2019 ? Whether the interest earned on such debentures to be taxed in India in A.Y. 2020-21 and if so, on what amount the tax shall be charged ? Answer be based only on statutory provisions and by ignoring the provisions of Double Taxation Avoidance Agreement (DTAA) between India and UK. (3 marks)

(iii) Explain the relationship of the companies PQR Ltd and Joly Inc of US and the nature of various transactions entered into between them during the year 2019-20. Compute the adjustment, if required to be made to the total Income of PQR Ltd under transfer pricing provisions. State whether the company can also claim benefit of deduction under section 10AA of the Act for the enhanced income due to adjustments made by application of transfer pricing provisions. Take the value of one US dollar as ₹75. (7 marks)

(c) Advice to Monika Steel Balls relating to the amount of ₹ 5 lakhs received as liquidated damages on the facts compiled under 'C' whether to be treated as Capital Receipt or Revenue Receipt. Support your answer with the decided case law, if any. (4 marks)

(d) State all those points which would be kept in mind while drawing up the scheme of voluntary separation to be offered by Nargis Agro Ltd to its employees on the facts as compiled under 'D'. What will be the tax treatment for the payments made under the scheme in the hands of Nargis Agro Ltd? (6 marks)

(e) Siddharth Hospitals Pvt. Ltd on the facts as compiled under 'E' wants to know whether the TPAs shall be deducting any tax at source out of the payments made by them to the hospital and if so under which section and at what rate such tax is to be deducted? (4 marks)

Answer 1(a)

Computation of Total Income of Ding Dong Ltd - Mumbai

Assessment Year 2020-21

Particulars			*Amount (Rs.)*
Profits & Gains from Business and Profession			7,00,00,000
Net profit as per Profit and Loss Account			
Add: Items debited but to be considered separately or to be disallowed			
	i)	Depreciation as per Companies Act, 2013	50,00,000
	ii)	Employees contribution to EPF [Employees contribution to EPF not been deposited on or before the due date under the PF Act, the same is not allowable as deduction as per section 36(1)(va) of the Income tax Act, 1961]	2,00,000
		Employers contribution to EPF [As per section 43B of the Income tax Act, 1961, Employer's contribution to EPF is allowable as deduction since the same has been deposited on or before the 'due date' of filing of return under section 139(1) of the Income tax Act, 1961]	Nil
	iii)	Provision for wages payable to workers. [The provision based on fair estimate of wages and on reasonable certainly of revision, is allowable as deduction, since ICDS -X requires reasonable certainly for recognition of a provision]	Nil
	iv)	Provision for doubtful debts {10% of Rs. 300 lakhs}[Provision for doubtful debts is allowable as deduction under section 36(1)(viia) of the Income tax Act, 1961 only in case of banks, public financial investment corporations, hence to be added]	30,00,000
	v)	Bad debt written off [Actual Bad debts written off in the books are allowable as deduction under section 36(1)(vii) of the Income tax Act, 1961].	Nil
	vi)	Provision for gratuity [Provision of Rs. 500 lakhs for gratuity though based on actuarial valuation is not allowable as per section 40A(7) of the Income tax Act, 1961. However, actual gratuity of Rs. 300 lakhs paid is allowable as deduction. Hence, the difference to be added back]	2,00,00,000

vii)	Commission paid to the recovery agent [Commission of Rs. 1 lakh paid to the recovery agent for realization of a debt is an allowable expense under section 37 of the Income tax Act, 1961 as per DCIT vs. Super Tannery (India) Ltd. (2005) 274 ITR 338 (All). Since TDS was not deducted 30% of it is to be disallowed]	30,000	
viii)	Purchase of packing paper [As per section 40A(2), the difference between the purchase price Rs.30,000 per ton and the fair market value Rs.28,000 per ton multiplied by the quantity purchased 500 tons to be added back since the purchase is from a related party]	10,00,000	
ix)	Sales tax not refunded to customers out of sales tax refund made by department [Refund amount of sales tax by the Government is chargeable as revenue receipt under section 41(1). Deduction can be claimed of amount refunded to customers (*CIT* vs. *Thirumalaiswamy Naidu & Sons (1998) 230 ITR 534*). Hence net amount of Rs. (3,00,000 - 2,00,000 = 1,00,000) be taxable and added.	1,00,000	2, 93,30,000
			9,93,30,000
***Less* : Items credited but to be considered separately / permissible expenditure and allowances.**			
i)	Depreciation as per Income-tax Act, 1961	80,00,000	
ii)	Over-valuation of Stock [The amount by which stock is overvalued to be reduced for computing business income. Difference between closing and opening stock, is to be adjusted to remove the effect of over valuation (255 lakhs – 200 lakhs x 10/110)]	5,00,000	
iii)	Additional Depreciation on new machine [Additional depreciation is allowable @ 20% on 50 lakhs being actual cost of new plant & machinery acquired on 10.06.2019 and was put to use for more than 180 days in the P. Y. 2019-20]	10,00,000	(95,00,000)
	Total Income		8,98,30,000

Answer 1(b)(i)

As per section 9(1)(i) of the Income tax Act, 1961 "income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situated in India are taxable in India". In the present case payments made were towards drawings and designs to non-resident foreign company are accruing in India and are thus taxable in India.

Separate payments made towards drawings and designs as "Engineering Fees" are in the nature of fee for technical services and thus are subject to tax as per section 9(1)(vii)(b) of the Income tax Act, 1961, since paid by a resident to the non-resident for the purpose of execution of Electrical Work in India.

Explanation-2 below section 9 defines "fees for technical services" to mean any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services including the provisions of services of technical or other personnel. Accordingly, lump sum payment made towards drawings and designs as "Engineering Fees" is in the nature of fee for technical services.

The facts in the problem are based upon the decision of the Karnataka High Court in case of Aeg Aktiengesllschaft vs. CIT(2004) 267 ITR 209

Answer 1(b)(ii)

The debentures of the value of Rs.100 lakh issued by Tony (India) Ltd to Engineers and Engineers of UK in consideration of providing the Technical know-how under the collaboration agreement are in the nature of fees for Technical Services as per Explanation 2 of Section 9 of the Income tax Act, 1961.

The value of debentures issued by an Indian company in consideration of providing technical know-how, in the nature of fee for technical services, deemed to accrue or arise in India to Engineers and Engineers of UK, a non-resident foreign company, under section 9(1)(vii) of the Income tax Act, 1961. Hence, it is taxable in India and the non-resident foreign company shall be paying tax on the amount of Rs.100 lakhs being the value of debentures.

As per section 9(1)(v) of the Income tax Act, 1961, income by way of interest payable by a person who is a resident of India is deemed to accrue or arise in India and shall be subject to tax as per section 9 of the Income tax Act, 1961.

Therefore, interest income from debentures of an Indian company is deemed to accrue or arise in India in the hands of Engineers and Engineers of UK by virtue of section 9(1)(v) of the Income tax Act, 1961. Hence, the amount of interest on debentures earned in previous year of Rs. 9 lakhs is taxable in A.Y. 2020-21.

Answer 1(b)(iii)

PQR Ltd, an Indian Company, and Joly Inc a US based company are deemed to be Associated Enterprises (AE) as per section 92A(2)(a) of the Income tax Act, 1961. Since Joly Inc holds shares carrying not less than 26% of the voting power in PQR Ltd of India by holding and having 32% of the shares and voting power in the company which is more than 26% to invoke the provisions of section 92A (2)(a) for being an associated enterprises (AE).

As per explanation attached to section 92B of the Income tax Act, 1961, the transactions entered into between these two companies for sale of product, lending or guaranteeing the lender and provision of services relating to customers and market research (as being entered into between the two companies) are included within the meaning of "international transaction".

Accordingly, transfer pricing provisions would be attracted and the income arising from such international transactions have to be computed having regard to the arm's length price (ALP). In this case, from the information given, the arm's length price (ALP) has to be determined and computed by taking the comparable uncontrolled price (CUP) method which is the most appropriate method since details of transactions entered into with the unrelated party are available.

Amount by which the total income of PQR Ltd is to be enhanced on account of adjustments to be made under CUP method in the value of International Transactions between the Company and Joly Inc shall be:

S. No	*Particulars*	*Rs. in lacs*
a)	Difference in the price of the T-shirts being @ $1 each for 1,50,000 pieces sold to Joly Inc. ($ 1 x 1,50,000 x Rs.75)	1,12,50,000
b)	Difference for excess payment of guarantee fee paid to Joly Inc for loan borrowed from foreign lender being difference between the amounts paid compared with payment made by unrelated party. ($20000 - $15000) = $5000 x 75	3,75,000
c)	Difference for excess payment for services to Joly Inc relating to customers details for market improvement compared with payment made by unrelated party being ($20000 - $15000) = $ 5000 x 75	3,75,000
	Total Income to be enhanced	**1,20,00,000**

PQR Ltd cannot claim deduction under section 10AA of the Income tax Act, 1961 in respect of Rs.120 lakh being the amount of income by which the total income is to be enhanced by virtue of the first proviso to section 92C(4) of the Act.

Answer 1(c)

The issue under consideration in this case is whether the liquidated damages received by the company from the supplier of machinery for delay in supply of machinery is revenue in nature or capital in nature.

On this issue, the Apex Court, in the case of CIT vs. Saurashtra Cement Ltd. (2010) 325 ITR 422, held that such liquidated damages were directly and intimately linked with the procurement of a capital asset which lead to delay in coming into existence of the profit making apparatus.

It was thus not a receipt in the course of profit earning process. Therefore, the amount received by the company towards compensation for sterilization of the profit earning source, not in the ordinary course of business, is a capital receipt in the hands of the company.

Applying the rationale of the Apex Court ruling in this case, the income by way of liquidated damages of Rs.3 lakh received by Monika Steel Balls from the supplier of machinery Punjab Machine tools Ltd is a capital receipt.

Note : As per Amendment by Finance Act 2018 in section 28(ii), a New clause (e) has been inserted which says that any compensation or other payment due to or received by any person, by whatever name called, at or in connection with the termination or the modification of the terms and conditions, of any contract relating to his business, shall be treated as business Income.

Answer 1(d)

Section 10(10C) of the Income tax Act, 1961 provides that any amount received or receivable by an employee from specified employer at the time of his voluntary retirement or termination of service under a scheme of voluntary separation is exempt to the extent such amount does not exceed Rs. 5,00,000.

The scheme for voluntary separation is to be in accordance with the guidelines prescribed under Rule 2BA of the Income tax Rules, 1962. The guidelines in Rule 2BA provide that the scheme of voluntary separation framed by the employer should be in accordance with the following requirements in order to be eligible for exemption:

i. The scheme applies to an employee who has completed 10 years of service or completed 40 years of age. (This requirement is not applicable in case of employer being a public sector company.)

ii. The scheme should apply to all employees (by whatever name called) including workers and executives of the company except directors.

iii. The scheme should result in overall reduction in the existing strength of the employees of the company.

iv. The vacancies caused by voluntary separation, should not be filled up.

v. The retiring employee should not be employed in another company or concern belonging to the same management.

vi. The amount receivable on voluntary separation should not exceed the amount equivalent to three months salary for each completed year of service or salary at the time of retirement multiplied by the balance of months of service left before the date of retirement on superannuation.

If exemption under section 10(10C) of the Income tax Act, 1961 in respect of VRS compensation is opted by the taxpayer, he is not eligible for further relief under section 89 of the Income tax Act, 1961.

Section 35DDA of the Income tax Act, 1961 provides that in the case of the company, where any expenditure has been incurred by way of payment to an employee under the scheme of voluntary retirement, one fifth of the total amount so paid shall be deducted in

computing the profits and gains of the business for that previous year and the balance shall be deductible in equal installments in each of the four immediately succeeding previous years.

Answer 1(e)

This issue has been clarified by the CBDT vide Circular No. 8/2009 dated 24.11.2009. As per provisions of section 194J (1) of the Income tax Act, 1961, any person, who is responsible for paying to a resident any sum by way of fee for professional services, shall, at the time of credit of such sum to the account of the payee or at the time of payment therefore in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct an amount equal to 10% of such sum as TDS.

Further, as per Explanation (a) to section 194J "professional services" includes services rendered by a person in the course of carrying on medical profession.

The services rendered by hospitals to various patients are primarily medical services and therefore, the provisions of section 194J are applicable on payments made by TPAs to hospitals etc. Further for invoking provisions of section 194J, there is no stipulation that the professional services have to be necessarily rendered to the person who makes payment to hospital. Therefore, TPAs who are making payment on behalf of insurance companies to hospital for settlement of medical/ insurance claims etc. under various schemes including Cashless Schemes are liable to deduct tax at source under section 194J on all such payments made to hospitals etc.

In view of the above, all such transactions between TPAs and hospitals would fall within the ambit of provisions of section 194J and tax at the rate of 10% out of the total amount so paid by TPAs is required to be deducted.

Question 2

(a) ***Vishwa Kalyan Charitable Trust*** *was formed on 1st March, 2017. It filed with the Commissioner of Income-tax (Exemption) its application for registration as per section 12A on 31st August, 2019 explaining that for good and sufficient reasons, it could not file the application so long after its formation and thus the registration to be granted since 01.03.2017.*

The trust for the accounting year ended on 31st Mach, 2020 earned an income of ₹5, 70,000 and has claimed that the income earned by it be treated as exempt under section 11 of the Income-tax Act, 1961. Explain with brief reasons in the context of the provisions contained under the Income Tax Act, 1961:

(i) by which date the application for registration should have been filed by the trust for claiming benefit u/s 11 and 12 and whether such an application could have been filed before the formation of the trust ?

(ii) can the trust be deemed to be registered in absence of an order of registration from the Commissioner of Income Tax (Exemption) on its application filed on 31.08.2019 and if so, then from which date ?

(iii) Whether a certificate of registration once granted can be cancelled and if so, the conditions thereof? (3×2 = 6 marks)

(b) Ankit Private Limited in its return of income filed for A.Y. 2019-20, has claimed a sum of ₹ 40,000 as a deduction on account of payments made for stamp duty

and registration charges of the lease deed from the income shown under the head "Income from house property". The Assessing Officer disallowed the claim of the assessee company in the assessment order passed under section 143(3). Examine the correctness of the action of the Assessing Officer as to disallowance so made in the context of provisions contained under the Income Tax Act, 1961. *(3 marks)*

(c) Zonga Ram is a Member of Legislative Assembly of Rajasthan. He underwent an open heart surgery in July, 2019 abroad in respect of which he was paid by the State Government an amount of ' 15 lacs towards reimbursement of his medical expenses. The Assessing Officer contended that such amount is taxable as a perquisite under section 17 of the Act and issued a show cause notice to Zonga Ram to tax the amount of ¹ 15 lacs so received by him in A.Y. 2020-21. Examine the correctness of the contention of the AO and support your answer with the ruling of decided case, if any. *(3 marks)*

Answer 2(a)

i) The application for registration under section 12A of the Income tax Act, 1961, can be filed at any time after formation of the Trust and the provisions of sections 11 and 12 would apply from the assessment year relevant to the financial year in which the application for registration is made.

No, the application for grant of registration under section 12A cannot be filed before the formation of the trust.

However, where registration has been granted and on the said date assessment relating to the earlier assessment years is pending, then the benefit of sections 11 and 12 shall be available in respect of income derived from property held under trust in those years, provided the objects and activities of the trust remained unchanged.

ii) As per section 12AA(2) , every order granting or refusing registration should be passed before the expiry of 6 months from the end of the month in which the application was received under section 12A of the Income tax Act, 1961.

The Supreme Court in case of CIT vs. Society for Promotion of Education (2016) 382 ITR 6 held that the trust should be deemed as registered if the application under section 12AA is not disposed of within the stipulated period of six months.

Therefore, in this case, the trust would be deemed as registered with effect from 31.8.2019 if the order of registration is not passed by CIT (exemption) by 28.02.2020. The benefit of exemption under section 11 and 12 would be available from A.Y. 2020-21 being the assessment year relevant to the financial year in which the application is made by trust on 31.08.2019.

iii) Commissioner of Income Tax (Exemption), if is satisfied that the activities of the trust are not genuine or are not being carried out in accordance with the objects of the trust, he shall after giving the trust a reasonable opportunity of being heard, pass an order in writing cancelling the registration of the trust.

Further, section 12AA(4) provides that where a trust or an institution has been granted registration and subsequently it is noticed that

- its activities are not being carried out in accordance with the object of the trust.

- the trust deliberately commits violation as referred to in section 13.
- the trust has not complied with the requirement of any other law, for the time being in force applicable to the trust and the order, holding that such non-compliance has occurred, has either not been disputed or has attained finality then, the Commissioner, may cancel the registration of such trust or institution. However, the registration shall not be cancelled if the trust or institution proves that there was a reasonable cause for the activities to be carried out in the said manner.

Answer 2(b)

Section 23 of the Income Tax Act, 1961 stipulates that in determination of net annual value of the let-out house property, the deduction allowed is of the municipal taxes paid by the owner.

Once the net annual value is determined, the deductions which are admissible are specified in section 24 namely statutory deduction @ 30% of the net annual value and deduction in respect of interest on borrowed capital taken for the purpose of acquiring, constructing, renewing or repairing the house property.

Amount spent towards stamp duty for drawing up the lease deed and for the registration charges are not to be allowed as deduction in determining the net annual value of the house property under any of the sections either 23 or 24 of the Income tax Act, 1961. Therefore, the action of the Assessing Officer in disallowing the deduction in respect of stamp duty and registration charges is correct.

Answer 2(c)

The facts of this case are similar to the facts in *CIT* v. *Shiv Charan Mathur* (2008) 306 ITR 126 where the Rajasthan High Court observed that MPs and MLAs do not fall within the meaning of "employees". The remuneration received by them, after swearing in, cannot be said to be taken and falling under salary within the meaning of section 15 of the Income tax Act, 1961, since the basic ingredient of employer-employee relationship is missing in all such cases.

The remuneration received by MPs and MLAs is taxable under the head "Income from Other Sources" and not under the head "Salaries". When the provisions of section 15 are not attracted to the remuneration received by MPs and MLAs, the provisions of section 17 also would not apply as section 17 only extends the definition of salary by providing that certain items mentioned therein would be included in salary as "perquisites".

The reimbursement of medical expenditure (incurred for open heart surgery abroad) to Zonga Ram MLA cannot be taxed as a perquisite under section 17 as being stated by AO in show cause notice. Applying the above ruling to the case the contention of the Assessing Officer is not correct.

Question 3

(a) Radhey Radhey International of Jaipur, a toys manufacturing company was transporting two of its machines from unit "A" located at Ajmer to unit "B" located at Jaipur (which are at a distance of 150 KMs) on 1st September, 2019 by a truck. On account of a civil disturbance, both the machines got damaged while

on its way in truck to unit "B". Company lodged a claim with the insurers for the damages so sustained to the machines. The insurance company admitted the claim and paid an amount of ₹8 lacs for the damages caused to both the machines.

On these facts, for submitting the return of income for the previous year ending 31st March, 2020, your advice is sought as to :

(i) Whether the damage of machines results in any transfer ?

(ii) How the amount of ₹8 lacs received from the insurance company to be treated for the purpose of taxation ?

(iii) Would there be any impact on the written down value of the block of plant and machinery as at 31st March, 2020 ? (6 marks)

(b) PQR Ltd a non-banking finance company was engaged in the business of leasing and hire purchase. It purchased motor cars from Ramada Motors and leased out these vehicles to its customers. The lease agreement with the customer stated that PQR Ltd was empowered to repossess the vehicle, in case the lessee committed default in payment. Registration of the vehicle in the name of lessee, during the period of lease is mandatory as per the Motor Vehicles Act, 1988. PQR Ltd claimed ₹15,00,000 as depreciation on the vehicles leased out for the year ended on 31.03.2020. The claim was rejected by the Assessing Officer on the ground that the assessee had merely financed the purchase of motor cars and was neither the owner nor the user of these motor cars as assets. Is the action of the Assessing Officer valid ? Discuss and support your answer with the ruling of a decided case law. (6 marks)

Answer 3(a)

i) Section 45(1A) of the Income tax Act, 1961, overrides section 45(1) of the of the Income tax Act, 1961 and compensation received on Damage or Destruction of Capital Asset due to civil disturbances chargeable to Capital gains whether or not it is a transfer as per Section 2(47) of the Income tax Act, 1961.

Receipt of insurance compensation in the form of money or any asset is to be treated as consideration and capital gain is chargeable to tax in the PY of receipt.

The two qualifying conditions prescribed are (a) the compensation should have been received because of damage or destruction of capital asset; and (b) the damage or destruction is as a result of circumstances mentioned therein.

As per the facts of the case, both the conditions are satisfied and therefore, the compensation is to be treated as consideration received for damages to the machine.

ii) Receipt of amount as insurance compensation of Rs. 8 lakhs has to be treated as sales consideration for computing capital gains in accordance with the provisions of section 45(1A) of the Act towards the damages caused to the machines (Capital Assets). Accordingly, The amount of Rs. 8 lakhs is to be adjusted in the value of the block of assets.

(iii) As per provisions of section 43(6)(c) of the Income tax Act, 1961, the receipt of insurance compensation of Rs. 8 lakhs shall be deducted from Written Down Value (WDV) of the Block of Assets.

If the written down value of the Block of assets in which damaged machines falls, is more than Rs. 8 lakhs, then the entire amount of Rs. 8 lakhs shall be deducted from written down value and if the opening written down value of the Block of assets plus actual cost of the assets put to use falling within the block plus expenditure in connection with the transfer, if any is less than Rs. 8,00,000 the difference shall be treated as short term capital gain by virtue of Section 50 of the Income Tax Act, 1961.

Answer 3(b)

The issue under consideration in this case is whether depreciation on leased vehicles can be denied to the lessor PQR Ltd on the ground that the vehicles are registered in the name of the lessee and that the lessor is not the actual user of vehicles.

Supreme Court in case of *1.C.D.S. Ltd.* vs. *CIT (2013) 350 ITR 527* observed that section 32 of the Income tax Act, 1961 imposes a twin requirement of "ownership" and "usage for business" as conditions for claim of depreciation. Satisfaction of these requirements entitles the lessor to claim depreciation on the leased out assets. As far as usage of the asset is concerned, the section requires that the asset must be used in the course of business. It does not mandate actual usage by the assessee.

In this case, the assessee PQR Ltd, the lessor used the vehicles in the course of its leasing business. Hence, the requirement of section 32 "usage for business" has been fulfilled, notwithstanding the fact that PQR Ltd, was not the actual user of the leased vehicles.

The Supreme Court further observed that the Motor Vehicle Act, 1988 contains a deeming provision which creates a legal fiction of ownership in favour of the lessees only for that Act and not for the purpose of law in general. No inference could be drawn from the registration certificate as to ownership of the vehicles, since registration in the name of the lessee during the period of lease is mandatory as per the Motor Vehicles Act, 1988.

Therefore, as long as the lessor has a right to certain the legal title against the rest of the word, it would be the owner of the asset in the eyes of law. In this case, PQR Ltd, the lessor, is the exclusive owner of the vehicle at all points of time as they are empowered to repossess the vehicle, in case the lessee committed a default. The proof of ownership lies in the lease agreement itself, which clearly points in favour of PQR Ltd.

Applying the rationale of the Supreme Court ruling in I.C.D.S Ltds' case, the action of the Assessing Officer in this case denying the depreciation claim of Rs. 15 lakhs to POR Ltd. is not valid.

Question 4

(a) Ram has a salary income (computed) of ₹6,00,000 for the financial year 2019-20. His minor son, Arjun has agricultural income of ₹80,000 for the same financial year. The Assessing Officer clubbed the agricultural income of the minor son for determining the rate of income-tax applicable to Ram. However, Ram

contended that agricultural income was exempt under section 10(1) of the Act and also not being specified in the definition of income under section 2(24). Hence, agricultural income of minor son should not be clubbed and the provisions of section 64(1A) cannot be attracted in his case.

Discuss the correctness or otherwise of the contention of Ram in the context of provisions of Income Tax Act, 1961. (4 marks)

(b) Manvendar Singh is a distributor of lottery tickets purchased various series of lottery tickets of Rajasthan Government for sale for the draw to be held on 01-09-2019. He won ₹10,00,000 as prize money on an unsold lottery ticket lying with him as on 31.08.2019.

The prize money so won by him on the unsold ticket was offered as business income. The Assessing Officer had put to tax the amount of ₹10 lacs as winning from lottery at the rate prescribed under section 115BB and not as business income so offered by him.

You are required to state in the context of provisions of the Act, whether the action of A.O. to tax the amount of ₹10 lacs as per section 115BB is justified and correct. (4 marks)

(c) Kamlesh Kant, a resident, aged 58 years, has the following income during the previous year 1.4.2019 to 31.3.2020:

** Salary income ₹7,75,000*

** Interest on savings bank account with Allahabad Bank ₹25,000*

He had made the following payments during the period 1.4.2019 to 31.3.2020:

(i) Insurance premium to Max Life Insurance Ltd amounting to ₹ 25,000 under a policy taken on life of his son. The policy was taken on 20th July, 2011 and the sum assured is of ₹1, 80,000.

(ii) Insurance premium to Life Insurance Corporation of India amounting to ₹ 22,000 under a policy taken on his life on 20th April, 2012 and the sum assured is of ₹2, 00,000.

(iii) Premium of ₹28,000 paid by cheque on health insurance for self to National Insurance Corporation Ltd and payment in cash of ₹5,000 to a hospital for preventive health check-up for self.

Compute the total income of Kamlesh Kant on the basis of the above particulars of income and payments for the A.Y. 2020-21. (4 marks)

Answer 4(a)

The facts of the case are similar to the case of Suresh Chand Talera vs. Union of India (2006) 282 ITR 341 where the M.P. High Court observed that the definition of income under section 2(24) is inclusive and not exhaustive. Hence, the fact that agricultural income has not been specified as one of the items in section 2(24) does not mean that agricultural income is not included in the word “income” which has been used in the Act.

Section 10 of the Income tax Act, 1961, provides that in computing the income of the previous year of a person any income falling in any of the clauses mentioned therein shall not be included. The first clause mentioned therein is "agricultural income". Thus, section 10 makes it clear that agricultural income is income but by express provisions therein, agricultural income has been excluded from the total income of an assessee for the purpose of levy of income-tax.

Section 4(1) of the Income tax Act, 1961, which is the charging section, provides that while the total income of a person is to be determined in accordance with the provisions of the Income-tax Act, 1961, the rate or rates at which tax will be levied on such income for any assessment year will be stipulated in the relevant Finance Act. The Annual Finance Act provides that the net agricultural income shall be taken into account in the manner provided therein for the purpose of determining the rates of income-tax applicable to the income of the assessee.

Therefore, in view of the above provisions, the High Court held that agricultural income of the minor son of the assessee has to be included in the income of the assessee for the purpose of determining the rate of income-tax applicable to the income of the assessee. Therefore, the contention of Ram is Incorrect and the agricultural income of the minor son Arjun is to be included in the income of Mr. Ram for rate purposes.

Answer 4(b)

The issue under consideration is whether winning of prize money on unsold lottery tickets held by the distributor of lottery tickets can be subject to tax prescribed under section 115BB of the Income tax Act, 1961, or is to be taxed as business income.

Kerala High Court in *CIT* vs. *Manjoo and Co.* (2011) 335 ITR 527 observed that the receipts of winnings from lottery by the distributor was not on account of any physical or intellectual effort made by him and therefore cannot be said to be "income earned" during the course of his business.

The unsold lottery tickets cease to be stock-in-trade of the distributor because, after the draw, those tickets are unsalable and have no value except waste paper value and the distributor will get nothing on account of the tickets except any prize winning ticket if held by him, which, if produced will entitle for the payment of prize money. Hence, the receipt of the prize money is not in the capacity as a lottery distributor but as a holder of the lottery ticket which won the prize.

The Lottery Department also does not treat it as business income received by the distributor but instead treats it as prize money paid on which tax is deducted at source. Thus, winnings from lotteries are assessable under the special provisions of section 115BB of the Act, irrespective of the head under which such income falls and the rate of 30% prescribed under section 115BB would be applicable on the amount of prize money winnings.

Accordingly, the Assessing Officer's intention to tax the prize money received by the distributor on unsold lottery tickets held by him at the rate prescribed under section 115BB of the Act is justified and correct.

Answer 4(c)

Computation of Total Income of Mr. Kamlesh Kant for AY 2020-21

Particulars	*Amount (Rs.)*
Income from Salaries	7,75,000
Income from other Sources (Interest on savings bank account)	25,000
Gross Total Income	8,00,000
Less : Deduction under Chapter VI-A	
i. Under section 80C (Life insurance premium paid) Premium paid in respect of policy taken on life of son (Note 1)	(25,000)
ii. Premium paid in respect of policy taken on own life (Note 1)	(20,000)
iii. Under section 80D (Medical insurance premium paid) (Note. 2)	(25,000)
iv. Under section 80TTA (Interest on savings bank account (Note 3)	(10,000)
Total Income	7,20,000

Notes:

1. Deduction under section 80C in respect of insurance premium paid in respect of a policy taken before 1.4.2012 shall be allowed up to 20% of sum assured and in respect of policy taken on or after 1.4.2012 it would be restricted to 10% of sum assured.
2. Deduction under section 80D is allowable in respect of health insurance premium paid by any mode other than cash and expenses on preventive health check-up (up to Rs.5,000) paid by any mode, including cash subject to maximum of Rs.25,000 which is the overall limit in respect of a resident individual and his family members (excluding parents), who are below the age of 60 years.
3. As per section 80TTA, deduction shall be allowed from the gross total income of an individual in respect of income by way of interest from the savings bank account subject to a maximum of Rs.10,000.

Note : Salary income of Rs. 7,75,000 is considered computed, as chargeable under the head salary, after allowing the standard deduction of Rs. 50,000 under section 16(ia) of the Income Tax Act, 1961. Alternatively : Salary income of Rs. 7,75,000 if considered as gross salary, then the standard deduction of Rs. 50,000 under section 16(ia) of the Income Tax Act, 1961needs to be deducted from gross salary for computing income chargeable under the head salary and taken as Rs. 7,25,000.

Question 5

(a) Assessment of Ram Bhajan Ltd for Asst. Year 2018-19 was completed under section 143(3) by making additions of ₹25 lakhs to the income declared in the return. The assessee company filed an appeal before the Commissioner (Appeals) which is pending till date for adjudication.

In this backdrop, answer the following in the context of provisions contained under the Income Tax Act, 1961 :

(i) Can the Assessing Officer initiate reassessment proceedings u/s 148 when the appeal is pending before Commissioner (Appeals) for adjudication on the basis of fresh information that there was escapement of income for the same assessment year ?

(ii) Can the Assessing Officer pass an order under section 154 for rectification of mistake in respect of the issues not being raised and are subject matter of appeal ?

(iii) Can the Commissioner of Income Tax make a revision under section 263 both in respect of matters covered in appeal and other matters ?

(b) Rolly Polly Exim Ltd Mumbai filed its original return for the previous year 2018-19 on 28th September, 2018 declaring loss of ₹22.50 lakh. However, the Manager (Taxation) noticed some calculation error in the original return so filed and therefore decided to file a revised return which was filed on 28th February, 2019 declaring loss of ₹29.50 lakh. The assessment of the company for the A.Y. 2019- 20 was pending and not completed at that point of time when the revised return was filed by the company on 28.02.2019.

The Assessing Officer is of the view that the loss indicated in the original return alone can be carried forward for set-off in the subsequent years since section 80 of the Income Tax Act, 1961 does not contemplate that a revised return can be filed.

You are required to give answer in the context of provision of the Act whether the contention of the Assessing Officer is correct and justified. (6 marks)

Answer 5(a)

(i) Assessing Officer as per the third proviso to section 147 of the Income tax Act, 1961, may assess or reassess such income, other than the income involving matters which are the subject matters of any appeal, reference or revision, which is chargeable to tax and has escaped assessment.

Therefore, even when an appeal is pending before Commissioner (Appeals), the Assessing Officer can initiate reassessment proceedings in respect of income chargeable to tax which has escaped assessment, and does not form part of the additions of Rs. 25 lakhs made to the returned income, which are the subject matter of appeal.

(ii) Assessing Officer as per section 154(1A) of the Income tax Act, 1961, can pass rectification order under section 154(1) to rectify a mistake which is apparent from records in relation to a matter other than the matter which has been considered and decided in the appeal before Commissioner (Appeals).

The issue under consideration in this case relates to rectification of a mistake in respect of a matter which is not the subject matter of appeal. Therefore, Assessing Officer can pass an order under section 154 for rectification provided the same is a mistake apparent from the records.

iii) As per section 263 of the Income tax Act, 1961, the Commissioner has the power to revise an order which is erroneous, prejudicial to the interest of revenue, even if is the subject matter of appeal before Commissioner (Appeals). However, the power of the Commissioner under section 263 shall extend to only such matters as had not been considered and decided in such appeal by Commissioner (Appeals).

In a case where the appeal is pending but not yet decided, the Commissioner cannot exercise his revisionary jurisdiction in respect of those issues which are the subject matter of appeal. [*CWT* vs. *Sampathmal Chordia* (2002) 256 ITR 440 (Mad.)]

Answer 5(b)

Rolly Polly Exim Ltd Mumbai had filed its loss return for AY 2018-19 under section 139(3) on 28-09-2018 before the time allowed under section 139(1) of the Income tax Act, 1961 being before 30th September, 2018. It can file its revised return within the time allowed under section 139(5) being before the expiry of end of the relevant assessment year or before completion of assessment, whichever is earlier.

In this case, the assessment for AY 2018-19 was not complete and was yet to be competed and the end of the relevant assessment year expires on 31.3.2019. Rolly Polly Exim Ltd Mumbai had filed the revised return on 28.2.2019 which is within the time allowed under section 139(5).

Section 139(3) makes it clear that the return of loss be filed within the time allowed under section 139(1). Once such a return is filed, all the provisions of the Act shall apply as if such return has been filed under section 139(1). In other words, a return filed under section 139(3) is deemed to be a return filed under section 139(1).

In view of such a specific provision there is no further necessity in section 80 of the Act to refer to such provision. Hence, there is no reason to exclude the applicability of section 139(5) to a return filed under section 139(3).

Therefore, a loss return filed under section 139(3) can be revised by filing a revised return under section 139(5) within the time allowed. Such loss as per the revised return can be carried forward, even though section 80 does not superficially provide for carry-forward of loss which has been determined to pursuance of return filed under section 139(5).

The contention of the Assessing Officer is therefore, not correct.

This has been supported by the Madras High court in the case of *CIT* vs. *Periyar District Co-op. Milk Producers Union Ltd* (2004) 266 ITR 0705.As per the decided case of Dhampur Sugar Mills Ltd, it was held that the revised return u/s 139(5) substitutes and steps into the shoes of the original return from the date, original return was filed.

Question 6

(a) Examine and state with brief reasons as to taxability or allowability or treatment to be given in each of the following independent cases while computing income under the head "Profits and gains from business or profession" in the return of income for the assessment year 2020-2021 :

(i) Amount received from State Government towards power subsidy with a stipulation that the same is to be adjusted in the electricity bills in each month in subsequent year.

(ii) Profits derived by an assessee engaged in carrying on the business as dealer in shares, on exchange of the shares held as stock in trade of one company with the shares of another company.

(iii) The amount of margin money forfeited by a bank on the failure of its constituents of not taking the delivery of the shares purchased by such bank on their behalf. (2×3=6 marks)

(b) Discuss and explain the correctness of the following statements in the context of the provisions of Income-tax Act, 1961 :

(i) The Joint Commissioner of Income-tax is empowered to issue direction to the Assessing Officer as he thinks fit for the guidance of the Assessing Officer during the assessment proceedings to complete the assessment in a specific manner.

(ii) Assessing Officer may direct for the audit of the accounts under section 142(2A) of the Act, during the assessment proceedings on the basis of certain grounds. (2×3=6 marks)

Answer 6(a)

(i) As per section 2(24)(xviii) of the Income tax Act, 1961, assistance in the form of subsidy or grant or cash incentive by the Central Government or a State Government or any authority or body or agency in cash or kind is chargeable to tax as income. ICDS-VII specify that Government grants should not be recognized until there is reasonable assurance that (i) the person receiving it shall comply with the conditions attached to them; and (ii) the grants shall be received by such person. However, recognition of such grant shall not be postponed beyond the date of actual receipt. Since power subsidy has been received by the assessee, it is revenue in nature and chargeable to tax in A.Y. 2020-21.

(ii) The difference between the price of shares of the first company and the market value of shares of the new company on the date of such exchange is to be treated as "profit" derived by the dealer in shares (on exchange of shares held as stock-in-trade of the first company with the shares of the new company) in the normal course of business, and hence such profit is taxable as business income. It was so held by the Supreme court in *Orient Trading Co. Ltd.* vs. *CIT* (1997) 224 ITR 371.

(iii) The bank is purchasing shares on behalf of the constituents, the forfeiture of margin money by the bank from the constituents for not paying the balance amount of purchase price and not taking delivery of shares purchased by the bank on their behalf is in the normal course of its banking business and hence, the forfeited amount is assessable as business income of the bank. The forfeited amount being revenue in nature cannot be adjusted against the purchase price of the shares. Supreme Court in the case of *CIT* vs. *Lakshmi Vilas Bank Ltd.*, (1996) 220 ITR 305 has confirmed this view.

Answer 6(b)

(i) The statement is Correct: As per section 144A of the Income tax Act, 1961, a Joint Commissioner may, on his own motion or on a reference being made to him by the Assessing Officer or on the application of an assessee, call for and examine the record of any proceeding in which an assessment is pending. Having regard to the nature of the case or the amount involved or for any other reason, if he considers it necessary or expedient, he may issue such directions as he thinks fit for the guidance of the Assessing Officer during the assessment proceedings to complete the assessment in a specific manner. Such directions shall be binding on the Assessing Officer. However, no directions which are prejudicial to the assessee shall be issued before an opportunity of being heard is given to the assessee.

A direction as to the lines on which an investigation connected with the assessment should be made shall not be deemed to be a direction prejudicial to the assessee. Such directions shall be binding on the Assessing Officer.

(ii) The statement is Correct : Assessing Officer as per section 142(2A) of the Income tax Act, 1961, may issue directions for special audit of accounts by giving a show cause notice to an assessee, with the previous approval of the Commissioner or Chief Commissioner on the basis of the following reasons:

- nature and complexity of accounts
- volume of the accounts
- doubts about the correctness of the accounts
- multiplicity of transactions in the accounts
- specialized nature of business activity of the assessee; and
- the interest of the revenue

Provided that the Assessing Officer shall not direct the assessee to get the accounts so audited unless the assessee has been given a reasonable opportunity of being heard.The provisions of sub-section (2A) shall have effect notwithstanding that the accounts of the assessee have been audited under any other law for the time being in force or otherwise. Every report under sub-section (2A) shall be furnished by the assessee to the Assessing Officer within such period as may be specified by the Assessing Officer.

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LABOUR LAWS & PRACTICE

(Elective Paper 9.6)

Time allowed : 3 hours *Maximum marks : 100*

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

Question 1

The problem is relating to compensation under section 3 of Workmen's Compensation Act. The sole point in the matter is whether the accident which occurred on 25th May, 2018, in the railway Yard at Lucknow and resulted in the loss of both legs of the respondent Mahabir, a machine man employed in the Carriage and Wagon Shops of East Indian Railway, Alambagh, Lucknow, arose 'out of and in the course of his employment' within the meaning of section 3 of the Act.

As facts of case Mahabir lives in Village Mahmudpur which is close to Malhaur railway station on the East Indian Railway. He used to come free of cost to Lucknow junction every morning from Malhaur along with other employees in a workmen's special provided by the railway and proceed after crossing the lines to the Alambagh Workshop which is at a distance of about a mile from the junction across the railway yard. This was a some what shorter route and it was taken as a matter of routine for going to and coming from the works in preference to a sub-way and two other overbridge routes which were also available.

When the workmen were on night shift, they were provided with special permits for travelling by ordinary passanger trains free of charge between Lucknow junction and Malhaur Station. Mahabir was on duty on the night between the 21st and 22nd May, 2018. He finished work at 5.30 a.m. and was returning as usual to the Lucknow junction station over the yard in order to catch the passanger train which left there at 8 a.m. for Malhaur. When he was within a short distance of the station platform, he crossed the line and in doing so he was run over by a shunting engine at about 6.30 a.m. As a result of the accident Mahabir's legs were crushed and they had to be ultimately amputated.

Mahabir file a case against Works Manager, Carriage and Wagon Workshop for compensation under the Workmen's Compensation Act, 1923.

As per section 3 of W.C. Act, 1923 "If personal injury is caused to a workman by accident arising out of and in the course of his employment, his employer shall be liable to pay compensation.

The expression 'out of and in the course of his employment' occurring in the aforesaid section has been the subject of interpretation in numerous case and it has been found almost a hopeless task to give such a comprehensive or exhaustive meaning as may be applicable to all cases.

In cases, therefore, which arise in consequence of an injury caused to an employee while he is actually engaged in the work for the doing of which he is employed, it is

hardly controversial on the ground of interpretation that this matter come under the section of Workman Compensation Act, 1923. The word 'employment', however has been given a wider meaning than the word 'work' and it has been universally accepted that a man may be in the course of employment without being actually engaged on work for the doing of which he is engaged.

From what has been said above, it would appear to be a legitimate corollary that what may be called environmental accidents, that is accidents resulting from the surroundings in which the workman is employed or through which he has to reach his place of work in order to carry out his obligations to his employer, may fall within the scope of the phrase 'arising out of or in the course of his employment. On the basis of the above facts, answer the following :

(a) Whether the accident of worker is in course of employment ?

(b) Whether the principle of notional extension can apply in case ? Discuss.

(c) Whether the term accident comes in definition of permanent disablement ? Explain.

(d) What are the procedure of Employer's Liability for Compensation ? Discuss.

(e) Discuss the concept of 'arising out of and in course of employment'.

(8 marks each)

Answer 1(a)

As regards personal injury, the employer becomes liable under Section 3 of the Employees' Compensation Act, 1923, if the injury is caused to an employee by accident arising out of and in the course of his employment.

The expression "in the course of employment" suggests the period of employment and the place of work. In other words, the workman, at the time of accident must have been employed in the performance of his duties and the accident took place at or about the place where he was performing his duties.

The word "employment" has a wider meaning than work. A man may be in course of his employment not only when he is actually engaged in doing something in the discharge of his duty but also when he is engaged in acts belonging to and arising out of it (*Union of India* v. *Mrs. Noorjahan*, 1979 Lab. I.C. 652).

The expression "in the course of employment" covers circumstances under which the accident takes place and the time when it occurred. A causal Connection or association between the injury by accident and employment is necessary. The onus is on the claimant to prove that accident arose out of and in the Course of employment

The Employment should have given rise to the circumstances of injury by accident. But a direct Connection between the injury caused by an accident and the employment of the workman is not always essential. Arising out of the employment does not mean that personal injury must have resulted from the mere nature of employment and is also not limited to cases where the personal injury is preferable to the duties which the workman has to discharge.

In the present case, the accident of the worker is "in the course of employment" because worker was at the site of accident because of his employment.

Yes in above case accident is in course of employment because there is a casual relationship between the accident and employment. This accident had occurred on account of a risk which is an incident of the employment.

Answer 1(b)

The theory of notional extension of employment is as below:

To make the employer liable it is necessary that the injury caused by an accident must have arisen in the course of employment. It means that the accident must take place at a time and place when he was doing his master's job.

It is well settled that the concept of "duty" is not limited to the period of time the workman actually commenced his work and the time he downs his tools, it extends further in point of time as well as place. But there must be nexus between the time and place of the accident and the employment. If the presence of the workman concerned at the particular point was so related to the employment as to lead to the Conclusion that he was acting within the scope of employment that would be sufficient to deem the accident as having occurred in the course of employment. It is known as doctrine of notional extension of employment.

In view of the above, Principle of Notional Extension will apply in this case.

Answer 1(c)

The Employees' Compensation Act, 1923 does not define the word Disablement. It only defines the partial and total disablement.

"Partial disablement can be classified as temporary partial disablement and permanent partial disablement.

(a) where the disablement is of a temporary nature' Such disablement as reduces the earning capacity of an employee in the employment in which he was engaged at the time of the accident resulting in the disablement and

(b) where the disablement is of a permanent nature such disablement as reduces for all time his earning Capacity in every employment which he was capable of undertaking at the time.

Total disablement means, such disablement whether of a temporary or permanent nature, which in capacitates an employee for all work which he was Capable of performing at the time of accident resulting in such disablement. Permanent total disablement shall be deemed to result from every injury specified in Part I of Schedule I or similarly total disablement shall result from any combination of injuries specified in Part II of Schedule I of the Act.

To make the employer becomes liable under Section 3 of the Employees' Compensation Act, 1923, the injury must be caused to an employee by accident arising out of and in the course of his employment. The personal injury must be caused by an "accident".

The expression accident must be construed to its popular sense. It has been defined as a mishap or an untoward event which is not expected or designed. What the Act intends to cover is what might be expressed as an accidental injury.

In view of the above the term accident comes in the definition of permanent partial disablement.

Answer 1(d)

Section 3 of the Employee's Compensation Act, 1923 provides for employers liability for compensation in case of occupational disease or personal injuries and prescribes the manner in which his liability can be ascertained.

The liability of an employer to pay compensation is limited and is subject to the provisions of the Employee's Compensation Act, 1923. Under section (3) (1) of the Act liability of the employer to pay compensation is dependent upon the following four Conditions:

(i) Personal injury must have been caused to a Workman

(ii) Such injury must have been caused by an accident

(iii) The accident must have arisen out of and in the Course of employment; and

(iv) The injury must have resulted either in, death of the workman or in his total or partial disablement for a period exceeding three days.

Further, According to Section 2(1) (c) of the Employee's Compensation Act, 1923, compensation means compensation as provided for by the Act. Amount of compensation is payable in the event of an employee meeting with an accident resulting into temporary or permanent disability or disease as stated in Schedule II and III in terms of Section 4 of the Act, read with Schedule IV.

No compensation has to be paid in respect of an employee whose injury has resulted in death and no payment of lump sum compensation to a woman or a person under a legal disability except by deposit with the Commissioner. The employer cannot make payment of compensation directly to the deceased legal heirs. It is the Commissioner who decides on the distribution of compensation to the legal heirs of the deceased employee. Compensation to be paid when due and penalty for default.

Answer 1(e)

The expression " arising out of suggests the cause of accident and the expression in the Course of" points out to the place and circumstances under which the accident takes place and the time when lit occurred. To make the employer liable, it is necessary that the injury is caused by an accident which must be raised but of and in the course of employment.

The expression "arising out of employment" suggests some causal connection between the employment and the accidental injury. The cause contemplated is the proximate cause and not any remote cause. Thus, where a workman suffers from heart disease and dies on account of strain of work by keeping continuously standing or working, held that the accident arose out of employment (*Laxmibai Atma Ram* v. *Bombay Port Trust*, AIR 1954 Bom.180).

In the case of *Mackenzie* v. *I.M. Issak*, it was observed that the words "arising out of employment' are understood to mean that during the course of the employment, injury has resulted from some risk incidental to the duties of the service which unless engaged

in the duty, owing to the master it is reasonable to believe the workman would not otherwise have suffered. There must be a causal relationship between the accident and employment. If the accident had occurred on account of a risk which is an incident of the employment, the claim for Compensation must succeed unless of course the workman has exposed himself to do an added peril by his own imprudence."

In the course of employment means during the currency of employment. In order to succeed in his claim a workman has to prove that he was at the time of injury engaged in the employer's business or in furthering that business and was not doing something for his own benefit or accumulation, He must show that he was doing something in discharge of a duty to this employer directly or indirectly imposed upon him by his contract of service.

Question 2

(a) *Mohan collect the tendu leaves from nearby forest during day time and along with his family roll them to bidies at night. He supply the finished product of bidies to nearby factory i.e., ABC Bidi Ltd.. Factory does the quality inspection of the finish product as per their fixed standards and accordingly accept or reject the product. Payments are made for the accepted quantity of bidies as per the factory rates. In the above kind of factual circumstances, decide with the help of set principle whether Mohan is an employee of the factory.* *(6 marks)*

(b) *Ramesh is working with XYZ Motor Manufacturing Ltd. as senior motor mechanic. The manufacturing company has two active trade union. Ramesh being introvert and shy in personality, has not shown much of the interest in trade union politics and not member of them. One day during course of employment on duty time, due to malfaction of machine, accident occurs causing him partially paralysed. He was admitted to hospital for one month. In his absence, company arbitrarily terminate him from job without paying proper and adequate compensation. On recovery he raise issue with company. The company dismiss his claim and blame him for being negligent on duty and cause of accident.*

Can Mohan raise an Industrial Dispute? Advice. *(6 marks)*

Answer 2(a)

A person to be a worker within the meaning of the Section 2(l) of the Factories Act, 1948 must be a person employed in the premises or the precincts of the factory. As held by the Supreme Court in the *State of Uttar Pradesh* v. *M. P. Singh (1960) 2 SCR 605: (AIR 1960 SC 569)* field workers who are employed in guiding, supervising and controlling the growth and supply of sugar cane to be used in the factory are not employed either in the precincts of the factory or in the premises of the factory. Hence the provisions of the Factories Act do not apply to them.

A workers or workman need to be employed in the factory. The concept of “employment” involves three ingredients, viz. employer, employee, and contract of employment. The employment is the contract of service between employer and employee where under the employee agrees to serve the employer subject to his control and supervision. The prima facie test for determination of the relationship between the employer

and employee is the existence of the right of the employer to supervise and control the work done by the employee not only in the matter of directing what work the employee is to do but also the manner in which he shall do his work (*Chintaman Rao* v. *State of M.P. AIR 1958 S.C. 388).*

Therefore, 'supervision and control' is the natural outcome when a person is employed by another person. In *Shankar Balaji Waje* v. *State of Maharashtra, AIR 1963 Bom. 236*, the question arose whether bidi roller is a worker or not. The management simply says that the labourer is to produce bidies rolled in a certain form. How the labourer carried out the work is his own concern and is not controlled by the management, which is concerned only with getting bidies rolled in a particular style with certain contents. The Supreme Court held that the bidi roller is not a worker. The whole conception of service does not fit in well with a servant who has full liberty to attend to his work according to his pleasure and not according to the orders of his master. Where the employer did retain direction and control over the workers both in manner of the nature of the work as 'also its details, they will be held as workers.

Same rational to be applied here in the given case. Mohan is not a worker as there is no superstation control of the employer on him.

Answer 2(b)

According to Section 2(k) of the Industrial Dispute Act, 1947, "industrial dispute" means any dispute or difference between employers and employers, or between employers and workmen, or between workmen and workmen, which is connected with the employment or non-employment or the terms of employment or with the conditions of labour, of any person.

These are following ingredient of the definition: -

(i) There should exist a dispute or difference;

(ii) The dispute or difference should be between:

  (a) employer and employer;

  (b) employer and workmen; or

  (c) workmen and workmen.

(iii) The dispute or difference should be connected with

  (a) the employment or non-employment, or

  (b) terms of employment, or

  (c) the conditions of labour of any person;

(iv) The dispute should relate to an industry as defined in Section 2(j).

It is not mandatary that the dispute should be raised by a registered trade Union. Once it is shown that a body of workmen either acting through their union or otherwise had sponsored a workman's case, it becomes an industrial dispute. The dispute can be raised by minority union also even a sectional union or a substantial number of members of the union can raise an industrial dispute.

In the case of *Workmen of Dimakuchi Tea Estate* v. *Dimakuchi Tea Estate (1958) I. L.L.J. 500*, the Supreme Court held that it is not that dispute relating to "any person" can become an industrial dispute. There should be community of interest. A dispute may initially be an individual dispute, but the workmen may make that dispute as their own, they may espouse it on the ground that they have a community of interest and are directly and substantially interested in the employment, non-employment, or conditions of work of the concerned workmen. All workmen need not to join the dispute. Any dispute which affects workmen as a class is an industrial dispute, even though, it might have been raised by a minority group. It may be that at the date of dismissal of the workman there was no union. But that does not mean that the dispute cannot become an industrial dispute because there was no such union in existence on that date. If it is insisted that the concerned workman must be a member of the union on the date of his dismissal, or there was no union in that particular industry, then the dismissal of such a workman can never be an industrial dispute although the other workmen have a community of interest in the matter of his dismissal and the cause for which on the manner in which his dismissal was brought about directly and substantially affects the other workmen. The only condition for an individual dispute turning into an industrial dispute, as laid down in the case of Dimakuchi Tea Estate is the necessity of a community of interest and not whether the concerned workman was or was not a member of the union at the time of his dismissal. Further, the community of interest does not depend on whether the concerned workman was a member or not at the date when the cause occurred, for, without his being a member the dispute may be such that other workmen by having a common interest therein would be justified in taking up the dispute as their own and espousing it. Whether the individual dispute has been espoused by a substantial number of workmen depends upon the facts of each case. If after supporting the individual dispute by a trade union or substantial number of workmen, the support is withdrawn subsequently, the jurisdiction of the adjudicating authority is not affected. However, at the time of making reference for adjudication, individual dispute must have been espoused, otherwise it will not become an industrial dispute and reference of such dispute will be invalid.

Therefore in the given case, dispute can be raised by Ramesh if such dispute is espoused by trade union.

Question 3

(a) Discuss the various provisions under the Factories Act, 1948 regarding the health of the Workers.

(b) Discuss the judicial activism in reference to Contract Labour Abolition Act, 1970. *(6 marks each)*

Answer 3(a)

Chapter III (Section 11-20) of the Factories Act, 1948 dealing with the provisions relating to Health of the worker. Health provisions for Workers are –

(i) Cleanliness (Section 11)

Section 11 of the Act makes provisions for ensuring cleanliness in the factory. It states that every factory shall be kept clean and free from effluvia arising from any drain, privy or other nuisance.

(ii) *Disposal of wastes and effluents (Section 12)*

Every occupier of a factory shall make effective arrangements for the treatment of wastes and effluents due to the manufacturing process carried on in the factory so as to render them innocuous and for their disposal.

(iii) *Ventilation and temperature (Section 13)*

Section 13 provides that every factory should make suitable and effective provisions for securing and maintaining (1) adequate ventilation by the circulation of fresh air; and (2) such a temperature as will secure to the workers reasonable conditions of comfort and prevent injury to health.

(iv) *Dust and fume (Section 14)*

There are certain manufacturing processes like chemical, textile or jute, etc., which generates lot of dust, fume or other impurities. It is injurious to the health of workers employed in such manufacturing process. Effective measures should be taken to prevent the inhalation and accumulation of dust, fumes etc.

(v) *Artificial humidification (Section 15)*

Humidity means the presence of moisture in the air. In certain industries like cotton, textile, cigarette, etc., higher degree of humidity is required for carrying out the manufacturing process. For this purpose, humidity of the air is artificially increased. This increase or decrease in humidity adversely affects the health of workers. The State Government may make rules prescribing standards of humidification.

(vi) *Overcrowding (Section 16)*

Overcrowding in the work-room does not only affect the workers in their efficient discharge of duties but their health also. Section 16 has been enacted with a view to provide sufficient air space to the workers. The section prohibits the overcrowding in the work-rooms to the extent it is injurious to the health of the workers.

(vii) *Lightening (Section 17)*

This Section provides for maintain sufficient and suitable lighting, natural or artificial, or both in every part of a factory where workers are working or passing.

(viii) *Drinking water (Section 18)*

This Section deals with the provisions relating to arrangements for drinking water in factories. It provides that in every factory effective arrangements shall be made for clean water.

(ix) *Latrines and urinals (Section 19)*

The section made it mandatory that in every factory-(a) sufficient latrine and urinal accommodation of prescribed types shall be provided conveniently situated and accessible to workers at all times while they are at the factory.

(x) *Spittoons (Section 20)*

According to the section, there shall be provided, in every factory, a sufficient number of spittoons in convenient places and they shall be maintained in a clean and hygienic condition.

Answer 3(b)

The object of the Contract Labour (Regulation and Abolition) Act, 1970 is to provide for regulation of the employment of Contract labour and its abolition under certain circumstances. The Courts took very active role in interpreting and favouring of the abolition of the Contract Labour and regulating the rights of the Contract Labour.

The First of it is the landmark judgement in *Standard Vacuum Refining Company* v. *Its Workmen, [1960] 3 SCR 466* in which the Supreme Court had affirmed the direction of the Industrial Tribunal for the abolition of the contract system of labour. Further the judgement of the Supreme Court in this historic case said that contract labour should not be employed where

(a) the work is perennial and goes on from day to day;

(b) the work is necessary for the factory;

(c) the work is sufficient to employ a considerable number of whole-time workmen; and

(d) the work is being done in most concerns through regular workmen.

Further in Catering Cleaners of *Southern Railway* v. *Union of India & Ors., AIR 1987 SC 777* the Supreme Court expressed in dismay with reference to contract labour engagement as follows: "Of late there has been a noticeable tendency on the part of big companies including public sector companies to get the work done through contractors rather than through their own departments". It is a matter of surprise that employment of contract labour is steadily on the increase in many organised sectors including the public sector, which one expects to function as a model employer.

In *Gujarat Electricity Board* v. *Hind Mazdoor Sabha, Supreme Court* has expressed its dismay "While parting with these matters, we cannot help expressing our dismay over the fact that even the undertakings in the public sector have been indulging in unfair labour practice by engaging contract labour when workmen can be employed directly even according to the tests laid down by Section 10 of the Act. The only ostensible purpose in engaging the contract labour instead of the direct employees is the monetary advantage by reducing the expenditure. Apart from the fact that it is an unfair labour practice, it is also an economically short-sighted and unsound policy, both from the point of view of the undertaking concerned and the country as a whole.

From the above, it can be inferred that the courts are also of the view that the Contract Labour engagement shall be abolished over a period of time as it leads to the abuse of labour rights for the economic benefit of the employers and is used mainly to depart from the responsibilities being an employer towards the employees.

Question 4

(a) Under the Workmen's Compensation Act, 1923 there must be some nexus between the death of workman and his employment in order to make the employer liable to pay compensation. Explain. (6 marks)

(b) A factory worker having a heart disease, while coming out of the factory, after four hours of work in the factory, profusely sweated and died aride the factory premises. Is the employer liable to pay compensation? (6 marks)

Answer 4(a)

The Employees' Compensation Act, 1923 is a social security legislation. It imposes statutory liability upon an employer to discharge his moral obligation towards his employees when they suffer from physical disabilities and diseases during the course of employment in hazardous working conditions. The Employees' Compensation Act, 1923 provides for payment of compensation to the employees and their dependents in the case of injury by industrial accidents including certain occupational diseases arising out of and in the course of employment resulting in death or disablement. The Act provides for cheaper and quicker mode of disposal of disputes relating to compensation through special proceedings than possible under the civil law. There must be some nexus between death of workman and his employment in order to make employer liable to pay compensation.

To make the employer liable it is necessary that the injury caused by an accident must have arisen in the course of employment. It means that the accident must take place at a time and place when he was doing his master's job.

It is well settled that the concept of "duty" is not limited to the period of time the workman actually commenced his work and the time he downs his tools. It extends further in point of time as well as place. But there must be nexus between the time and place of the accident and the employment. If the presence of the workman concerned at the particular point was so related to the employment as to lead to the conclusion that he was acting within the scope of employment that would be sufficient to deem the accident as having occurred in the course of employment.

It is known as doctrine of notional extension of employment; whether employment extends to the extent of accident depends upon each individual case.

A workman while returning home after duty was murdered within the premises of the employer. It was held that there was casual and proximate connection between the accident and the employment. Since the workman was on spot only for his employment and his wife is entitled for compensation (*Naima Bibi* v. *Lodhne Colliery*). If an employee in the course of his employment has to be in a particular place by reason where he has to face a peril which causes the accident then the casual connection is established between the accident and the employment.

Answer 4(b)

In the case of *Smt. Sunderbai* v. *The General Manager, Ordinance Factory Khamaria, Jabalpur, 1976 Lac. I.C. 1163 (MP)*, the Madhya Pradesh High Court has clarified the difference between accident and injury. Accident means an untoward mishap which is not expected or designed by workman, 'Injury' means physiological injury. Accident and injury are distinct in cases where accident is an event happening externally to a man, e.g., where a workman falls from the ladder and suffers injuries. But accident may be an event happening internally to a man and in such cases accident and injury coincide. Such cases are illustrated by failure of heart and the like, while the workman is doing his normal work. Physiological injury suffered by a workman mainly due to the progress of disease unconnected with employment may amount to an injury arising out of and in the course of employment if the work that the workman was doing at the time of the occurrence of the injury contributed to its occurrence. The connection between employments must

be furnished by ordinary strain of ordinary work if the strain did in fact contribute to accelerate or hasten the injury. The burden of proof is on applicant to prove the connection of employment and injury

In this case, the stress and strain of four hours of work in the factory must be taken to be an accelerating factor to death. The death was the result of the stress and strain, which the workman suffered earlier during the period of work, a connection is established between the employment and his death. In this case death was held to be in the course of employment. [*Director DNK Project* vs. *Stat. D. Buchitalli 1989 14t LLJ 259 (Orissa)*].

In view of the above, the employer is liable to pay compensation.

Question 5

(a) Write a brief essay on the Concept of bonus and profit sharing.

(b) Define and explain the term 'Continuous Service' as laid down in the Payment of Gratuity Act, 1972. (6 marks each)

Answer 5(a)

The term "bonus" is not defined in the Payment of Bonus Act, 1965. Webster International Dictionary defines bonus as "something given in addition to what is ordinarily received by or strictly due to the recipient". The Oxford Concise Dictionary defines it as "something to the good into the bargain (and as an example) gratuity to workmen beyond their wages".

The purpose of payment of bonus is to bridge the gap between wages paid and ideal of a living wage. An employee is entitled to be paid by his employer a bonus in an accounting year subjected to the condition that he/she has worked for not less than 30 working days of that year.

Section 10 of the Payment of Bonus Act, 1965 states that subject to the other provisions of this Act, every employer shall be bound to pay to every employee in respect of any accounting year a minimum bonus which shall be 8.33 per cent of the salary or wage earned by the employee during the accounting year or one hundred rupees whichever is higher, whether or not the employer has any allocable surplus in the accounting year.

According to section 11, if the allocable surplus exceeds the amount of minimum bonus payable to the employees under Section 10, the employer shall, in lieu of such minimum bonus, be bound to pay to every employee in respect of that accounting year bonus which shall be an amount in proportion to the salary or wage earned by the employee during the accounting year subject to a maximum of twenty per cent of such salary or wage.

On the question whether the Act deals only with profit bonus, it was observed by the Supreme Court in *Mumbai Kamgar Sabha* v. *Abdulbhai Faizullabhai, (1976) II LLJ 186,* that "bonus" is a word of many generous connotations and, in the Lord's mansion, there are many houses. There is profit based bonus which is one specific kind of claim and perhaps the most common. There is customary or traditional bonus which has its emergence from long, continued usage leading to a promissory and expectancy situation materialising in a right. There is attendance bonus and what not. The Bonus Act speak

and speaks as a whole Code on the sole subject of profit based bonus but is silent and cannot, therefore, annihilate by implication, other distinct and different kinds of bonuses, such as the one oriented on custom. The Bonus Act, 1965 as it then stood does not bar claims to customary bonus or those based on conditions of service. Held, a discerning and concrete analysis of the scheme of the Bonus Act and reasoning of the Court leaves no doubt that the Act leaves untouched customary bonus.

Bonus Linked with profit sharing :

Section 31A of the Payment of Bonus Act, 1965 enables the employees and employers to evolve and operate a scheme of bonus payment linked to production or productivity in lieu of bonus based on profits under the general formula enshrined in the Act. There is a logical presumption that whatever is statutorily payable under the Act would be on the basis of profits. However, bonus payments under Section 31A are also subject to the minimum (8.33 per cent) and maximum (20 per cent).

Answer 5(b)

Gratuity is an old age retiral social security benefit. It is a lump sum payment made by an employer to an employee in consideration of his past service when the employment is terminated. The Payment of Gratuity Act provides for the payment of gratuity to employees engaged in factories, mines, oilfields, plantations, ports, railway companies, shops or other establishments.

Gratuity shall be payable to an employee on the termination of his employment after he has rendered continuous service for not less than five years:- (i) on his superannuation; or (ii) on his retirement or resignation; or (iii) on his death or disablement due to accident or disease, However, the completion of continuous service of five years shall not be necessary where the termination of the employment of any employee is due to death or disablement.

Continuous Service:

According to Section 2A of the Payment of Gratuity Act, 1972:

(1) An employee shall be said to be in 'continuous service' for a period if he has, for that period been in uninterrupted service, including service which may be interrupted on account of sickness, accident, leave, absence from duty without leave (not being absence in respect of which an order treating the absence as break in service has been passed in accordance with the standing orders, rules or regulations governing the employees of the establishment), layoff, strike or a lock-out or cessation of work not due to any fault of the employee, whether such uninterrupted or interrupted service was rendered before or after the commencement of this Act;

(2) Where an employee (not being an employee employed in a seasonal establishment) is not in continuous service within the meaning of clause (1) for any period of one year or six months, he shall be deemed to be in continuous service under the employer:

   (a) for the said period of one year, if the employee during the period of twelve calendar months preceding the date with reference to which calculation is to be made, has actually worked under the employer for not less than:

      (i) one hundred and ninety days in the case of an employee employed

below the ground in a mine or in an establishment which works for less than six days in a week; and

(ii) two hundred and forty, days in any other case;

(b) for the said period of six months, if the employee during the period of six calendar months preceding the date with reference to which the calculation is to be made, has actually worked under the employer for not less than:

(i) ninety five days, in the case of an employee employed below the ground in a mine or in an establishment which works for less than six days in a week; and

(ii) one hundred and twenty days in any other case;

Explanation.-- The number of days on which an employee has actually worked under an employer shall include the days on which--

(i) he has been laid-off under an agreement or as permitted by standing orders made under the Industrial Employment (Standing Orders) Act, 1946, or under the Industrial Disputes Act, 1947, or under any other law applicable to the establishment;

(ii) he has been on leave with full wages, earned in the previous year;

(iii) he has been absent due to temporary disablement caused by accident arising out of and in the course of his employment; and

(iv) in the case of a female, she has been on maternity leave; so, however, that the total period of such maternity leave does not exceed such period as may be notified by the Central Government from time to time.

(3) Where an employee, employed in a seasonal establishment, is not in continuous service within the meaning of clause (1), for any period of one year or six months, he shall be deemed to be in continuous service under the employer for such period if he has actually worked for not less than seventy-five per cent of the number of days on which the establishment was in operation during such period.

Question 6

Define Strike and Lock-out. When are Strikes and Lock-outs illegal? Can financial aid be given to workers engaged in such illegal Strikes and Lock-out? (12 marks)

Answer 6

Strikes and lock-outs are the two weapons in the hands of workers and employers respectively, which they can use to press their viewpoints in the process of collective bargaining. The Industrial Disputes Act, 1947 does not grant an unrestricted right of strike or lock-out. Under Section 10(3) and Section 10A (4A) of the Industrial Disputes Act, 1947, 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.

According to Section 2(q) of Industrial Disputes Act, 1947, Strike means:-

(1) cessation of work by a body of persons employed in any industry acting in combination,

(2) or a concerted refusal to any number of persons who are or have been employed in any industry to continue to work or to accept employment, or

(3) 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.

According to Section 2(l) of Industrial Disputes Act, 1947, "Lock-out" means the temporary closing of a place of employment, or the suspension of work, or the refusal by an employer to continue to employ any number of persons employed by him.

Illegal strikes and lock-outs

According to Section 24 (1) of the Industrial Disputes Act, 1947 a strike or lock-out shall be illegal if it is:-

(1) commenced or declared in contravention of Section 22 in a public utility, service;

(2) Commenced in contravention of Section 23 in any industrial establishment (including both public utility and non- public utility service)

(3) Continued in contravention of an order made by the Appropriate Government under Section 10 (3) or sub - section (4A) of Section 10A of the Act.

Section 24 (2) provides that where a strike or lock-out in pursuance of an industrial dispute has already commenced and is in existence at the time of reference of the dispute to a Board, an arbitrator, la Labour Court, Tribunal or National Tribunal, the Continuance of such strike or lock-out shall not be deemed to be illegal provided that such strike or lock -out was not at its commencement in contravention of the provisions of this Act or the continuance there of was not prohibited under Section 10 (3) or Sub section (4-A) of Section 10-A.

Section 25 of the Industrial Disputes Act, 1947 prohibits financial aid to illegal strikes and lock-outs, It says that no person shall knowingly spend or apply any money in direct furtherance or support of an illegal strike or lock-out. Section 25 has the following ingredients:-

(1) spending or applying money;

(2) money spent or applied in direct furtherance or support of an illegal strike or lockout;

(3) the strike or lockout must actually be illegal;

(4) knowledge on the part of the person expending or applying money that the strike or lock-out is illegal.

It is sufficiently clear that the persons spending or applying money must know that the strike or lock-out is illegal. This means rea is a necessary element of an offence under this section. The provisions of this section are attracted only if the strike or lock-out is illegal and not otherwise.

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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) The following is the extract from the Balance Sheets of Popular Ltd.: ₹/lakh

EQUITY AND LIABILITIES	As at 31st March, 2017	As at 31st March, 2018	Assets	As at 31st March, 2017	As at 31st March, 2018
(1) Shareholder's funds:			(1) Non-current assets		
(a) Share capital			(a) Fixed assets	550	650
Equity share capital of 500 of ₹ 10 each	500	500	(b) Non-current Investments		
(b) Reserve and Surplus			10% Investments	250	250
(i) General Reserve	400	425	(2) Current Assets		
Profit and loss account	50	80	(a) Inventories	260	300
(2) Non- Current Liabilities			(b) Trade receivables		
Long term borrowing			Sundry Debtors	170	110
(i) 18% Debentures	180	165	(c) Cash and Cash		
			Equivalents	46	43
(3) Current Liabilities					
(a) Trade payables- Sundry Creditors	35	45			
(b) Short term provisions Provision for taxation	11	13			
Proposed dividend	100	125			
Total	1276	1353	Total	1276	1353

The following additional information is also provided:

(i) Replacement values of Fixed assets were ₹1,100 lakhs on 31st March, 2017 and ₹1,250 lakhs on 31st March, 2018 respectively.

(ii) Rate of depreciation adopted on Fixed Assets was 5% p.a.

(iii) 50% of the stock is to be valued at 120% of its book value.

(iv) 50% of investments were trade investments.

(v) Debtors on 31st March, 2018 included foreign debtors of $ 35,000 recorded in the books at ' 35 per U.S. Dollar. The closing exchange rate was $1 = ₹ 39.

(vi) Creditors on 31st March, 2018 included foreign creditors of $ 60,000 recorded in the books at $1 = ₹33. The closing exchange rate was $1 = ₹39.

(vii) Profits for the year 2017-18 included ₹60 lakhs of government subsidy which was not likely to recur.

(viii) ₹125 lakhs of Research and Development expenditure was written off to the Profit and Loss Account in the current year. This expenditure was not likely to recur.

(ix) Future maintainable profits (pre-tax) are likely to be higher by 10%.

(x) Tax rate during 2017-18 was 50%, effective future tax rate will be 40%.

(xi) Normal rate of return expected is 15%.

A Director of the company has expressed his fears that the company does not enjoy a goodwill in the prevalent market circumstances. In this context:

(i) Critically examine this and establish whether Popular Ltd. has or does not have any goodwill.

(ii) If your answers were positive on the existence of goodwill, show the leverage effect it has on the company's result. Industry average return was 12% on the long-term funds and 15% on equity funds. *(20 marks)*

(b) Calculate Economic Value Addition (EVA) :

Equity Share Capital	*₹5,00,000*
13% Preference Share Capital	*₹2,00,000*
Reserves and Surplus	*₹6,00,000*
Non trade investments (Face value 1,00,000) Rate of Interest	*10%*
20% Debentures	*₹3,00,000*
Profits before tax	*₹2,00,000*
Tax Rate	*40%*
WACC	*13%*

(5 marks)

(c) *The following data relating to a project are provided by the Management of G Ltd. :*

Annual saving	*₹4,20,000*
Useful life	*4 years*
Profitability Index	*1.04291*
Internal Rate of Return	*14%*
Salvage Value	*Nil*

Assume that the only outflow is at the beginning of year 1. Find (i) Net Present Value (to the nearest rupee) and (ii) Cost of Capital (as a % up to one decimal point)

Table Showing Present Value of ₹1 at different discount rates : (You are required to use PV factors only up to three decimals as shown below)

End of Year\Rate	*14%*	*13%*	*12%*	*11%*
1	*0.877*	*0.885*	*0.893*	*0.901*
2	*0.769*	*0.783*	*0.797*	*0.812*
3	*0.675*	*0.693*	*0.712*	*0.731*
4	*0.592*	*0.613*	*0.636*	*0.659*
Total	*2.913*	*2.974*	*3.038*	*3.103*

(7 marks)

(d) *ABC Ltd. wants to raise ₹5,00,000 as additional capital. It has two mutually exclusive alternative financial plans. The current EBIT is ₹17,00,000 which is likely to remain unchanged. The relevant Information is :*

Present Capital Structure : 3,00,000 Equity shares of ₹10 each and 10% Bonds of ₹20,00,000.

Tax Rate :	*50%*
Current EBIT :	*₹17,00,000*
Current EPS :	*₹2.50*
Current Market Price :	*₹25 per share*
Financial Plan I :	*20,000 Equity Shares at ₹25 per share*
Financial Plan II :	*12% Debentures of ₹5,00,000.*

What is the indifference level of EBIT ? Identify the financial break-even level.

(8 marks)

Answer 1(a)

Working Notes

(1) Future maintainable profits

Particulars	*₹in Lakhs*	*₹in Lakhs*
Increase in General Reserve	25	
Increase in profit and loss	30	
Proposed Dividend	125	
Profit after Tax		180
Pre - Tax Profit =180/(1-0.5)		360
Less: Non trading Investment Income(10% of Rs 125)	12.50	
Subsidy	60.00	
Exchange loss on creditors($0.6lakhs *(Rs 39-Rs 33)]	3.60	
Additional Depreciation on increase in value of fixed assets(current year) (1250-650=600*(5/100) i.e.,	30.00	
		253.90
Add : Exchange Gain on Debtors ($0.35lakhs*(Rs 39- Rs 35)]	1.40	
Research and development expenses written off	125.00	
Stock Adjustment (30-26)	4.00	130.40
		384.3
Add : Expected increase of 10%		38.43
Future Maintainable PBT		422.73
Less : Tax @ 40% (40% of Rs 422.73)		169.09
Future Maintainable Profit		253.64

(2) Calculation of Capital employed (CE)

Particulars	*₹in Lakhs As on 31.03.17*	*₹in Lakhs As on 31.03.18*
Replacement cost of fixed assets	1100.00	1250.00
Trade investments (50%)	125.00	125.00
Current cost of stock		
130+130*(120/100)	286.00	
150+150*(120/100)		330.00
Debtors	170.00	111.40

Cash at bank	46.00	43.00
Total (A)	1727.00	1859.4
Less : Outside liabilities		
18% Term loan	180.00	165.00
Sundry Creditors	35.00	48.60
Provision for tax	11.00	13.00
Total (B)	26.00	226.60
Capital Employed (A-B)	1501.00	1632.80

Average Capital employed at current value = (CE as on 31.03.2017 +CE as on 31.03.2018) / 2 = (1501+ 1632.80)/2 = 1,566.90 Lakhs

* Average capital employed can also be calculated in the following manner:

Closing capital employed as on 31/03/2018	₹1632.80 lakhs
Less: ½ of actual post tax profit for 2017-2018	₹90.00 lakhs
Average Capital Employed	₹1542.80 lakhs

(3) Valuation of Goodwill

(i) According to Capitalisation of Future Maintainable Profit Method

	₹ in lakhs
Capitalised value of Future Maintainable Profit (253.64 /15)x 100	1,690.93
Less : Average capital employed	1,566.90
Value of Goodwill	124.03

Or

(ii) According to Capitalisation of Super Profit Method

	₹ in lakhs
Future Maintainable Profit	253.64
Less : Normal Profit @15% on average capital employed (1566.90 x 15%)	235.04
Super profit	18.60
Capitalised value of super profit i.e., Goodwill	124.00

Goodwill exists; hence director's fear is not valid.

Leverage Effect on Goodwill:

		₹ in lakhs
Future Maintainable Profit on equity fund	253.64	
Future Maintainable Profit on Long-term Trading Capital employed		
Future Maintainable Profit After Tax	253.64	
Add : Interest on Long-term Loan (Term Loan) (After considering Tax) 165 x 18% = 29.7 x (50/100)	14.85	268.49
Average capital employed (Equity approach)	1,566.90	
Add : 18% Term Loan (180+165)/2	172.50	
Average capital employed (Long-term Fund approach)	1739.40	

Value of Goodwill:

	₹ in lakhs
(A) Equity Approach	
Capitalised value of Future Maintainable Profit = (253.64/15) x 100	1690.93
Less: Average capital employed	1566.90
Value of Goodwill	124.03
(B) Long-Term Fund Approach	
Capitalised value of Future Maintainable Profit = (268.49/12) x 100	2237.42
Less : Average capital employed	1739.40
Value of Goodwill	498.02

Comments on Leverage effect of Goodwill:

Adverse Leverage effect on goodwill is 373.99 lakhs (i.e., Rs 498.02 - 124.03). In other words, Leverage Ratio of Popular Ltd. is low as compared to industry for which its goodwill value has been reduced when calculated with reference to equity fund as compared to the value arrived at with reference to long term fund.

Answer 1(b)

Economic Value Added = (Return on operating capital - weighted average cost of capital) x Operating capital.

Working Note - 1

Calculation of Return on Operating Capital:

NOPAT =	₹
Profit before tax	2,00,000
+Interest Expense	60,000
-Non operating income	10,000
Operating EBIT	2,50,000
Less of economic taxes@ 40%	1,00,000
NOPAT	1,50,000

Working Note - 2

Calculation of Operating Capital

	₹
Equity Share capital	5,00,000
Reserves and surplus	6,00,000
13% Preference shares	2,00,000
20% Debentures	3,00,000
Total	16,00,000
Less : non-operating assets	1,00,000
Operating capital	15,00,000

ROOC = 1,50,000/15,00,000x100 = 10%

EVA = (10% - 13%) 15,00,000 = ₹(45,000)

Alternative Answer

EVA = NOPAT – (operating Capital X WACC)

= 150,000 – (15,00,000 X 13%)

= 1,50,000 -195,000

= ₹(45,000)

Answer 1(c)

PV of cash inflows at 14% = cost of project

Cost of project = PV of ₹4,20,000 for 4 years at 14% = 4,20,000 x 2.913= ₹12,23,460

(i) NPV:

PI = PV of cash inflow/PV of Initial cash outflow = 1.04291

Hence , PV od cash inflow = initial cash outflow (cost of project) 12,23,460 * 1.04291 = ₹12,75,959

NPV = PVCIF - Cash Outflow = 12, 75,959 – 12, 23,460 = ₹52,499

(ii) Cost of Capital:

PV of Cash Inflows at cost of Capital(r) for 4 years = ₹12, 75,959

PV Factor for 4 years = 12, 75,959 / 4, 20,000 = 3.038 which is at 12%. Hence, Cost of Capital = 12%.

Answer 1(d)

1. Computation of EBIT - EPS Indifference Point:

Particulars	*Financial Plan 1 - Equity*	*Financial Plan 11 - Debt*
Owner's Funds	(3,00,000 x10+20,000 x 25) = ₹ 35,00,000	3,00,000 x 10 = ₹30,00,000
Borrowed Funds (given)	₹20,00,000	20,00,000 +5,00,000 = ₹25,00,000
Total Capital Employed	₹55,00,000	₹55,00,000

Particulars	*Financial Plan 1*	*Financial Plan II*
EBIT (let it be X)		
Less : Interest	20,00,000 x 10% =₹ 2,00,000	(20,00,000x10% +5,00,000x12%) = ₹ 2,60,000
EBT	X-2,00,000	X-2,60,000
Less : Tax at 50%	½ X-1,00,000	½ X-1,30,000
EAT	½ X-1,00,000	½ X-1,30,000
Number of Equity Shares	3,00,000+20,000=3,20,000	(given) 3,00,000
EPS	(1/2X-1,00,000)÷ 3,20,000	[1/2 X-1,30,000] ÷3,00,000

For indifference between the above alternatives, EPS should be equal. Hence, we have

$$\frac{1/2\ X - 1,00,000}{3,20,000} \quad \frac{1/2\ X - 1,30,000}{3,00,000}$$

On Cross Multiplication, 1.5X - 30 Lakhs = 1.6X - 41.6 Lakhs; or X = 11.6 Lakhs Hence EBIT should be Rs 11.60 Lakhs and at that level, EPS will be Rs 1.50 under both alternatives.

2. Computation of Financial Break-Even Point

The Financial BEP for the two plans are — Plan I EBIT = ₹2,00,000 (i.e. 10% interest on ₹20,00,000) Plan II EBIT = ₹2,60,000 (i.e. 10% interest on ₹20,00,000 and 12% interest on Rs 5,00,000)

Question 2

(a) Mention the contents of valuation report as required under Companies (Registered Valuers and Valuation) Rules, 2017.

(b) Explain the methods of Valuation of Intangible Assets under Income Approach.

(5 marks each)

Answer 2(a)

As per the Companies (Registered Valuers & Valuation) Rules, 2017. The valuer shall, in his report, state the following:-

1. Background information of the asset being valued.
2. Purpose of the valuation and appointing authority.
3. Identity of the Valuer and any other experts involved in the valuation.
4. Disclosure of the Valuer's interest or conflict, if any.
5. Date of appointment, valuation date and date of the valuation report.
6. Inspections and/or investigations undertaken.
7. Nature and sources of the information used or relied upon.
8. Procedures adopted in carrying out valuation and valuation standards followed.
9. Valuation methodology used.
10. Restrictions on use of the valuation report, if any.
11. Major factors that were taken into account during the valuation.
12. Conclusion; and
13. Caveats, limitation and disclaimers to the extent they explain or elucidate the limitations faced by Valuer, which shall not be for the purpose of limiting his responsibility for the valuation report.

Answer 2(b)

Income Based Approach : Future earnings which are attributable to the Intangible asset are forecasted over its useful life and discounted to its present value. This approach is appropriate in case of technology, customer related intangibles, trademarks, operating licenses and non-competition agreements.

METHODS OF VALUATION UNDER INCOME APPROACH:

Excess Earnings Method: This method removes the earnings attributable to net tangible assets from the total earnings of the Company. The balance earnings represent earnings on account of intangible assets. The same is divided by an appropriate capitalization rate to extrapolate the combined value of Goodwill and other intangible assets.

Relief from Royalty Method : This method is based on the assumption that a brand owner can license the brand to a hypothetical operating company. The operating company in turn would pay royalty at an expressed rate of sales. The present value of all future cash inflows from royalty will be the value of the Brand.

Multi Period Excess Earnings Method : This method first calculates the future cash inflows from the business in which the intangible asset is engaged. From these cash flows, cash flows attributable to tangible assets and other contributory assets are deducted to zero in on cash flows attributable purely for the Asset in question. They are discounted to present value to find out the value of the Intangible asset. A variant of the Multi Period Excess Earnings Method is the Distributor method which attempts to allocate earnings attributable to customer relationships based on profit margins earned by Distributors.

Greenfield Method : The assumption in this model is that the subject to asset is the only asset owned by business as of the valuation date. Then assumptions are made regarding start-up costs and further capital investment required to utilize the subject asset. These assumptions are made with a view to developing an operation comparable to one in which the subject asset is actually utilized. In this method it forecasts the cash flows attributable to the subject asset by subtracting necessary investments. The projected cash flows are then discounted to present value to determine income based value of the Intangible assets.

Question 3

(a) A Ltd. wants to acquire T Ltd. and has offered a swap ratio of 1 : 2. Following information is provided :

	A Ltd.	*T Ltd.*
Profit after Tax	*₹18,00,000*	*₹3,60,000*
Equity Shares Outstanding	*6,00,000*	*1,80,000*
EPS	*₹ 3*	*₹2*
PE Ratio	*10 Times*	*7 Times*
MPS	*₹ 30*	*₹14*

Calculate :

(i) Number of Equity shares to be issued by A Ltd. for acquisition of T Ltd.

(ii) EPS of A Ltd. after acquisition

(iii) Equivalent earnings per share of T Ltd.

(iv) Expected Market price of A Ltd. after acquisition, assuming its PE Multiple remains unchanged.

(v) Market Value of the merged firm. *(5 marks)*

(b) What is a hostile takeover/merger ? What are the different types of defence strategies followed. *(5 marks)*

Answer 3(a)

(i) Number of Shares to be issued by A Ltd

Exchange Ratio = 0.5

New Shares = 180,000*0.5 = 90,000

EPS of A Ltd after acquisition

Total Earnings	18,00,000 + 360,000	₹ 21,60,000
No. of Shares	600,000+ 90,000	690,000
EPS	21,60,000/ 690,000	₹ 3.13

(ii) Equivalent EPS of T Ltd

No. of new shares = 0.5

EPS = ₹ 3.13

Equivalent EPS = ₹ 1.57

(iii) New Market Price of A Ltd (PE remains unchanged)

Present PE Ratio of A Ltd : 10 times

Expected EPS after merge : ₹3.13

Expected Market Price : 3.13 *10 = ₹31.30

(iv) Market Value of Merged Firm

Total Number of Shares : 690,000

Expected Market Price : ₹ 31.30

Total Value : 690,000 *31.30 = ₹ .215, 97,000

Answer 3(b)

In case of a hostile merger, one which is opposed by the target company's management, the acquirer may decide to circumvent the target management's objections by submitting a proposal directly to the Board of Directors of a target company, bypassing its CEO and this tactic is called a bear hug.

Post the bear hug, there could be two routes. One route is where the target management will reconsider its decision and enter in to negotiations, which is unlikely, post which this takes the path of the friendly merger. The other route is that a bear hug doesn't work, in which case the acquirer may contemplate reaching out to the shareholders of the target company directly.

Once the hopeful acquirer has taken a decision to reach out to the shareholders of the target company directly, this could again culminate into two paths, i.e. a tender offer or a proxy fight.

Pre-takeover Defence Strategies

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 target company to purchase the shares of the target company at a substantial discount (say 50%). It is likely that 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 gets 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 to 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 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 4

(a) As a Professional Valuer, what would be your basis of valuation when a concern is 'not a going concern' ?

(b) Explain the concept of 'departure' under International Valuation Standards.

(5 marks each)

Answer 4(a)

As a Valuer, if the company is not a going concern, then Liquidation Value is applicable. A going concern assumption generally increases the value placed on a company's inventory. Usually, inventory that can be sold in the company's regular distribution channels would realize higher amounts than inventory that must be sold immediately because a company is being liquidated. Vice versa for Not a Going Concern.

LIQUIDATION VALUE

International Valuation Standards Council

"Liquidation Value"

IVS 104, dealing with "Bases of Value" defines "Liquidation Value" as the amount that would be realised when an asset or group of assets are sold on a piecemeal basis, that is without consideration of benefits (or detriments) associated with a going-concern business. Liquidation value can be either in an orderly transaction with a typical marketing period or in a forced transaction with a shortened marketing period and a valuer must disclose whether an orderly or forced transaction is assumed.

Concept of Liquidation Value

According to Divestopedia, "Liquidation value is the value of all the assets owned by a company when it is no longer a going concern. It also means the amount of money that can be collected when the assets of a company are sold, with an aim to meet the final obligations of the organization. This value presumes that the seller will sell all the assets of the organization as quickly as possible, even if they are below the existing market value." To calculate the liquidation value, the liabilities are subtracted from the assets. The existing assets will be first used to meet the debt obligations of the company. The remaining amount, if any, is then distributed amongst the shareholders.

Divestopedia explains two types of "Liquidation Value". This is briefly explained below:

a) *Orderly Liquidation Value* : The orderly liquidation value (OLV) is typically included in an appraisal of hard tangible assets (i.e., Machinery/ equipment etc.,). It is an estimate of the gross amount that the tangible assets would fetch in an auction-style liquidation with the seller needing to sell the assets on an "as-is, where is" basis. The term, orderly, implies that the liquidation would allow for a reasonable time to identify all available buyers, and the seller would have control of the sale process.

b) *Forced Liquidation Value* : Unlike OLV, in Forced Liquidation Value (FLV), the first available buyer is used and the seller does not have control of the sale

process. Forced liquidation value (FLV) is the amount of money that a company will receive if it sold its assets in an auction immediately. The idea behind this FLV is to get an estimate of the financial position of the company in the worst possible situation and circumstances. It is based on the assumption that the business will sell its assets in the quickest time possible, which will usually lead to low price.

The OLV of tangible assets would be less than its Fair Value (FV) and more than the Force Liquidation Value (FLV) It would be pertinent to note that Regulation 35 of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) (Amendment) Regulations, 2018 requires the resolution professional to appoint two registered valuers who shall submit to the resolution professional an estimate of the fair value and of the liquidation value computed in accordance with internationally accepted valuation standards, after physical verification of the inventory and fixed assets of the corporate debtor.

Answer 4(b)

Departure under IVS

A "departure" is a circumstance where specific legislative, regulatory or other authoritative requirements must be followed that differs from some of the requirements within IVS. Departures are mandatory in that a valuer must comply with legislative, regulatory and other authoritative requirements appropriate to the purpose and jurisdiction of the valuation to be in compliance with IVS. A valuer may still state that the valuation was performed in accordance with IVS when there are departures in these circumstances.

The requirement to depart from IVS pursuant to legislative, regulatory or other authoritative requirements takes precedence over all other IVS requirements.

If there are any departures that significantly affect the nature of the procedures performed, inputs and assumptions used, and/or valuation conclusion(s), a valuer must also disclose the specific legislative, regulatory or other authoritative requirements and the significant ways in which they differ from the requirements of IVS (for example, identifying that the relevant jurisdiction requires the use of only a market approach in a circumstance where IVS would indicate that the income approach should be used).

Departure deviations from IVS that are not the result of legislative, regulatory or other authoritative requirements are not permitted in valuations performed in accordance with IVS.

PART B

Question 5

(a) In a dynamic business environment, structuring a successful business model would depend on many factors. Elucidate with various scenarios and environment. *(5 marks)*

(b) Discuss suitable business models for the following start-up business :

(i) Ride sharing taxis

(ii) Fashions and Fashion Jewellery. *(4 marks)*

(c) Discuss the significance and shortcomings of the following in relation to FMCG business :

(i) Debt Ratio

(ii) Efficiency Ratio

(iii) Business worth. *(6 marks)*

Answer 5(a)

The answer should cover the features of the sustainable business model with practical examples.

Whatever be the business model, sustainability should be at its core, otherwise a business cannot be successful. In light of this, the ensuing paragraphs discuss about the features of a sustainable business model.

1. *Diversity* : The firm needs a diverse set of resources, people and investments to be resilient. While diverse investments are seen to draw on resources and absorb managerial attention, a single line of business, single source of revenue, or people with similar mindsets can expose the firm to greater risks. Firms can no longer simply 'stick to the knitting'.

2. *Modularity* : Matrixed organizations are often seen as facilitating knowledge flows. However, such organizations are not only resource intensive, they expose the whole organization to shocks as they reverberate through the organization. Organizations need to be less interdependent, and focus on modularity, so they can be insulated from shocks.

3. *Openness* : Resilient firms must know what's going on outside their boundaries. These firms can sense issues on the horizon. They are constantly monitoring the external environment, and drawing scenarios of possible futures. They expect not only to react to those potential futures, but also help to shape them. The link between the organization and the external business and natural environment is vital, permeable, and acquiescent.

4. *Slack resources* : In an era of just-in-time production, slack resources are often seen as costly and wasteful. However, innovation and adaptation requires both financial and creative investments, and the space to change direction. Firms that can ride storms must allow for a little more time to accommodate new ideas, scenarios, and shifts in thinking.

5. *Matching cycles* : Firms often think about optimizing performance and getting more from less. But, these thinking puts firms on a treadmill, doing the same thing faster every day and, it has them bumping up against resource constraints. Resilient businesses think, not about constant growth, but rather about cyclical processes: cycles of growth and contraction, cycles of production, and cycles of consumer purchase patterns. Understanding the rhythms of business and the environment will allow the firm to synchronize with them meaningfully, and not overreact to what is likely just a cycle. These ideas need to developed and tested. But, they offer a starting place for dialogue for a 21st century business model based on sustainability.

6. *Identify your specific audience* : Targeting a wide audience won't allow your business to hone in on customers who truly need and want your product or service. Instead, when creating your business model, narrow your audience down to two or three detailed buyer personas. Outline each persona's demographics, common challenges and the solutions your company will offer. As an example, Home Depot might appeal to everyone or carry a product the average person needs, but the company's primary target market is homeowners and builders.
7. *Establish business processes* : Before your business can go live, you need to have an understanding of the activities required to make your business model work. Determine key business activities by first identifying the core aspect of your business's offering. Are you responsible for providing a service, shipping a product or offering consulting? In the case of Ticketbis, an online ticket exchange marketplace, key business processes include marketing and product delivery management.
8. *Develop a strong value proposition* : How will your company stand out among the competition? Do you provide an innovative service, revolutionary product or a new twist on an old favourite? Establishing exactly what your business offers and why it's better than competitors is the beginning of a strong value proposition. Once you've got a few value propositions defined, link each one to a service or product delivery system to determine how you will remain valuable to customers over time.
9. *Determine key business partners* : No business can function properly (let alone reach established goals) without key partners that contribute to the business's ability to serve customers. When creating a business model, select key partners, like suppliers, strategic alliances or advertising partners. Using the previous example of Home Depot, key business partners may be lumber suppliers, parts wholesalers and logistics companies.
10. *Leave room for innovation* : When launching a company and developing a business model, your business plan is based on many assumptions. After all, until you begin to welcome paying customers, you don't truly know if your business model will meet their ongoing needs. For this reason, it's important to leave room for future innovations. Don't make a critical mistake by thinking your initial plan is a static document. Instead, review it often and implement changes as needed.

Answer 5(b)

(i) On-demand model is suitable for a start-up is 'ridesharing exist'.

On-Demand Model : As the world speeds up, consumers have a adopted a preference for instant gratification. The on-demand economy has a growing appetite for greater convenience, speed, and simplicity. Smartphones have driven transformational shifts in how we consume goods and services, and many consumers have become acclimated to purchasing at the press of a button. On-demand startups like Uber are shaking up their industries, and also provide stead contracted work for consumers who want to become solo-preneurs. Startup, Handy, has also seen explosive growth by providing handymen at a moments notice, servicing a need for consumers that was not previously available for situations where a consumer can not wait a few days to fix a problem in their home.

Why It Works : The on-demand market leaders today know that this successful model is much more cost-effective, scalable, and more efficient that it's ever been. The model allows a startup to leverage new technology, while utilizing existing infrastructures. Another benefit lies in the use of freelance labor with its obvious advantages in cost cutting. There has also been an influx of VC belief and capital in this revenue model.

Others Who Have Followed : Spothero is a startup that provides parking on-demand when you are on your way to an event or into the city. Another growing startup in the space is Postmates who provide a local, on demand delivery of goods. Glamsquad is providing on-demand services for the beauty industry, and Washio provides the same service for the dry cleaning and laundry sector.

(ii) Fashions and Fashion Jewellery

The Modernized Direct Sales Model : Direct sales companies like Avon and Amway understand there is a big business opportunity in the model. In 2009, direct selling accounted for $117B in sales worldwide. Chloe + Isabel, a fashion jewelry startup, is reinventing the direct sales model by appealing to fashion forward students who have tuition to pay and others who are unable to secure full-time employment. The startup designs, produces, and markets fashion jewelry, and interested sellers or merchandisers can sign up and create their own online store to sell their jewelry and earn a 30% commission utilizing the startups technology infrastructure. The startup has seen incredible success using this model, and increased loyalty of its sellers (who are also its customers).

Why It Works : This model is perfect for today's economy where people are more willing than ever to supplement their income, and seek new career paths. With unemployment still high, and more companies offering supplemental income opportunities, this model continues to rise in popularity. Another reason is that social media allows sellers to reach more people than ever, increasing their success as merchandisers, and bringing in higher revenues for the company. Finally, software available now has dramatically improved productivity and flow for direct sales reps.

Others Who Have Followed : Sequoia-funded newcomer, and another jewelry and accessories startup Stella & Dot has found massive success in using this type of business model. Trumaker, is also finding success with this model in the mobile men's apparel space and call their direct sellers "Outfitters"

Answer 5(c)

The answer should cover the Debt Ratios and Efficiency Ratios.

(i) Debt Ratios : These ratios concentrate on the long-term health of a business, particularly the effect of the capital and finance structure on the business.

(a) **Debt to Equity Ratio :**

What you need : Balance Sheet

The formula : **Debt –to-Equity Ratio = Total Liabilities / Total Shareholder Equity**

What it means : Total liabilities and total shareholder equity are both found on the balance sheet. The debt-to equity ratio measures the relationship between

the amount of capital that has been borrowed (i.e. debt) and the amount of capital contributed by shareholders (i.e. equity). Generally speaking, as a firm's debt-to-equity ratio increases, it becomes more risky because if it becomes unable to meet its debt obligations, it will be forced into bankruptcy.

Interest Coverage Ratio:

What you need : Income Statement

The formula : **Interest Coverage Ratio = EBIT / Interest Expense**

What it means : The interest coverage ratio, is a measure of how well a company can meet its interest payment obligations. Anything lower than 1.0 is usually a sign of trouble.

(ii) Efficiency Ratios : These ratios give investors insight into how efficiently a business is employing resources invested in fixed assets and working capital. It's can also be a reflection of how effective a company's management is.

a) *Asset Turnover Ratio:*

What you need : Income Statement, Balance Sheet

The formula : **Asset Turnover Ratio = Sales / Average Total Assets**

What it means : The asset turnover ratio tells how good the company is at using its assets to make products to sell. For example, if Company A reported $100,000 of sales and owns $50,000 in assets, its asset turnover ratio is 2x. For ever $1 of assets it owns, it can generate $2 in sales each year.

b) *Inventory Turnover Ratio:*

What you need : Income Statement, Balance Sheet

The formula : Inventory Turnover Ratio = Costs of Goods Sold / Average Inventory

OR

Inventory Turnover Ratio = Cost of Revenue from Operations / Average Inventory

What it means : If the company you're analysing holds has inventory, you want that company to be selling it as fast as possible, not stockpiling it. The inventory turnover ratio measures this efficiency in cycling inventory. By dividing costs of goods sold (COGS) by the average amount of inventory the company held during the period, you can discern how fast the company has to replenish its shelves. Generally, a high inventory turnover ratio indicates that the firm is selling inventory (thereby having to spend money to make new inventory) relatively quickly

(iii) **Business Worth**

In the context of FMCG industry the value of business is a function of multiple factors such as:-

a. Brand strength

b. Distribution penetrative and reach in the multiple titrations and geographic

c. Quality of management

d. Quality and capacity of production facilities.

The value of business of FMCG Company would be a combination of tangible and intangible assets. In case of FMCG, intangibles (such a brand) carrier a higher value than the tangibles.

Question 6

(a) Discuss What-if analysis.

(b) What are the benefits & uses of Sensitivity Analysis ?

(c) Write a note on revenue forecasting with reference to any industry which you like the most. *(5 marks each)*

Answer 6(a)

The technique used to determine how independent variable values will impact a particular dependent variable under a given set of assumptions is defined as sensitive analysis. It's usage will depend on one or more input variables within the specific boundaries, such as the effect that changes in interest rates will have on a bond's price.

It is also known as the what – if analysis. Sensitivity analysis can be used for any activity or system. All from planning a family vacation with the variables in mind to the decisions at corporate levels can be done through sensitivity analysis. It helps in analyzing how sensitive the output is, by the changes in one input while keeping the other inputs constant.

Sensitivity analysis works on the simple principle: Change the model and observe the behaviour.

The parameters that one needs to note while doing the above are:

1) *Experimental Design* : It includes combination of parameters that are to be varied. This includes a check on which and how many parameters need to vary at a given point in time, assigning values (maximum and minimum levels) before the experiment, study the correlations: positive or negative and accordingly assign values for the combination.

2) *What to Vary*: The different parameters that can be chosen to vary in the model could be:

   a) the number of activities

   b) the objective in relation to the risk assumed and the profits expected

   c) technical parameters

   d) number of constraints and its limits

3) *What to Observe :*

   a) the value of the objective as per the strategy

   b) value of the decision variables

   c) value of the objective function between two strategies adopted

Measurement of sensitivity analysis

Below are mentioned the steps used to conduct sensitivity analysis:

1. Firstly the base case output is defined; say the NPV at a particular base case input value (V1) for which the sensitivity is to be measured. All the other inputs of the model are kept constant.
2. Then the value of the output at a new value of the input (V2) while keeping other inputs constant is calculated.
3. Find the percentage change in the output and the percentage change in the input.
4. The sensitivity is calculated by dividing the percentage change in output by the percentage change in input.

This process of testing sensitivity for another input (say cash flows growth rate) while keeping the rest of inputs constant is repeated till the sensitivity figure for each of the inputs is obtained. The conclusion would be that the higher the sensitivity figure, the more sensitive the output is to any change in that input and vice versa.

Answer 6(b)

Using Sensitivity Analysis for decision making

One of the key applications of Sensitivity analysis is in the utilization of models by managers and decision makers. All the content needed for the decision model can be fully utilized only through the repeated application of sensitivity analysis. It helps decision analysts to understand the uncertainties, pros and cons with the limitations and scope of a decision model.

Most if not all decisions are made under uncertainty. It is the optimal solution in decision making for various parameters that are approximations. One approach to come to conclusion is by replacing all the uncertain parameters with expected values and then carry out sensitivity analysis. It would be a breather for a decision maker if he / she has some indication as to how sensitive will the choices be with changes in one or more inputs.

Uses of Sensitivity Analysis

1) The key application of sensitivity analysis is to indicate the sensitivity of simulation to uncertainties in the input values of the model.
2) They help in decision making.
3) Sensitivity analysis is a method for predicting the outcome of a decision if a situation turns out to be different compared to the key predictions.
4) It helps in assessing the riskiness of a strategy.
5) Helps in identifying how dependent the output is on a particular input value. Analyses if the dependency in turn helps in assessing the risk associated.
6) Helps in taking informed and appropriate decisions
7) Aids searching for errors in the model.

Answer 6(c)

Forecasting revenue is one 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

The different approaches to forecasting can be classified in several ways. A useful classification is as follows:

i) *Extrapolation techniques* : Extrapolation techniques, like, time 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.

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INSOLVENCY - LAW AND PRACTICE

(Elective Paper 9.8)

Time allowed : 3 hours *Maximum marks : 100*

NOTE : *Answer **ALL** Questions*

Question 1

Read the following carefully and answer the questions given at the end:

BSC Bank filed an application for initiating Corporate Insolvency Resolution Process (CIRP) against one of its borrower company M/s Moon Storm Pvt. Ltd., in the National Company Law Tribunal (NCLT). The NCLT allowed the application and passed order for commencement of CIRP. Rohit has been appointed as Interim Resolution Professional (IRP) and moratorium was declared.

The Committee of Creditor (CoC) was constituted and Rohit was appointed as Resolution Professional by CoC. Meetings of the CoC was convened from time to time and expression of interest for Resolution Plan was invited from various parties via public notice. However, no Resolution Plan was received during the currency of 180 days period. Hence, NCLT on the recommendation of RP extended the initial time period from 180 days to 270 days. Since, no one had shown the expression of interest even during the extended period of 270 days, the CoC appointed another Resolution Professional (RP) after the expiry of 270 days.

When the matter of resolution could not be completed within the extended time. NCLT, extended the period of CIRP by further period of 90 days after the expiry of 270 days by exercising the power conferred under Section 55 of Insolvency and Bankruptcy Code, 2016 by treating the matter as 'Fast Track Corporate Insolvency Resolution Process' and also determined the 'Corporate Insolvency Resolution Process fee' and the 'Cost' incurred and payable to the Resolution Professional.

Aggrieved from the said order of the NCLT, the Resolution Professional preferred appeals against the order of the NCLT. In light of the above facts, answer the following questions :

(a) Whether the NCLT has power to convert the CIRP as a 'Fast Track Insolvency Resolution Process' under Section 55 of the Insolvency and Bankruptcy Code, 2016 ?

(b) Whether Committee of Creditors has jurisdiction to replace the Resolution Professional after completion of 270 days.

(c) Whether the NCLT is empowered to decide the resolution cost, including the resolution fee payable to the Resolution Professional.

(d) How is the fast track process different from the Corporate Insolvency Resolution Process under Chapter II of Part II of the Insolvency and Bankruptcy Code, 2016. *(10 marks each)*

Answer 1(a)

Section 55 of the Insolvency and Bankruptcy Code, 2016 deals with the Fast track corporate insolvency resolution process. According to Section 55 a Corporate Insolvency Resolution process carried out in accordance with this Chapter IV of Part II of the Code be called as fast track corporate insolvency resolution process. An application for fast tract corporate insolvency resolution process may be made in respect of the following corporate debtors, namely:

(a) a corporate debtor with assets and income below a level as may be notified by the Central Government: or

(b) a corporate debtor with such class of creditors or such amount of debt as may be notified by the Central Government, or

(c) Such other category of corporate persons as may be notified by the Central Government.

Section 57 of the Insolvency and Bankruptcy Code, 2016 deals with the manner of initiating fast track corporate insolvency resolution process. An application for fast track corporate insolvency resolution process may be filed by a creditor or corporate debtor as the case may be, along with- (a) the proof of the existence of default as evidenced by records available with an information utility or such other means as may be specified by the Board; and (b) such other information as may be specified by the Board to establish that the corporate debtor is eligible for fast track corporate insolvency resolution process. Manner of initiating fast track corporate insolvency resolution process.

The given case is similar to *Sanjay Kumar Ruia* v. *Catholic Syrian Bank Ltd. & Anr. (Company Appeal (AT) (Insolvency) No. 560 of 2018)* where it was held that the NCLT cannot exercise its power under sub-section (2) of Section 55 of the Code, which was not applicable, and therefore the Adjudicating Authority has no power to convert the 'Corporate Insolvency Resolution Process' into a 'Fast Track Corporate Insolvency Resolution Process' under Section 55 of the Code.

Section 55 of the Code clarifies that Fast Track CIRP is only limited to certain class of corporate Debtor.

In the present case, the application itself was not filed under Section 55 but filed under Section 7 of the Insolvency and Bankruptcy Code, 2016.

Therefore, Section 55 of the Insolvency and Bankruptcy Code, 2016 may not be invoked by NCLT against the Corporate Debtor i.e. NCLT will not have any power or Jurisdiction to convert the CIRP initiated under Section 7, 9 or 10 of IBC as a Fast Track Insolvency Resolution Process under Section 55 of the IBC.

Answer 1(b)

Section 12 of the Insolvency and Bankruptcy Code, 2016, which deals with the time limit for completion of insolvency resolution process and provides that:

1. The corporate insolvency resolution process shall be completed within a period of one hundred and eighty days from the date of admission of the application to initiate such process,

2. The resolution professional shall file an application to the Adjudicating Authority to extend the period of the corporate insolvency resolution process beyond one hundred and eighty days, if instructed to do so by a resolution passed at a meeting of the committee of creditors by a vote of sixty-six per cent. of the voting shares.
3. On receipt of an application, if the Adjudicating Authority is satisfied that the subject matter of the case is such that corporate insolvency resolution process cannot be completed within one hundred and eighty days, it may by order extend the duration of such process beyond one hundred and eighty days by such further period as it thinks fit, but not exceeding ninety days:

Provided that any extension of the period of corporate insolvency resolution process under this section shall not be granted more than once.

In terms of section 27 of the Code, where, at any time during the corporate insolvency resolution process, the Committee of Creditors (COC) is of the opinion that a resolution professional appointed is required to be replaced, it may replace him with another resolution professional.

In terms of section 30, 31 & 33 of the Code, after completion of 270 days NCLT may either approve the Resolution Plan, if any, as approved by COC or if there is no plan approved, the NCLT pass an order of liquidation.

The given case is similar to *Sanjay Kumar Ruia* v. *Catholic Syrian Bank Ltd. & Anr. (Company Appeal (AT) (Insolvency) No. 560 of 2018)* where it was held that the NCLT had no jurisdiction to proceed with the 'Corporate Insolvency Resolution Process' beyond the period of 270 days. After completion of 270 days, the Committee of Creditors ceased to exist and thereby they have no jurisdiction to replace a Resolution Professional.

Therefore, Committee of Creditors has no jurisdiction to replace Resolution Professional after 270 days in the present case.

Answer 1(c)

Insolvency resolution process costs under Section 5(13) of the Insolvency and Bankruptcy Code, 2016 means- (a) the amount of any interim finance and the costs incurred in raising such finance; (b) the fees payable to any person acting as a resolution professional; (c) any costs incurred by the resolution professional in running the business of the corporate debtor as a going concern; (d) any costs incurred at the expense of the Government to facilitate the insolvency resolution process; and (e) any other costs as may be specified by the Board;

Regulation 31 of the IBBI (Insolvency Resolution Process of Corporate Persons) Regulation, 2016 states that insolvency resolution process costs under Section 5(13)(e) shall mean-

(a) amounts due to suppliers of essential goods and services under Regulation 32;

(aa) fee payable to authorised representative under sub-regulation (8) of regulation 16A;

(ab) out of pocket expenses of authorised representative for discharge of his functions under section 25A,

(b) amounts due to a person whose rights are prejudicially affected on account of the moratorium imposed under section 14(1)(d);

(c) expenses incurred on or by the interim resolution professional to the extent ratified under Regulation 33;

(d) expenses incurred on or by the resolution professional fixed under Regulation 34; and

(e) other costs directly relating to the corporate insolvency resolution process and approved by the committee.

Regulation 34 of the IBBI (Insolvency Resolution Process of Corporate Persons) Regulation, 2016 the committee shall fix the expenses to be incurred on or by the resolution professional and the expenses shall constitute insolvency resolution process costs.

Explanation - For the purposes of this Regulation, "expenses" mean the fee to be paid to the resolution professional and other expenses, including the cost of engaging professional advisors, to be incurred by the resolution professional."

Keeping in view Regulation 31 read with Regulation 34 of the IBBI (Insolvency Resolution Process of Corporate Persons) Regulation, 2016, NCLT had no jurisdiction to decide the resolution cost including the fee payable of the 'Resolution Professional'.

Answer 1(d)

The aim of the Insolvency and Bankruptcy Code, 2016 is to conclude the fast track resolution procedure within half of the default time period specified under the Code. The person or entity seeking the fast track relief must support that the case is fit for the Fast-track.

Therefore, whosoever files the application for fast track process under Chapter IV of Part II (Section 55) of the Insolvency and Bankruptcy Code will have to file the application along with the proof of the existence of default as evidenced by records available with an information utility or such other means as may be specified by the Board to establish that the corporate debtor is eligible for fast track corporate insolvency resolution process.

Fast track Process under Chapter IV of Part II	*Corporate Insolvency Resolution Process(CIRP) under Chapter II of Part II*
Corporate debtor with assets and income below a level as may be notified by the Central Government	No such restrictions.
A corporate debtor with such class of creditors or such amount of debt as may be notified by the Central Government	No such restrictions.
Time limit for corporate insolvency resolution process be completed within is 90 days from the insolvency commencement date	Time limit is for corporate insolvency resolution process be completed within is 180 days (Maximum 330 days) from the insolvency commencement date
Can be extended beyond the initial period 90 days up to 45 days	Can be extended beyond the initial period of 180 days up to 90 days.

Question 2

(a) *One of the leading Bank granted credit facility to Invent Ltd. and on default in making repayment by the Company, the Bank filed an application for initiation Corporate Insolvency Resolution Process (CIRP). Before the National Company Law Tribunal (NCLT), the Company argued that as its liabilities stood suspended pursuant to a relief order passed by Government of Maharashtra under Maharashtra Relief Undertaking (Special Provisions Act), 1958 (MRU Act) no amounts were due and payable byit to Bank and hence, the application for CIRP under the Insolvency and Bankruptcy Code, 2016 (IBC, 2016) could not be admitted. Under the MRU Act, the State Government may take over management of undertaking and impose moratorium in the same manner as contained in IBC, 2016.*

Examine in the light of decided case, whether the CIRP application filed by the Bank under IBC, 2016 will prevail? *(6 marks)*

(b) *You are appointed as Resolution Professional by Committee of Creditors. You have made a public announcement inviting Expression of Interest. Based on your invitation few Parties have submitted Resolution plans. As per the provisions of Insolvency and Bankruptcy Code, 2016 (IBC, 2016) Resolution Plans submitted should satisfy few criteria. As a Resolution Professional brief the criteria for a valid Resolution Plan under IBC, 2016.* *(6 marks)*

Answer 2(a)

In terms of Section 6 of the Insolvency and Bankruptcy Code, 2016 where any corporate debtor commits a default a financial creditor, an operational creditor or the corporate debtor itself may initiate Corporate Insolvency Resolution Process (CIRP) in respect of such corporate debtor.

The given case have the similar facts as was in the case of *Innoventive Industries Ltd.* v. *ICICI Bank Ltd., Civil Appeal Nos. 8337-8338 of 2017*, decided by the Supreme Court of India. The case involved contradictory provisions in the Code and a state law of Maharashtra state, Maharashtra Relief Undertakings (Special Provisions) Act, 1958. This brought the two legislation on a collision course, for the simple reason that enforcement of one will hinder the enforcement of the other. The Code instead provides for taking over of an undertaking's business by an 'Insolvency Professional' through a committee of creditors. 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.

The Supreme 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. In this case the Supreme Court has opined that the provisions of the Code will have supremacy over every other law, whenever and wherever any conflict arises. Hence the provisions of the Insolvency and Bankruptcy Code shall have an overriding effect over MRU Act.

The NCLT was right in admitting the bank's application for CIRP, declared moratorium and appointed an Interim Resolution Professional (IRP).

Answer 2(b)

Section 30(2) of the Insolvency and Bankruptcy Code, 2016 provides that the Resolution Professional shall examine each resolution plan received by him to confirm that each resolution plan fulfils the following criteria:

a. provides for the payment of insolvency resolution process costs in a manner specified by the Board in priority to the payment of other debts of the corporate debtor:

b. provides for the payment of the debts of operational creditors in such manner as may be specified by the Board which shall not be less than the amount to be paid to the operational creditors in the event of a liquidation of the corporate debtor under section 53, whichever is higher, and provides for the payment of debts of financial creditors, who do not vote in favour of the resolution plan, in such manner as may be specified by the Board, which shall not be less than the amount to be paid to such creditors in accordance with sub-section (1) of section 53 in the event of a liquidation of the corporate debtor.

c. provides for the management of the affairs of the Corporate debtor after approval of the resolution plan;

d. the implementation and supervision of the resolution plan;

e. does not contravene any of the provisions of the law for the time being in force,

f. conforms to such other requirements as may be specified by the Board

Explanation.—For the purposes of clause (e), if any approval of shareholders is required under the Companies Act, 2013 or any other law for the time being in force for the implementation of actions under the resolution plan, such approval shall be deemed to have been given and it shall not be a contravention of that Act or law.

If the Resolution Professional is satisfied that the resolution plan fulfils the above criteria, he shall present such resolution plan to the committee of creditors for its approval.

Question 3

(a) After acceptance of the application for initiating Corporate Insolvency Resolution Process (CIRP) by National Company Law Tribunal (NCLT), the powers of the Board of Directors of the Company (Corporate Debtor) is suspended. The Company wants to make an appeal against the order of the NCLT. Whether the suspended Board of the Company can make appeal? Elucidate quoting relevant case law, if any. *(6 marks)*

(b) An Operational Creditor of a Company has made an application to National Company Law Tribunal (NCLT) for initiating Corporate Insolvency Resolution Process (CIRP) for non-payment his dues for long time. The NCLT ordered for commencement of CIRP. During the course of CIRP period Corporate Director has agreed to settle the dues of Operational Creditor and requested him to withdraw the CIRP. Whether NCLT may allow the withdrawal of application

admitted under Insolvency and Bankruptcy Code, 2016 in the above case. Will your answer differ, if the above application is made by Financial Creditor and subsequently Corporate Debtor settle its dues? (6 marks)

Answer 3(a)

The present case is similar to the case of *Steel Konnect (India) Private Limited* v/s. *Hero Fincorp Ltd.*, In the case of *Steel Konnect (India) Private Limited* v/s. *Hero Fincorp Ltd.*, Initially Courts were of view that once an insolvency application is admitted, the Code does not permit erstwhile company directors to maintain an appeal on behalf of the corporate debtor and only the interim resolution professional (IRP") can maintain an appeal on behalf of the company.

Further, it was observed the power of the IRP as provided under the Code does not include the power to initiate proceedings on behalf of the Corporate Debtor. The aforesaid issue was raised in *Steel Konnect (India) Pvt Ltd.* v. *M/s Hero Fincorp Ltd.* where it was held that upon admission of application under the Insolvency and Bankruptcy Code, 2016 and commencement of corporate insolvency resolution process, for preferring an appeal before NCLAT; the corporate debtor can appear through its Board of Directors or its officer or its authorized representative.

If corporate debtor is represented before Adjudicating Authority during appeal through its Board of Directors, no objection can be raised in this regard as initiation of corporate insolvency resolution process only suspends functioning of Board of Directors in that corporate debtor not the Board of Directors as a whole. Also, the directors continue to be in their position and are still present in the records maintained by the Registrar of Companies. They are just put in temporary suspension for 180/270 days till continuation of the insolvency resolution process.

Therefore, suspended Board of Directors being aggrieved party can make an appeal against the order of NCLT.

Answer 3(b)

Section 12A of the Insolvency and Bankruptcy Code, 2012 provides that the Adjudicating Authority may allow the withdrawal of application admitted under section 7 or section 9 or section 10. on an application made by the applicant with the approval of ninety per cent voting share of the committee of creditors, in such manner as may be specified.

Section 12 A of IBC read with Regulation 30A of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 specifically deals with withdrawal of CIRP after admission. Section 12A provides that CIRP can be withdrawn after admission, if the same is approved by ninety per cent voting share of the committee of creditors. Withdrawal may be allowed even after issuance of invitation for Expression of Interest.

Where Committee of Creditors (CoC) is not constituted, a party can approach NCLT for withdrawal of an application on settlement and where CoC is constituted, 90% of the voting share of the CoC agree for withdrawal.

The answer would not differ if the application is made by the financial creditor and subsequently corporate debtor settles its dues.

Question 4

(a) *'The United Nations Commission on International Trade Law's, Model Law on Cross Border Insolvency do not lead to harmonization of Insolvency Laws enacted by the individual Countries'. Do you agree with this statement ? Explain.*

(b) *A Director of a Private Limited Company, which is already in Corporate Insolvency Resolution Process has approached you to file an application for Bankruptcy for himself. Explain him the present status of applicability of the Insolvency and Bankruptcy Code, 2016 (IBC 2016) and also list out the prohibitions for individuals on declaration as Bankrupt under the IBC 2016. (6 marks each)*

Answer 4(a)

No, we do not agree with the said statement. In fact the UNCITRAL Model Law on Cross Border Insolvency do harmonize the Insolvency Laws enacted by the individual countries.

Globally, cross-border insolvency laws are based on one country providing assistance to the other in taking control of the assets and eventual disposition of such assets of the debtor company. Such aims are achieved by the mutual recognition of each country's insolvency regime.

Some countries have adopted the UN Commission on International Trade Law (UNCITRAL) Model Law on cross-border insolvency, adopted in 1997. The model law is designed to provide a harmonized approach to the treatment of cross-border insolvency proceedings, facilitate cooperation between the courts and office holders involved in the insolvency in different jurisdictions, and provide for the mutual recognition of judgements and direct access of foreign representatives to the courts of the enacting state.

The Legislative Guide on Insolvency Law is intended to be used as a reference by national authorities and legislative bodies when preparing new laws and regulations or reviewing the adequacy of existing laws and regulations.

The UNCITRAL Model Law on Cross-Border Insolvency, is designed to assist States to equip their insolvency laws with a modern, harmonized and fair framework to address more effectively instances of cross-border insolvency. Those instances include cases where the insolvent debtor has assets in more than one State or where some of the creditors of the debtor are not from the State where the insolvency proceeding is taking place.

Answer 4(b)

Presently Insolvency and Bankruptcy Code, 2016 is applicable for Companies incorporated under the Companies Act, 2013 and Limited Liability Partnerships incorporated under LLP Act.

Chapter IV of Part III of the Insolvency and Bankruptcy Code, 2016 (the Code) deals with the provisions of bankruptcy order for individuals and partnership firms. The provisions related to insolvency resolution of individual and partnership firm have been notified under the Code.

Section 141 of the Insolvency and Bankruptcy Code, 2016 provides that a bankrupt from the bankruptcy commencement date shall:

a) not act as a director of any company, or directly or indirectly take part in or be concerned in the promotion, formation or management of a company:

b) without the previous sanction of the bankruptcy trustee, be prohibited from creating any charge on his estate or taking any further debt:

c) be required to inform his business partners that he is undergoing a bankruptcy process;

d) prior to entering into any financial or commercial transaction of such value as may be prescribed, either individually or jointly, inform all the parties involved in such transaction that he is undergoing a bankruptcy process:

e) without the previous sanction of the Adjudicating Authority, be incompetent to maintain any legal action or proceedings in relation to the bankruptcy debts, and

f) not be permitted to travel overseas without the permission of the Adjudicating Authority

Any restriction to which a bankrupt may be subject under this Section shall cease to have effect if the bankruptcy order against him is modified or recalled under Section 142 of the Insolvency and Bankruptcy Code, 2016 or he is discharged under Section 138 of the Insolvency and Bankruptcy Code, 2016.

Question 5

(a) The M Ltd. (Corporate Debtor - CD) was engaged by 'BB' TV for conducting tele-voting for one of its prime program. M Ltd. in turn sub-contracted the work to the K Ltd. (Operational Creditor - OC) and issued purchase orders between October and December, 2013 in favour of the K Ltd.

The bills so raised were payable within 30 days of receipt by the M Ltd. It is pertinent to note here that a Non-Disclosure Agreement (NDA) was executed between the parties (CD and OC) on 26th December, 2014 with effect from 1st November, 2013. In view of non-payment of dues, a demand notice dated 23rd December, 2016 was sent by the OC under Section 8 of Insolvency and Bankruptcy Code, 2016. To this notice, the CD responded that there exists serious and bona fide disputes between the parties and that nothing was payable as the OC had been told on 30th January, 2015 that no amount would be paid to the OC since it had breached the NDA.

Based on the above facts examine by quoting relevant case, if any whether breach of Non-Disclosure Agreement amounts to default ?

(b) 'Integrity, objectivity and Independence are the primary criteria to be appointed as Resolution Professionals' — Elucidate the statement highlighting few important code of conduct for Insolvency professionals under the Insolvency and Bankruptcy Code, 2016. (6 marks each)

Answer 5(a)

The facts of the case is similar to that of the case of *Mobilox Innovations Private Limited* Vs. *Kirusa Software Private Limited, Civil Appeal No. 9405 of 2017*. In this case

the Supreme Court opined that once the operational creditor has filed an application, which is otherwise complete, the adjudicating authority must reject the application under Section 9(5)(2)(d) if notice of dispute has been received by the operational creditor or there is a record of dispute in the information utility. The Hon'ble Supreme Court was of the opinion that the breach of Non-Disclosure Agreement (NDA) was sufficient to construe the existence of a dispute to invalidate the CIRP application filed by the operational creditor.

According to Section 8(2) of the Code the corporate debtor shall, within a period of ten days of the receipt of the demand notice or copy of the invoice mentioned in sub-section (1) bring to the notice of the operational creditor, existence of a dispute, if any, or record of the pendency of the suit or arbitration proceedings filed before the receipt of such notice or invoice in relation to such dispute.

It is clear that such notice must bring to the notice of the operational creditor the "existence" of a dispute or the fact that a suit or arbitration proceeding relating to a dispute is pending between the parties.

According to Section 9(5) (ii) (d) of the Code, the Adjudicating Authority shall, within fourteen days of the receipt of the application, by an order, reject the application and communicate such decision to the operational creditor and the corporate debtor, if notice of dispute has been received by the operational creditor or there is a record of dispute in the information utility.

Therefore, all that the adjudicating authority is to see at this stage is whether there is a plausible contention which requires further investigation and that the "dispute" is not a patently feeble legal argument or an assertion of fact unsupported by evidence

Answer 5(b)

Integrity and Objectivity

1. An insolvency professional must maintain integrity by being honest, straightforward, and forthright in all professional relationships.
2. An insolvency professional must not misrepresent any facts or situations and should refrain from being involved in any action that would bring disrepute to the profession.
3. An insolvency professional must act with objectivity in his professional dealings by ensuring that his decisions are made without the presence of any bias, conflict of interest, coercion, or undue influence of any party, whether directly connected to the insolvency proceedings or not.
4. An insolvency professional appointed as an interim resolution professional, resolution professional, liquidator, or bankruptcy trustee should not himself acquire, directly or indirectly, any of the assets of the debtor, nor knowingly permit any relative to do so.

Independence

1. An insolvency professional must maintain complete independence in his professional relationships and should conduct the insolvency resolution,

liquidation or bankruptcy process, as the case may be, independent of external influences.

2. In cases where the insolvency professional is dealing with assets of a debtor during liquidation or bankruptcy process, he must ensure that he or his relatives do not knowingly acquire any such assets, whether directly or indirectly unless it is shown that there was no impairment of objectivity, independence or impartiality in the liquidation or bankruptcy process and the approval of the Board has been obtained in the matter.

3. An insolvency professional shall not take up an assignment under the Code, if he, any of his relatives, any of the partners or directors of the insolvency professional entity of which he is a partner or director, or the insolvency professional entity of which he is a partner or director is not independent, in terms of the Regulations related to the processes under the Code, in relation to the corporate person/ debtor and its related parties.

4. An insolvency professional shall disclose the existence of any pecuniary or personal relationship with any of the stakeholders entitled to distribution under sections 53 or 178 of the Code.

5. An insolvency professional shall not influence the decision or the work of the committee of creditors or debtor, or other stakeholders under the Code, so as to make any undue or unlawful gains for himself or his related parties, or cause any undue preference for any other persons for undue or unlawful gains and shall not adopt any illegal or improper means to achieve any mala side objectives

Question 6

You have been invited to attend a Committee of Creditors meeting in which you are proposed to be appointed as Resolution Professional. At the Meeting, the Interim Resolution Professional has informed the Committee that certain 'preferential transactions' and 'undervalued transactions' might have taken place in the Corporate Debtor.

Write a brief note to the Committee of Creditors about 'preferential transactions', 'undervalued transactions', relevant time of such transactions and exceptions to such transactions as per the provisions of the Insolvency and Bankruptcy Code, 2016. *(12 marks)*

Answer 6

Preferential Transactions and Relevant Time

Related parties often possess information of the corporate debtor's financial affairs and may collude with him to siphon off assets with the knowledge that the corporate debtor might become insolvent in the near future.

Section 43 of the Insolvency and Bankruptcy Code, 2016 deals with Preferential Transactions and Relevant Time. Section 43(1) of the Code provides that where the liquidator or the resolution professional, as the case may be, is of the opinion that the corporate debtor has at a relevant time given a preference in such transactions and in such manner as laid down in sub-section (2) to any persons as referred to in sub-section

(4), he shall apply to the Adjudicating Authority for avoidance of preferential transactions and for, one or more of the orders referred to in section 44.

Exception : According to Section 43(2) of the Code, a corporate debtor shall be deemed to have given a preference, if– (a) there is a transfer of property or an interest thereof of the corporate debtor for the benefit of a creditor or a surety or a guarantor for or on account of an antecedent financial debt or operational debt or other liabilities owed by the corporate debtor; and (b) the transfer under clause (a) has the effect of putting such creditor or a surety or a guarantor in a beneficial position than it would have been in the event of a distribution of assets being made in accordance with section 53.

Section 43(3) of the Code states that for the purposes of sub-section (2), a preference shall not include the following transfers– (a) transfer made in the ordinary course of the business or financial affairs of the corporate debtor or the transferee; (b) any transfer creating a security interest in property acquired by the corporate debtor to the extent that – (i) such security interest secures new value and was given at the time of or after the signing of a security agreement that contains a description of such property as security interest, and was used by corporate debtor to acquire such property; and (ii) such transfer was registered with an information utility on or before thirty days after the corporate debtor receives possession of such property: Provided that any transfer made in pursuance of the order of a court shall not, preclude such transfer to be deemed as giving of preference by the corporate debtor.

Explanation. – For the purpose of sub-section (3) of this section, "new value" means money or its worth in goods, services, or new credit, or release by the transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable by the liquidator or the resolution professional under this Code, including proceeds of such property, but does not include a financial debt or operational debt substituted for existing financial debt or operational debt.

As per Section 43(4) of the Code, a preference shall be deemed to be given at a relevant time, if – (a) It is given to a related party (other than by reason only of being an employee), during the period of two years preceding the insolvency commencement date; or (b) a preference is given to a person other than a related party during the period of one year preceding the insolvency commencement date.

When transaction shall be considered undervalued: Section 45(2) of the Insolvency and Bankruptcy Code, 2016 provides that a transaction shall be considered undervalued where the corporate debtor:

(a) makes a gift to a person: or

(b) enters into a transaction with a person which involves the transfer of one or more assets by the corporate debtor for a consideration the value of which is significantly less than the value of the consideration provided by the corporate debtor, and such transaction has not taken place in the ordinary course of business of the corporate debtor.

Relevant Period for Avoidable Transactions : Section 46 of the Insolvency and Bankruptcy Code, 2016 prescribes the relevant period during which a transaction must be entered into for it to be challenged as a transaction at undervalue. According to

section 46(1), in an application for avoiding a transaction at undervalue, the liquidator or the resolution professional, as the case may be, shall demonstrate that –

(i) such transaction was made with any person within the period of one year preceding the insolvency commencement date: or

(ii) such transaction was made with a related party within the period of two years preceding the insolvency commencement date.

Section 46(2) empowers the Adjudicating Authority to require an independent expert to assess evidence relating to the value of the transactions mentioned in section 46.

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