Question 1

Draft any five of the following:

(i) Letter to directors for passing a resolution by circulation along with draft resolution.
(ii) Resolution for declaring interim dividend.
(iii) General meeting resolution for appointment of branch auditor.
(iv) Notice by a member proposing another member's name for directorship of the company.
(v) Resolution approving the appointment of Managing Director, notwithstanding that he is already the Managing Director of another company.
(vi) Resolution to give effect to consolidation of shares made by the company in its memorandum of association.

Answer 1(i)

Letter to Directors for passing a resolution by circulation along with draft resolution

To

Mr.________________

Address in India only

Dear Sir,

We are stating hereunder following resolution which is intended to be passed as a resolution by circulation as provided in Section 289 of the Companies Act, 1956 for your kind consideration.

"RESOLVED that pursuant to the provisions of Section 313 of the Companies Act, 1956, read with those of Article ........ of the Articles of Association of the Companies, Shri.................. be and is hereby appointed as alternate director to Shri............... during the latter's absence for a period of not less than three months from the State of ............... and that the alternate director shall vacate his office as and when Shri............... returns to the said State."

You are requested to return the duly signed duplicate copy of this letter at the
registered office of the company within _______ days of this letter, mentioning your assent/dissent.

Yours faithfully

For___________

Company Secretary

Answer 1(ii)

Board Resolution for declaring interim dividend

“RESOLVED that approval of the Board of Directors be and is hereby given to the Company for the payment of interim equity dividend at the rate of____% and absorbing Rs. _____ out of the estimated profits of the Company for the half year ended ______ and that such dividend be paid to those equity shareholders whose names appear in the register of members as on______”.

“RESOLVED further that the record date for the said purpose will be ______”.

“RESOLVED further that the company secretary of the company be and is hereby authorized to advertise in the newspaper(s) of wide circulation as regards the record date and also to duly notify to the stock exchange(s)”.

Answer 1(iii)

Ordinary Resolution in the general meeting for appointment of branch auditor

“RESOLVED that pursuant to the provisions of Section 228 and other applicable provisions, if any of the Companies Act, 1956, M/s_________, Chartered Accountants, New Delhi be and are hereby appointed as the branch auditors of the Company for auditing the books of accounts maintained by the Delhi branch of the Company and to hold office from the conclusion of this meeting until the conclusion of next annual general meeting of the company at a remuneration to be fixed by the Board of Directors”.

Answer 1(iv)

Notice by a member proposing another member’s name for directorship of the company

To

M/s_________ Limited

Dear Sir,

Sub : Notice for appointment of director

Pursuant to the provisions of Section 257 of the Companies Act, 1956, I ______ a member of your Company hereby give notice of my intention to propose Mr.______ who
is also a member of your company (Folio No.) as a Director of the Company. A sum of Rs.500/- by way of demand draft made in favour of the Company is enclosed with this notice.

Kindly acknowledge receipt.

Yours faithfully,

Name of the member
Folio No.
No. of shares held

Answer 1(v)

Board Resolution approving the appointment of Managing Director, notwithstanding that he is already the Managing Director of another company

“RESOLVED that subject to the approval of the Central Government pursuant to sub-section (4) of section 316 of the Companies Act, 1956, Mr. XYZ who is already the Managing Director of ABC Limited be and is hereby appointed as a Managing Director of the Company for a period of five years commencing from 1st May, 2010, with the consent of all the Directors present at the meeting of which meeting and the resolution to be moved thereat specific notice was given to all the Directors then in India, on the terms and conditions contained in the draft agreement tabled before the meeting and initialed by the Chairman for purposes of identification”.

Answer 1(vi)

Ordinary Resolution to give effect to consolidation of shares made by the company in its memorandum of association

“RESOLVED THAT—

(i) pursuant to Section 94(1)(b) and other applicable provisions, if any, of the Companies Act, 1956, and Article... of Articles of Association of the company, all the 5,00,00,000 (five crore) equity shares of Rs.5 (Rupees five) each of the company be and are hereby consolidated into two crore and fifty lakh (2,50,00,000) equity shares of Rs.10/- (Rupees ten) each;

(ii) all the present shareholders holding in all 2,00,00,000 (two crore) issued, subscribed and fully paid equity shares of Rs. 5 (Rupees five) each be issued, in lieu of their present shareholding, the number of fully paid consolidated equity shares of Rs. 10 (Rupees ten) each;

(iii) the board of directors of the company be and is hereby authorised to take all the necessary steps for giving effect to the foregoing resolution, including recall of the existing share certificates, issue of new share certificates in lieu of the existing issued share certificates in terms of the foregoing resolutions and in accordance with the applicable provisions of the Companies Act, 1956 and those of the Companies (Issue of Share Certificates) Rules, 1960.”
Question 2

(a) Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s):

(i) A user can check the status of transactions by entering the _____________ on website of MCA-21.

(ii) The Companies Act, 1956 allows a company to convert its fully paid-up shares into _____________.

(iii) A _____________ is allotted at the time of registration of charge.

(iv) The directors appointed by the principle of _____________ hold office for _____________ and cannot be removed by the company in general meeting under section 284.

(v) Casual vacancy in the Board may arise from death, _______ and_________. (Mention any two other reasons.)

(vi) The declaration of bonus issue in lieu of _____________ is not permitted.

(b) Choose the most appropriate answer from the given options in respect of the following:

(i) The minimum number of directors of the audit committee in the case of a listed company with 12 directors shall be —
   (a) 2 Directors
   (b) 3 Directors
   (c) 4 Directors
   (d) 5 Directors.

(ii) The Central Government may exempt any class of companies from complying with the provisions of Schedule VI of the Companies Act, 1956, if it is necessary to grant such exemption in the —
   (a) National interest
   (b) Public interest
   (c) Social interest
   (d) Company’s interest.

(iii) In a listed company with 11 directors, what is the quorum for the Board meeting —
   (a) 2 Directors
   (b) 3 Directors
   (c) 4 Directors
   (d) 5 Directors.

(iv) A casual vacancy arising out of resignation of company’s auditor can be filled by —
   (a) Company in general meeting by ordinary resolution
(b) Company in general meeting by special resolution

(c) Board of directors

(d) Audit committee.

(v) Which one of the following sections of the Act specifies that the provisions of the Companies Act, 1956 override the provisions in the memorandum of association —

(a) Section 2

(b) Section 4

(c) Section 9

(d) Section 13.

(1 mark each)

(c) Expand the following:

(i) EDIFAR

(ii) SRN

(iii) SARFAESI

(iv) ISC

(v) ESPS.

(1 mark each)

Answer 2(a)

(i) A user can check the status of transactions by entering the Service Request Number on website of MCA-21.

(ii) The Companies Act, 1956 allows a company to convert its fully paid-up shares into Stock.

(iii) A Charge Identification Number is allotted at the time of registration of charge.

(iv) The directors appointed by the principle of Proportional representation hold office for Three years and cannot be removed by the company in general meeting under section 284.

(v) Casual vacancy in the Board may arise from death, Resignation and Insolvency (Mention any two other reasons.)

(vi) The declaration of bonus issue in lieu of Dividend is not permitted.

Answer 2(b)

(i) (b) Three directors

(ii) (b) Public interest

(iii) (c) 4 directors

(iv) (a) Company in general meeting by ordinary resolution

(v) (c) Section 9.

Answer 2(c)

(i) EDIFAR – Electronic Data Information Filing and Retrieval
Question 3

(a) State, with reasons in brief, whether the following statements are true or false:

(i) A fresh notice of every adjourned meeting is necessary.
(ii) A proxy shall not be entitled to vote on show of hands in a general meeting.
(iii) In terms of Clause 49 of the listing agreement, not less than 40% of the Board of directors shall consist of independent directors.
(iv) Resignation of a whole-time director shall take effect once it is tendered.
(v) Provisions of section 372A do not apply in the case of loan/guarantee by a company to another company in which it is holding 90% of the paid-up capital.

(b) “Variation of members’ rights is hanging like Democles’ sword on the members in the present liberalised global economy.” Do you agree with this statement in Indian context? Support your answer with reasons.

Answer 3(a)

(i) **False.** An adjourned meeting is merely the continuation of the original meeting and unless the Articles of Association of a company provide otherwise, a fresh notice of the adjourned meeting is not necessary. If, however, the meeting is adjourned sine die, a fresh notice must be given.

(ii) **True.** A proxy shall not be entitled to vote on show of hands in a general meeting unless the Articles of Association of the company provide otherwise. A proxy is entitled to vote only on a poll. Further, a proxy does not have any right to speak at a meeting (vide section 176).

(iii) **False.** As per Clause 49 I (A) (ii) of the listing agreement, where the Chairman of the Board is a non-executive director, at least one-third of the Board should comprise of independent directors and in case he is an executive director, at least half of the Board should comprise of independent directors.

(iv) **False.** The resignation of a whole-time director before the expiry of his terms of office becomes effective only when it is accepted by the company, as he is bound by the terms and conditions of his appointment.

(v) **False.** Section [372A(8)(c)] of the Companies Act, 1956 specifically provides that nothing contained in section 372A shall apply to any loan made by a holding company to its wholly owned subsidiary. Further, sub-section 8(d) of section 372A of the Act provides that nothing contained in this section shall apply to any guarantee given or any security provided by a holding company in respect of loan made to its wholly owned subsidiary. Therefore, the provisions
of section 372A of the Companies Act, 1956 will apply in the case of loan/guarantee by a company to another company in which it is holding 90% of the paid-up capital.

Answer 3(b)

The power to vary members’ rights is contained in section 106 of the Companies Act, 1956. It is indeed a danger to retail shareholders because the aforesaid provision read with section 86 of the Act makes it easier for the controlling group to vary the rights to its advantage.

Apparently, section 106 provides statutory checks on variation of rights by requiring the consent in writing of at least 3/4th of holders of shares of the concerned class or by passing a special resolution of the members of the concerned class in a meeting. This is intrinsically a theoretical approach as retail shareholders (whose number may be in thousands) are generally not aware of the pernicious implications of the move. Also, very few retail shareholders attend the general or class meetings of companies. The move for variation will invariably come from the controlling group to acquire higher voting power to consolidate its grip over the company which in the long run may not be beneficial to the ordinary retail shareholders.

Again, with the amendment of section 86 in the year 2000 to enable issue of shares with differential rights, the passage has been rendered smooth. Further, the Companies (Passing of the Resolution by Postal Ballot) Rules, 2001 provides that resolutions relating to variation in the rights attached to a class of shares or debentures or other securities as specified under section 106 shall be passed through postal ballot.

The experience with postal ballots so far is not very encouraging. It does not allow discussion. If any particular matter requires ‘yes or no’ response, the lay members without much thought may be inclined to write yes or they may not send their responses. Also, responses which are technically defective or received late will be rejected. Therefore, the controlling group will not spare any effort in organizing voting/consent as may be appropriate to achieve its objective.

Question 4

(a) For consideration of certain items of business, special notice is required to be given. Comment. (4 marks)

(b) Discuss the procedure for removal of a director by the Central Government. (4 marks)

(c) It is mandatory that the Company Secretary shall be the compliance officer of a company. Comment. (4 marks)

(d) Discuss the terms of reference for audit committee. (4 marks)

Answer 4(a)

The following matters require special notice for consideration at a general meeting:

(i) Resolution for appointment of an auditor other than the retiring auditor at an annual general meeting. [Section 225(1)].

(ii) Resolution at an annual general meeting to provide that a retiring auditor shall not be re-appointed. [Section 225(1)].
(iii) Resolution to remove a director before the expiry of his period of office.
[Section 284].

(iv) Resolution to appoint another director in place of the removed director.
[Section 284].

(v) Where the Articles of Association of a company provide for the giving of a special notice for a resolution in respect of any specified matter or matters.

**Answer 4(b)**

**Procedure for removal of a director by the Central Government**

The Central Government shall, by order, remove from office any director concerned in the conduct and management of the affairs of a company, against whom there is a decision of the Company Law Board under Section 388D of the Act (Section 388E).

The decision of the Company Law Board is given on a reference made by the Central Government under Section 388B of the Act.

Where in the opinion of the Central Government there are circumstances suggesting:

(a) that any person concerned in the conduct and management of the affairs of a company is or has been, in connection therewith, guilty of fraud, misfeasance, persistent negligence or default in carrying out his obligations and functions under the law, or breach of trust; or

(b) the business of a company is not or has not been conducted and managed by such person in accordance with sound business principles or prudent commercial practices; or

(c) the business of a company is or has been conducted and managed by such person in a manner which is likely to cause, or has caused, serious injury or damage to the interest of the trade, industry or business to which such company pertains; or

(d) the business of a company is or has been conducted and managed by such person with intent to defraud its creditors, members or any other persons or otherwise for a fraudulent or unlawful purpose or in a manner prejudicial to public interest;

the Central Government may state a case against the person aforesaid and refer the same to the Company Law Board with a request that the Company Law Board may inquire into the case and record a decision as to whether or not such person is a fit and proper person to hold the office of director or any other office connected with the conduct and management of any company.

**Answer 4(c)**

Clause 47(1)(c) of the listing agreement of stock exchanges applicable to listed companies requires a company to appoint the Company Secretary to act as Compliance Officer who will be responsible for monitoring the share transfer process and report to the Company’s Board in each meeting. The compliance officer will directly liaise with the authorities such as SEBI, Stock Exchanges, Registrar of Companies, etc., and investors with respect to implementation of various clauses, rules, regulations and other directives of such authorities and investor service and complaints of related matter.
Answer 4(d)

The following is the brief description of the terms of reference for Audit Committee:

(i) Adopt and review formal written charts approved by the Board for its self-governance.

(ii) Review with the management the annual/half yearly/quarterly financial statements.

(iii) Hold separate discussions with the Head- Internal Audit, Statutory Auditors and members of the Audit Committee to find out whether the company’s financial statements are fairly presented in conformity with the generally Accepted Accounting Principles (GAAP).

(iv) Review the adequacy of accounting records maintained in accordance with the provisions of Companies Act, 1956.

(v) Look into reasons for substantial defaults, if any, in payments to depositors, creditors and shareowners.

(vi) Review the performance of Statutory Auditors and recommend their appointment and remuneration to the Board considering their independence and effectiveness.

(vii) Perform other activities consistent with the Memorandum and Articles of the Company, the Companies Act, 1956 and other governing laws.

Question 5

(a) What is directors’ and officers’ liability insurance? (6 marks)

(b) How does a director resign from the Board of directors in a private limited company, if the Board fails to accept his resignation? (6 marks)

(c) The articles of association of a company incorporated in 2001 provided that a director should hold 2,000 shares of the value of Rs.10 each as qualification shares. At the annual general meeting held in September, 2003, an ordinary resolution was passed increasing the share qualification of directors to 6,000 shares. The company then issued notice to the directors who did not hold 6,000 shares to acquire additional qualification shares within one month. Madhok, a director who was asked to acquire additional qualification shares, received the notice. He seeks your advice. What advice would you give him? (4 marks)

Answer 5(a)

Directors’ and Officers’ liability insurance policy is designed to protect fortune of Directors and officers of a company (public or private) against the consequences of their personal liability for financial losses arising out of wrongful acts and/or omissions done, or wrongfully attempted in their capacity as Directors or officers.

Wrongful act is defined as any actual or alleged error, omission, mis-statement, misleading statement, neglect, breach of duty or negligent act by any one of the Directors or Officers solely in their capacity as Directors or officers of the Company.

Directors’ and Officers’ liability coverage comprises two sections (a) damages awarded against Directors and Officers including legal costs (b) company reimbursement.
The Directors’ and Officers’ section indemnifies the Directors and officers in respect of claims made against them where the company is not legally permitted to reimburse them. (In the absence of D&O insurance cover, Directors and officers would have to pay the loss settlement and defense costs out of their own resources).

Such policy covers former, present and future members of the board of directors and the management.

Answer 5(b)

The Companies Act does not make express provision for the resignation of a director. A director may resign his office in the manner provided by the articles. If the articles contain no provision regarding the resignation by a director, he may resign his office at any time by giving reasonable notice to the company, no matter whether the company accepts it or not [Abdul Hug v. Katpadi Industries Ltd. A.I.R. 1960 Mad. 482].

Thus, in the absence of any provision in the articles, resignation once made will take effect immediately when the intention to resign is made clear. In such a case the resignation tendered by a director unequivocally in writing will take effect from the time when such resignation is tendered.

A managing or whole-time director, however, cannot resign merely by giving a notice. His resignation is governed by the terms and conditions of his appointment. In the case of [Achutha Pai v. Registrar of Companies, (1966) 36 Comp. Cas 598 (Ker)], it was held that the resignation becomes effective only when the company accepts the resignation and relieves him (managing director) from his duties.

Answer 5(c)

There is no statutory requirement that a director must hold qualification shares in the company in which he is a director. Section 270 of the Companies Act, 1956 lays down that if the articles of a company provide for share qualification, each director must obtain his qualification shares within two months after his appointment as director and the nominal value of the qualification shares shall not exceed Rs. 5,000 or the nominal value of the one share where it exceeds five thousand rupees.

In the present case, two aspects are covered. One is that the special resolution necessary to alter the articles of association of a company was not passed. Secondly, the provisions of Section 270 were violated. In 2001, when the company was incorporated, the minimum limit for holding of qualification shares was fixed at Rs. 20,000. Further, the company increased the limit for holding of qualification shares at Rs. 60,000 in September, 2003 which is clearly a violation of Section 270 of the Act.

Therefore, Madhok is advised not to proceed for taking the additional shares and approach the company on the above mentioned lines.

Question 6

(a) Anmol Ltd. in its annual general meeting appointed all its directors by passing one single resolution. No objection was made to the resolution by any one present in the meeting. Examine the validity of the appointment and subsequent acts of the Board of directors explaining the relevant provisions of the Companies Act, 1956. Will it make any difference, if Anmol Ltd. is a government company? (8 marks)
(b) As a Company Secretary, draft a specimen notice of disqualification under Section 274(l)(g) for a director of your company who is otherwise eligible for reappointment in the ensuing annual general meeting. (4 marks)

(c) Madhav, a chartered accountant, is a director in MNL Ltd. The company proposes to appoint/engage the firm M & Co., in which Madhav is a partner in one or more of the following capacities:

(i) Consultants on regular retainer basis.
(ii) Authorised representatives to appear before tribunals.

Discuss whether the provisions of section 314 are attracted in the above situations. (4 marks)

Answer 6(a)

As per Section 263 of the Companies Act, 1956, at a general meeting of a public company or of a private company, which is a subsidiary of a public company, a motion shall not be made for the appointment of two or more persons as directors of the company by a single resolution, unless a resolution that it shall be so made has first been agreed to by the meeting without any vote being given against it. Also, a resolution moved in contravention of this provision shall be void, whether or not objection was taken at the time of its being so moved.

In the present case, Anmol Ltd. passed a single resolution appointing all the directors. The resolution is void since before moving the resolution for appointment of all the directors by a single resolution, no resolution was passed to the effect that all the directors shall be appointed by a single resolution. It is immaterial that no member objected to the appointment of all the directors by a single resolution.

As per Section 290 of the Companies Act, 1956, the act of these directors shall not be invalidated until the defect in their appointment is discovered. However, where such defect comes to the knowledge of the company, all subsequent acts of these directors shall be invalid.

Further, section 263 of the Act does not apply to a Government company in which the entire paid-up share capital is held by the Central Government or by any State Government or Governments or by the Central Government and one or more State Governments [Notification No. GSR 577(E), dated 16-7-1985]. Therefore, if Anmol Ltd. is a government company (and satisfy the conditions as mentioned above), the appointment of all the directors by a single resolution shall be valid.

Answer 6(b)

XYZ Ltd.
Registered Office……..

To

Shri________________
___________________

We regret to write to you that since M/s. ABC Co.Ltd. (address__________) of which you are a director has not filed annual accounts and annual report for a continuous
period of three financial years from ______ to ______, under section 274(1)(g) of the Companies Act, 1956, you are not eligible for being appointed as a director of our company. Therefore, our company will not be able to re-appoint you again as the director of the company in its ensuing AGM where you are due to retire by rotation.

You may kindly note that by virtue of this disqualification, you shall not be eligible to be appointed as director of our company for a period of five years.

Yours faithfully,
For XYZ Ltd.

(Signed)
Company Secretary

Answer 6(c)

It is considered by the Department of Company Affairs that an advocate or solicitor appears in a court of law as an officer of the court in pleading the cause of justice and hence, such appearance and receiving fees on that account cannot lead to an inference of holding an office or place of profit under the company under Section 314 of the Companies Act, 1956. However, if such a solicitor/advocate, etc. is appointed on a regular retainer basis for rendering legal advice other than appearance in courts, the provisions of Section 314 will be applicable. [Circular: No. 14/75 [8/12/314 (1B) / 75-CL-V], dated 5-6-1975]

Hence, in view of the above:

(i) Appointment of a firm M & Co., in which Madhav (a director of the company) is a partner, as consultant on regular retainer basis shall be covered by the respective provisions of Section 314(1) and (1B) of the Companies Act, 1956.

(ii) However, appointment of a firm M & Co. as authorized representatives to appear before tribunals will not be covered by the provisions of Section 314(1) and (1B) of the Act.

Question 7

(a) Enumerate the procedure for conversion of a public company into a private company. (8 marks)

(b) Write notes on any two of the following:
   (i) Filing of document in physical form in the context of MCA-21
   (ii) Corporate Identification Number (CIN)
   (iii) Directors’ responsibility statement. (4 marks each)

Answer 7(a)

Procedure for conversion of a public company into a private company

1. Hold a meeting of the Board of directors to consider and approve the proposal for conversion of public company into a private company.
The following resolutions must be passed at the board meeting:

(i) To approve the proposal and fix time, date and venue for holding an extraordinary general meeting of the company.
(ii) To authorize the company secretary or some competent officer to issue the notice of the general meeting on behalf of the Board.

2. Hold general meeting and have the special resolutions passed.

3. Within thirty days of passing of the special resolutions, file e-form 23 to the Registrar of Companies.

4. If the number of members of the company is above fifty, appropriate steps should be taken to reduce the number to fifty or below.

5. Send six copies including one certified copy of the amendments to the stock exchanges where the securities of the company are listed.

6. An application in e-form 1B along with the minutes of the members’ meeting and prescribed application fee will have to be made, within three months from the date of passing of the special resolution for alteration of the articles, for obtaining the Central Government’s approval to the alteration of the articles of the company.

7. If the Registrar of Companies so directs, publish a notice in newspaper(s) as per his direction.

8. Send to the stock exchanges where the securities of the company are listed, three copies of proceedings of the general meeting.

9. After the alteration of the articles has been approved by the Central Government, a printed copy of the altered articles of the company should be filed with the concerned Registrar of Companies in e-form 62 within one month of the date of receipt of the order of approval.

10. Surrender to the Registrar, the Certificate of Incorporation of the company in order to obtain fresh Certificate of Incorporation.

11. Change the name of the company in all copies of the memorandum and articles of association, letter heads, invoice forms, receipt forms, all other stationery items, common seal of the company, sign boards and at every other place where the name of the company appears.

12. Issue a general notice in newspapers informing members and public at large that the company has been converted into a private limited company.

Answer 7(b)(i)

Filing of document in physical form in the context of MCA-21

After the introduction of MCA-21, all the forms which were previously physically filed with the Registrar of Companies are now being electronically filed with the Registrar of Companies.

Main features of e-filing of documents under the MCA-21 system are briefly discussed below:

— To support the provisions of e-filing, the Central Government under
Section 610A and 610E of the Companies Act have enacted the Companies (electronic filing and authentication of documents) Rules, 2006.

— Every company has been allocated a Corporate Identity Number (CIN). CIN can be found from the MCA-21 portal through search based on ROC Registration No., Existing Company Name, etc.

— The e-forms are required to be authenticated by the authorized signatories using digital signatures as defined under the Information Technology Act, 2000.

— Various e-forms e.g. 2, 3, 5,10,17,18, 23, 24AB, 25C, 32 are to be pre-certified by a Chartered Accountant or a Cost Accountant or a Company Secretary in whole time practice.

— MCA-21 system provides for the facility of payment of statutory fees through multiple modes i.e. (i) Off-line payment through a challan generated by the system and payment of fees at the counter of the notified bank branches through DDs/Cash; (ii) on-line payments through Internet Banking and Credit Cards [Master Card/VISA].

Further, the process of e-stamping has been introduced. However, it has not been made mandatory. Companies have option to pay stamp duty in electronic manner through MCA21 system or in physical form as per the existing procedure. The Companies (Electronic Filing) Rules, 2006 provides that where the documents are required to be filed on Non-Judicial Stamp Paper, and if the stamp duty on such documents is paid electronically through Ministry of Corporate Affairs portal www.mca.gov.in, in such case, the company shall not be required to make physical submission of such documents, in addition to their submission in the electronic form. This process is available only in such States/Union Territories which have agreed to the request of Ministry of Corporate Affairs for collection of e-stamp duty on their behalf.

**Answer 7(b)(ii)**

**Corporate Identity Number (CIN)**

Every company has been allocated a Corporate Identity Number (CIN). CIN can be found from the MCA-21 portal through search based on:

— ROC Registration No.
— Existing Company Name
— Old Name of Company (in case of change of name, user is required to enter old name and the system displays corresponding current name).
— Inactive CIN [In case of change of CIN, the user is required to enter previous (inactive) CIN Number].

**Answer 7(b)(iii)**

**Directors’ Responsibility Statement**

Sub-section (2AA) of Section 217 of the Companies Act, 1956 provides that the Board’s report shall also include a Directors’ Responsibility Statement, indicating therein,—

(i) that in the preparation of the annual accounts, the applicable accounting
standards have been followed along with proper explanation relating to material
departures.

(ii) that the directors had selected such accounting policies and applied them
consistently and made judgements and estimates that are reasonable and prudent
so as to give a true and fair view of the state of affairs of the Company at the
end of the financial year and of the profit or loss of the Company for that period.

(iii) that the Directors have taken proper and sufficient care for the maintenance of
adequate accounting records in accordance with the provisions of this Act for
safeguarding the assets of the Company and for preventing and detecting fraud
and other irregularities.

(iv) that the Directors have prepared the annual accounts on a going concern basis.

Question 8

Distinguish between any four of the following:

(i) ‘Preferential issue’ and ‘issue of preference shares’.

(ii) ‘E-Form 20’ and ‘e-Form 20A’

(iii) Meaning assigned to ‘insider’ and ‘connected person’ in the SEBI (Prohibition of

(iv) Procedure for appointment of ‘cost auditor’ and ‘statutory auditor’.

(v) Appointment of a Company Secretary by a private company under ‘the Indian
Law’ and ‘the Law in the United Kingdom.’

Answer 8(i)

‘Preferential issue’ and ‘issue of preference shares’

Preferential issue: Among the many ways by which companies can raise capital is
preferential issue — an issue of fresh shares or convertible debentures allotted to a
select set of people, whether promoters, their relatives, or institutional investors. One
could call it a wholesale equity market since the retail investors or shareholders are not
invited to participate.

Promoters have used preferential allotments as a means for raising their stake in
their companies — whether through shares or equity warrants, which can be converted
at a later date. Unfortunately, however, allegations abound that the system has been
misused by unscrupulous promoters, who initially sell their existing holdings at a higher
price in the secondary market, and then build up their stakes through such issues at a
lower price.

Preference shares: Section 85(1) of the Companies Act, 1956 provides that a
preference share or preference share capital is that part of share capital which fulfills
both the following requirements:

(a) With respect to dividend, it carries a preferential right to be paid a fixed amount
or an amount calculated at a fixed rate, which may be either free of or subject to
income-tax.
(b) With respect to capital, it carries on winding up or re-payment of capital, a preferential right to be repaid the amount of the capital paid-up or deemed to have been paid-up whether or not there is preferential right to the payment of either or both of the following amounts, namely:

(i) any money remaining unpaid, in respect of the amount specified in clause (a) up to the date of winding up or re-payment of capital; and

(ii) any fixed premium or premium on any fixed scale specified in the memorandum or articles of the company.

Answer 8(ii)

‘E-form 20’ and ‘E-Form 20A’

_E-form 20:_ E-form 20 has to be filed by a public company having share capital as a declaration of compliance for obtaining certificate of commencement of business where no prospectus is issued. A copy of the statement in lieu of prospectus is required to be mandatorily attached. The original duly filled-in and signed e-form 20 on stamp paper should be sent to the concerned ROC simultaneously.

_E-form 20A:_ E-form 20A is required to be filed within 30 days from the date of passing of special resolution in pursuance of Section 149(2A) or 149(2B) of the Companies Act, 1956. The original e-form 20A duly filled in and signed on a stamp paper is required to be sent to the concerned ROC simultaneously along with copy of the special resolution or the approval letter of the Central Government where ordinary resolution has been passed pursuant to Section 149(2B).

Answer 8(iii)

Meaning assigned to ‘insider’ and ‘connected person’ in the SEBI (Prohibition of Insider Trading) Regulations, 1992

_Insider:_ Insider means any person, who is or was connected with the company or is deemed to have been connected with the company and who is reasonably expected to have access to unpublished price sensitive information in respect of securities of a company or who has received or had access to such unpublished price sensitive information.

_Connected person:_ Connected person means any person who -

(a) is a director of a company as defined in clause (13) of Section 2 of the Companies Act, 1956 or is deemed to be director of the company by virtue of sub-clause (10) of Section 307 of that Act; or

(b) occupies the position of an officer or an employee of the company or holds a position involving a professional or business relationship between himself and the company whether temporary or permanent and who may reasonably be expected to have access to unpublished price sensitive information in relation to the company.

For this purpose, the words “connected person” shall mean any person who is a connected person six months prior to an act of insider trading.
Answer 8(iv)

**Procedure for appointment of ‘cost auditor’ and ‘statutory auditor’**

*Cost auditor*: The cost auditor is appointed under Section 233B by the Board of Director of a company with the previous approval of Central Government. However, before appointing a cost auditor, a public company shall obtain a written certificate from the proposed cost auditor to the effect that the appointment, if made, will be in accordance with the provisions of Section 224(1B) of the Act.

*Statutory auditor*: Every company shall at each annual general meeting appoint an auditor or auditors to hold office from the conclusion of that meeting until the conclusion of next AGM. Such auditor is called statutory auditor. While appointing the statutory auditor, every public limited company shall obtain a written certificate from the proposed auditor to the effect that the appointment or reappointment, if made will be in accordance with the limits specified under Section 224(1B) i.e. the maximum number of companies that an auditor can audit.

To sum up, statutory auditor is appointed at the AGM while cost auditor is appointed by the Board with the previous approval of Central Government.

Answer 8(v)

**Appointment of a Company Secretary by a private company under ‘the Indian Law’ and ‘the Law in the United Kingdom’**

Section 383A of Companies Act, 1956 lays down that every company having a paid up share capital of rupees five crore or more must have a whole-time secretary and such secretary must be a member of the Institute of Company Secretaries of India (ICSI). The word used in this context is ‘every company’. As such even a private company in India is mandatorily required to appoint a whole-time company secretary once its paid-up capital is rupees five crore or more.

As per Section 270 and 271 of UK Companies Act, 2006, a private company is not required to have a company secretary and only public companies are required to appoint a qualified company secretary. Also, Section 272 provides that if it appears to the Secretary of State that a public company is in breach of Section 271 (i.e. it has not employed a company secretary), the Secretary of State may give the company a direction to appoint a company secretary.
Question 1

(a) “Drafting of petitions, deeds and documents is an art. Even acquiring working knowledge in this demands application of skills of higher order.” Discuss pinpointing the skills and tasks involved in such an exercise. (10 marks)

(b) In the present litigational corporate scenario, what are the role expectations from a Company Secretary with regard to drafting and conveyancing? (5 marks)

(c) What is meant by ‘recitals’ as a component in a deed? What is its evidentiary value? (5 marks)

Answer 1(a)

The essence of the process of drafting is synthesis of law and fact in a language. A proper understanding of drafting cannot be realised unless the nexus between the law, the facts, and the language is fully understood and accepted. Drafting of legal documents requires, as a pre-requisite, the skills of a draftsman, the knowledge of facts and law so as to put facts in a systematised sequence to give a correct presentation of legal status, privileges, rights and duties of the parties, their obligations, terms and conditions, breaches and remedies etc. in a self-contained and self-explanatory form without any patent or latent ambiguity or doubtful connotation. This requires serious thinking followed by prompt action to reduce the available information into writing with a legal meaning.

A draftsman, in the first instance, must ascertain the names, description and addresses of the parties to the instrument. He must obtain particulars about all necessary matters which are required to form part of the instrument. He must also note down with provision any particular directions or stipulations which are to be kept in view and to be incorporated in the instrument.

When the draftsman has digested the facts, he should next consider as to whether those intentions can be given effect to without offending against any provision of law. A corporate executive, therefore, must note down the most important requirements of law which must be fulfilled while drafting complete instrument on the subject. Knowledge of law of the land in general and knowledge of the special enactments applicable in a particular situation is an essential requirement for a draftsman to ensure that the provisions of the applicable law are not violated or avoided.

It is also to be ensured that the format of documents adopted adheres to the customs and conventions in vogue in the business community or in the ordinary course of legal transactions. For any change in the form of such document, use of juridical and technical language should invariably be followed. The statements of negatives should generally be avoided. The order of the draft should be strictly logical. Legal language should be, to the utmost possible extent, precise and accurate. The draft must be readily intelligible to laymen. Document should be supported by the schedules, enclosures or annexures in case any reference to such material has been made in that.
Answer 1(b)

The Company Secretary is an expert professional well versed with company affairs and administration. He is supposed to act as a fulcrum for effective corporate governance. Now law is an integral part of corporate administration—both as per statutes as well as general rules of practice. So the Company Secretary must have some basic proficiency in law relating to company administration.

Besides, a Company Secretary acts as an authorized representative before various Tribunals/quasi judicial bodies. It is necessary for him to learn art of advocacy or court craft for effective delivery of results to his clients when he acts as an authorized representative before any tribunal/quasi judicial body.

For winning a case, art of advocacy is important. Advocacy/court craft is learned while entering the practising side of the profession. Apart from the legal side of the profession, advocacy is often useful and sometimes vital, in client interviewing, in negotiation and in meetings, client seminars and public lectures. It is a valuable and lifelong skill worth mastering.

Technical and legal knowledge about the area in which Company Secretaries are acting is essential. Better their knowledge, the better their advocacy skills and the greater their impact. Good advocacy or negotiating skills will not compensate for lack of appropriate knowledge.

Answer 1(c)

Recitals contain the short story of the property up to its vesting into its transferors. Care should be taken that recitals are short and intelligible. Recitals may be of two types. One, narrative recitals which relates to the past history of the property transferred and sets out the facts and instrument necessary to show the title and relation to the party to the subject matter of the deed as to how the property was originally acquired and held and in what manner it has developed upon the grantor or transferor. The extent of interest and the title of the person should be recited. It should be written in chronological order i.e. in order of occurrence. This forms part of narrative recitals. This is followed by inductive recitals, which explain the motive or intention behind execution of deed.

Recitals should be inserted with great caution because they precede the operative part and as a matter of fact contain the explanation to the operative part of the deed. If the same is ambiguous recitals operate as estoppel. Recital offers good evidence of facts recited therein. Recitals are not generally taken into evidence but are open for interpretation for the courts. If the operative part of the deed is ambiguous anything contained in the recital will help in its interpretation or meaning. In the same sense, it is necessary that where recitals contain chronological events that must be narrated in chronological order.

Recital generally begins with the words “Whereas” and when there are several recitals instead of repeating the words “Whereas” before each and every one of them, it is better to divide the recitals into numbered paragraphs for example, “Whereas” —

1.
2.
3.
etc.
It has been held that Recitals carry evidentiary importance in the deed. It is an evidence against the parties to the instrument and those claiming under and it may operate as estoppel [Ram Charan v. Girija Nandini, 3 SCR 841 (1965)].

Question 2

(a) Explain the following:

(i) Consent order

(ii) Testimonium

(iii) Counter affidavit

(iv) Deed escrow

(v) Author of the trust. (2 marks each)

(b) Koncept Ltd. was under liquidation. The official liquidator sold 4.68 acres of its land to Affluent Ltd. by auction. Possession of the land was handed over to Affluent Ltd., but without any conveyance deed in their favour. Affluent Ltd. served legal notice on the official liquidator demanding conveyance deed, but in vain. After the expiry of the period prescribed under section 80 of the Code of Civil Procedure, 1908, Affluent Ltd. instituted a civil suit seeking a decree of specific performance. After due hearings, the civil court decreed the suit and directed defendant official liquidator to convey 4.68 acres of land to plaintiff Affluent Ltd. after considering any objections in response to a notice to be published in newspapers.

The official liquidator complied with the decree and published notices in newspapers. No objections were received. Still the official liquidator did not execute conveyance deed, on the pretext that along with Koncept Ltd., Kite Co. was also under liquidation and had common boundary wall with Affluent Ltd. Kite Co.’s land had already been sold. Therefore, the official liquidator was willing to execute conveyance for 3.16 acres of land only and not 4.68 acres of land as claimed by Affluent Ltd., the judgment creditor. This plea was not pressed in written statement or hearings in the court of civil judge.

Decide the official liquidator’s liability to execute conveyance deed for the entire area. Cite case law, if any. (6 marks)

Answer 2(a)(i)

Consent Order

Consent Order means an order settling administrative or civil proceedings between the regulator and a person (party) who may prima facie be found to have violated securities laws. Here, Administrative/Civil enforcement actions include issuing directions, suspension or cancellation of certificate of registration, imposition of monetary penalty, pursuing suits and appeals in Courts and Securities Appellate Tribunal (SAT). It may settle all issues or reserve an issue or claim, but it must precisely state what issues or claims are being reserved. A Consent Order may or may not include a determination that a violation has occurred.
Consent Order provides flexibility of wider array of enforcement and remedial actions which will achieve the twin goals of an appropriate sanction, remedy and deterrence without resorting to litigation, lengthy proceedings and consequent delays.

**Answer 2(a)(ii)**

**Testimonium**

Testimonium is the clause in the last part of the deed. Testimonium signifies that the parties to the document have signed the deed. This clause marks the close of the deed and is an essential part of the deed. Thus testimonium clause can be worded according to the status and delegation of executants.

**Answer 2(a)(iii)**

**Counter Affidavit**

Pleadings filed by a defendant/respondent in answer to the claims set out by the plaintiff/petitioner, in the form of an affidavit and/or supported by an affidavit are referred to as a counter affidavit. This nomenclature is generally used while filing pleadings on behalf of a defendant/respondent before the High Court and/or certain other Tribunals and Commissions etc. The rules of pleadings as are applicable to a written statement, apply to a counter affidavit as well. Filing of a counter affidavit is obligatory when the defendant/respondent is so required by the Court. Failure of the defendant/respondent to file a counter affidavit on the day fixed by the Court, will not entitle him, as of right, thereafter to file it. It does not mean that the defendant/respondent will be shut out once for all. He may be permitted by the Court to file it on a later date on sufficient grounds shown for not filing the same in time.

**Answer 2(a)(iv)**

**Deed Escrow**

A deed signed by one party and delivered to another as an “escrow” for it is not a perfect deed. It is only a mere writing (Scriptum) unless signed by all the parties and dated when the last party signs it. The deed operates from the date it is last signed. Escrow means a simple writing not to become the deed of the expressed to be bound thereby, until some condition should have been performed. *(Halsbury Laws of England, 3rd Edn., Vol. II, p. 348).*

**Answer 2(a)(v)**

**Author of the Trust**

A trust is defined in the Indian Trusts Act, 1882 as an obligation annexed to the ownership of property, and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him for the benefit of another or of another and the owner. (Section 3)

The person who reposes or declares the confidence is called the ‘author of the trust’. The person who accepts the confidence is called the ‘beneficiary’.
The facts of the case are similar to *Shivarpan Engineering (P) Ltd. v. Official Liquidator, High Court of Kolkata*, [(2009) 147Comp Cas 199 (Cal)].

The point to be decided in the above mentioned case was whether the Official Liquidator is required to execute conveyance deed for the disputed area of the land.

The Calcutta High Court held that the Lower Court had already passed orders to convey 4.68 acres of land in favour of the applicant. No application for the variation or modification of the earlier order had been filed by the Official Liquidator. No person had come to claim title to any part of the land comprised of 4.68 acres of land, inspite of the publication of notice, as directed by the Court.

Therefore, Official Liquidator was bound to give effect to the earlier orders by conveying 4.68 acres of land in favour of the applicant. In the event, the Official Liquidator was unable to deliver 4.68 acres, he was at liberty to execute the conveyance for the area that he could convey and was to refund the sum accordingly to the applicant.

In view of the decision of the Calcutta High Court in the aforesaid case, the Official Liquidator in the given problem is bound to give effect to the earlier orders by conveying 4.68 acres of land in favour of Affluent Ltd.

Question 3

(a) Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s):

(i) A will is ________________.
(ii) Hypothecation is ______________ form of pledge.
(iii) A power of attorney can be executed only in favour of a ____________.
(iv) Registration and stamp duty is compulsory in case of mortgage value of Rs. ______________ and above.
(v) Outsourcing is the contracting out of a company’s non-core, non-revenue producing activities to ____________.
(vi) Mortgage by deposit of title deeds is called ______ mortgage in English law.

(1 mark each)

(b) State, with reasons in brief, whether the following statements are true or false:

(i) A proxy lodged with a company under Section 176 is a power of attorney.
(ii) All deeds are documents and vice-versa.
(iii) Habeas corpus is a remedy available to a person who is detained with legal justification.
(iv) An assignment is a form of transfer of property.
(v) Non-putting of seal on an agreement may not invalidate the agreement, if it has otherwise been properly executed.

(2 marks each)
Answer 3(a)

(i) A will is an Instrument.

(ii) Hypothecation is an extended form of pledge.

(iii) A power of attorney can be executed only in favour of a Major.

(iv) Registration and stamp duty is compulsory in case of mortgage value of Rs. 100/- and above.

(v) Outsourcing is the contracting out of a company’s non-core, non-revenue producing activities to Specialists.

(vi) Mortgage by deposit of title deeds is called Equitable mortgage in English law.

Answer 3(b)

(i) True: The proxy lodged with the company under Section 176 of the Companies Act, 1956, is also a power of attorney. In that case a shareholder who is not able to attend the meeting authorises another person on his behalf to attend and vote at the meeting. It is a particular power of attorney.

(ii) False: All deeds are documents. But it is not always that all documents are deeds.

(iii) False: The writ of habeas corpus is a remedy available to a person who is confined without legal justification.

(iv) True: An assignment is a form of transfer of property and it is commonly used to refer the transfer of an actionable claim or a debt or any beneficial interest in movable property.

(v) True: The putting of seal of the company on agreements entered on behalf of the company is governed by the provisions in the Articles of Association of the company and/or by the resolution of the Board authorizing the entering of the agreement. However, non putting of seal on an agreement if it is not mandatory in terms of Articles of Association or board Resolution, may not invalidate the agreement if it has been otherwise been properly executed

Question 4

(a) Yuvi Ltd., in a litigation, was levied a penalty by the Company Law Board on 1st February, 2009. It submitted an appeal to the High Court impugning the penalty order but after the stipulated period. Can the High Court condone the delay and allow the appeal? Cite case law, if any. (6 marks)

(b) Desire Ltd. proposed to increase its share capital. A notice calling for general meeting for considering and approving increase in share capital was issued to the shareholders. Questioning the validity of the notice, a shareholder objected that the amount of proposed increase was not specified in the notice. Is this objection legally valid? Justify your answer. (5 marks)
(c) Three partners, Aman, Bhuvan and Charaan, decided to dissolve their firm named ABC & Co., by mutual consent. However, Aman agreed to continue the business in his own name, as a sole proprietor, and all the other partners agreed to this. Draft a notice of dissolution of ABC & Co. for insertion in a national newspaper.

(5 marks)

Answer 4(a)

The High Court can not condone the delay and allow the appeal.

In a similar case Hetal Alpesh Muchhala v. Adityesh Educational Institute [2009]152 Comp.Cas 75 (Bom), the issue involved was whether the High Court has power to condone the delay beyond 60 days. The Court answering in negative held that under Section 10F of the Companies Act, 1956 a party is allowed to file an appeal to the High Court within 60 days from the date of communication of the decision or order of the Company Law Board. As per the proviso to the Section 10F this period may be extended for a further period “not exceeding” 60 days, if the High Court is satisfied that the appellant was prevented by “sufficient cause” from filing the appeal within the initial period of 60 days.

The words used in the proviso to Section 10F of the Act are “not exceeding 60 days thereby clearly prescribing the time limit of only 60 days, in addition to the initial period of 60 days allowed under Section 10F of the Act to enable a party to file an appeal. The proviso clearly shows that the power vested in the court to condone the delay on sufficient cause being shown is directory and subject to the discretion of the court. However the maximum period to the extent of which such delay is capable of being condoned is mandatorily prescribed and not open to exercise of any discretion. The words “not exceeding” cannot be given any other meaning except “not more than” or “not beyond” or “not thereafter”. To hold that the court could entertain an application to set aside the decision /order passed by the Company Law Board beyond the extended period under the proviso to the Section 10F of the Act would render the phrase “not exceeding 60 days” otiose.

The court held that the Legislature has consciousy restricted the right of appeal under Section 10F of the Act, only to questions of law so as to ensure that there is as far as possible an early finality to the issues and consequent redressal of grievances. All decisions on questions of fact as decided by the Company Law Board are final and conclusive.

Answer 4(b)

Section 173 of the Companies Act, 1956 requires every company to annex an explanatory statement for every special business to be transacted in the meeting of shareholders. The explanatory statement is to bring to the notice of the members all material facts concerning each item of special business. Therefore, the objection of the shareholder is valid since the details on the item to be considered are lacking. The notice is not a valid notice.

Answer 4(c)

Notice of Dissolution of Partnership for insertion in a newspaper

Notice is hereby given that the partnership lately subsisting between us the undersigned A.B.C……& Co........ carrying on business as......... at............ under
the firm of ABC and has this day been dissolved by mutual consent. All debts due to and owing by the said late firm will be received and paid by the said A who will continue to carry on the same said business under the same style and firm.

Sd/- A,B and C

Question 5

Write notes on any four of the following:

(i) Habendum
(ii) Replication
(iii) Necessary clauses in a sub-lease deed
(iv) Del credere agency
(v) Arbitration award.

(4 marks each)

Answer 5(i)

Habendum

Habendum is a part of deed which states the interest, the purchaser is to take in the property. Habendum clause starts with the words “THE HAVE AND TO HOLD”. Formerly in England if there was a gratuitous transfer, the transferee was not deemed to be the owner of the beneficial estate in the property, the equitable estate wherein remained with the transferor as a resulting trust for him. It was therefore, necessary to indicate in the deed that it was being transferred for the use of the transferee if it was intended to confer an equitable estate in him. It was for that reason that the habendum commenced with the words: “to have to hold to the use of…………”. Now it is not necessary to express it so. In the modern deeds, however, the expression “to have and” are omitted. The habendum limits the estate mentioned in the parcels. The transferee is mentioned again in the habendum for whose use the estate is conveyed. If the property conveyed in encumbered, reference thereto should be made in the habendum. If the parties to transfer enter into covenants, they should be entered after the habendum.

Answer 5(ii)

Replication

A written reply of the plaintiff by way of defense to pleas raised in the counter affidavit/written statement from the defendant, is termed as a rejoinder or replication. Such statements are subsequent pleadings as contemplated in Order 8, Rule 9 of the Civil Procedure Code. Under Rule 9, leave of the court is essential before any party can present a further pleading after the written statement has been filed. The only subsequent pleading that may be filed without the leave of the court is the written statement filed by way of defense to a set-off or a counter-claim. It should be borne in mind that while filing a rejoinder/replication, a party cannot be allowed to fill up gaps or lacuna in his pleadings. Nor again can a party introduce new material facts or different cause of action except in a case where subsequent to filing of the petition/suit, the petitioner/plaintiff discovers new matters and accordingly seeks leave of the Court to submit such further particulars in his pleadings.
Answer 5(iii)

Necessary clauses in sub-Lease deed

A sub-lease is a demise by a lessee for lesser term than he himself has. Every lessee, however short his term may be, may make a sub-lease unless he is refrained by the contract of the tenancy from subletting. Like a lease deed, the clauses necessary for a sub lease deed are:

1. Material facts are mentioned in the operative part.
2. Consideration: Reserved rent is mentioned in the beginning of the Testatum: The entire consideration, including premium, etc., should be mentioned.
3. Operative Part: It shows clearly the sub lessor divesting himself of possession and the sub lessee coming into possession.
4. Habendum: The nature of the lease, commencement and duration of the term are specified here.
5. Reddendum: This is peculiar to a deed of lease. Here is mentioned the mode and time fixed for payment. It begins with the word rendering or paying with reference to the reserved rent. Rent is payable during the term of the lease. Place where payable and instalments are mentioned. If there is apportionment of rent that is also mentioned.
6. Covenants: Terms and conditions are mentioned in several paragraphs. The usual covenants are to be found in Section 108 of the Transfer of Property Act; other important covenants generally refer to payment of taxes, repairs, insurance, subletting purpose of the lease, e.g. residential purpose, renewal and forfeiture.

Answer 5(iv)

Del Credere Agency

There is a special type of agency, which combines agency with guarantee. This is known as del credere agency. A del credere agent is one who, for an extra remuneration undertakes the liability to guarantee the due performance of the contract by the buyer. By reason of his charging a del credere commission he assumes responsibility for the solvency and performance of the contract by the vendee and thus indemnifies his principal against loss. He, therefore, gives an additional security to the seller, but he does not shift the responsibility of payment from the buyer to the seller.

Answer 5(v)

Arbitration Award

Award means the decision of the arbitrator to whom the dispute is referred. Section 2(b) of the Arbitration and Conciliation Act, 1996 states arbitral award includes an interim award.

Section 31 of the Act lays down the requirements as to form and contents of an arbitration award. The law requires that the award shall be made in writing and signed by all the members of the arbitral tribunal or by the majority of them if the reason for any omitted signature is stated, stating its date and the place of arbitration. Such place is deemed to be place of the award. After the award is made, a signed copy is to be delivered to each party.
The arbitral award under section 31 of the Act must state the reasons, unless the parties have specifically agreed that reasons need not be given or the award is based on agreed terms. The award must state the reasons upon which it is based.

Question 6

(a) Define the term ‘deed’. Explain any seven usual clauses in a deed. (8 marks)

(b) Whether an unburnt fresh hard disk in a computer is a ‘document’ within the meaning of section 3 read with section 65B of the Indian Evidence Act, 1872? Discuss with reference to case law. (4 marks)

(c) What is the difference between ‘mortgage’ and ‘lease’ from the point of view of drafting of an agreement? (4 marks)

Answer 6(a)

Deed is the term normally used to describe all the instruments by which two or more persons agree to effect any right or liability. A deed may be defined as a formal writing of a non-testamentary character which purports or operates to create, declare, confirm, assign, limit or extinguish some right, title, or interest. The most suitable and comprehensive definition has been given by Norten on ‘Deeds’ as follows:

A deed is a writing

(a) on paper, vallum or parchment,

(b) sealed, and

(c) delivered, whereby an interest, right or property passes, or an obligation binding on some persons is created or which is in affirmance of some act whereby an interest, right or property has been passed.

The seven usual parts or clauses in a deed are as follows:

1. Description of the Deed Title
2. Place and Date of execution of a Deed
3. Description of Parties to the Deed
4. Recitals
5. Testatum
6. Consideration
7. Receipt Clause

1. Description of the Deed Title: The deed should contain the correct title such as “This Deed of Sale”, “This Deed of Mortgage”, etc. These words should be written in capital letters in the beginning of document. This part hints the nature of the deed and gives a signal to the reader about the contents of the Deed.

2. Place and Date of Execution of a Deed: The date on which the document is executed comes immediately after the description of the deed. It is the date of execution which is material in a document for the purpose of application of law of
limitation, maturity of period, registration of the document and passing on the title to the property as described in the document. Date of execution of document is inscribed on the deed.

The place determines the territorial and legal jurisdiction of a document as to its registration and for claiming legal remedies for breaches committed by either parties to the document and also for stamping the document, as the stamp duty payable on document differs from State to State.

3. **Description of Parties**: The basic rule is that all the proper parties to the deed including inter-parties should be properly described in the document because inter-parties are pleaded as they take benefit under the same instrument. While describing the parties, the transferor should be mentioned first and then the transferee. Where there is a confirming party, the same may be placed next to the transferee. In the order of parties, transferee comes in the last. Full description of the parties should be given to prevent difficulty in identification.

4. **Recitals**: Recitals contain the short story of the property up to its vesting into its transferors. Care should be taken that recitals are short and intelligible. Recitals may be of two types. One, narrative recitals which relates to the past history of the property transferred and sets out the facts and instrument necessary to show the title and relation to the party to the subject matter of the deed This is followed by introductory recitals, which explain the motive or intention behind execution of deed.

Introductory recitals are placed after narrative recitals. The basic objective of doing so, is to put the events relating to change of hand in the property.

5. **Testatum**: This is the “witnessing” clause which refers to the introductory recitals of the agreement, if any, and also states the consideration, if any, and recites acknowledgement of its receipt.

6. **Consideration**: Consideration is very important in a document and must be expressed. In the absence of mention of consideration the evidentiary value of document is reduced that the document may not be adequately stamped and would attract penalty under the Stamp Act.

7. **Receipt**: Closely connected with consideration is the acknowledgement of the consideration amount by the transferor, who is supposed to acknowledge the receipt of the amount.

**Answer 6(b)**

The issue whether hard disc of a computer is a document within the meaning of sections 3 and 65B of the Evidence Act, 1872 was decided in the case *Dharamvir v. CBI* [148 (2008) DLT 288].

In this case it was held that hard disc is a document. The court held that as long as nothing at all is written on to a hard disc and it is subjected to no change, it will be a mere electronic storage device like any other hardware of the computer. Once the hard disc is subject to any change, then even if it restored to the original position by reversing that change, the information concerning the two steps, viz., the change and its reversal will be stored in the subcutaneous memory of the hard disc and can be retrieved by using software designed for that purpose. Therefore, a hard disc that is once written upon or
subjected to any change is itself an electronic record even if it does not at present contain any accessible information.

In addition there could be active information available on the hard disc which is accessible and convertible into other forms of data and transferable to other electronic devices. The active information would also constitute an electronic record. Given the wide definition of the words ‘document’ and ‘evidence’ in the amended Section 2(o) and 2(t) of IT Act, there can be no doubt that an electronic record is a document.

**Answer 6(c)**

**Mortgage and Lease**

*Mortgage*: A mortgage is a transfer of interest in specific immovable property for the purpose of securing the payment of money advanced or to be advanced by way of a loan, existing or future debt or the performance of an acknowledgement, which may give rise to pecuniary liabilities (Section 58 of the Transfer of Property Act, 1882).

The transferor in the case of a mortgage is called a ‘mortgagor’ and the transferee as ‘mortgagee’, the principal money and interest of which payment is secured for the time being are called the ‘mortgage money’ and the instrument, if any, by which a transfer is effected is called a “mortgage deed”. Mortgage is of various types.

*Lease*: According to Section 105 of the Transfer of Property Act, 1882, a lease of immovable property is a transfer of a right to enjoy property. It is a sort of contractual arrangement between the two parties whereby one acquires the right to use the property called “lessee” and the other who allows the former the right to use his owned property, called the “lessor”.

Leasing arrangement provides an enterprise with the use and control over assets without receiving title to them. This arrangement could be oral or written allowing the use of assets for a specified period of time. The written lease agreement is signed by both the owner of the assets i.e. the lessor and the user of the assets i.e. ‘the lessee’. The lessee does not get the final ownership. In other words, leasing involves the use of an asset without assuming, or intending to assume, ownership.

**Question 7**

(a) “Practising of good professional etiquettes is necessary for professional success in the emerging business scenario.” Discuss.  
(b) Write a note on ‘covenants and undertakings’.  
(c) What is meant by ‘pleadings’? Explain the fundamental rules of pleadings.

**Answer 7(a)**

Etiquette is the fine art of behaving in front of others. It is a set of practices and forms which are followed in a wide variety of situations; many people consider it to be a branch of decorum, or general social behavior. Each society has its own distinct etiquette, and various cultures within a society also have their own rules and social norms.

In today’s world of business, professionals need to know how to conduct themselves within the corporate world. One of the best ways to do so is to practice good professional
etiquette. Practicing good professional etiquette is necessary for professional success in the emerging business scenario which is constantly changing and making the market place more competitive and contestable. Corporates look for those candidates who possess manners, a professional look and demeanor, and the ability to converse appropriately with business colleagues and clients. Though academic knowledge and skills of a professional may be spectacular, but not knowing proper etiquette required to be successful in the professional career could be a roadblock preventing him to achieve success in the professional life and business relationships. Good professional etiquette indicates to potential employers that the person they are hiring is a mature, responsible adult who can aptly represent their company.

**Answer 7(b)**

**Covenants and Undertakings**

The term covenant has been defined as an agreement under seal, whereby parties stipulate for the truth of certain facts. In Whasten’s Law Lexicon, a covenant has been explained as an agreement or consideration or promise by the parties, by deed in writing, signed, sealed and delivered, by which either of the parties, pledged himself to the other than something is either done or shall be done for stipulating the truth of certain facts. Covenant clause includes undertakings also. Usually, covenant is stated first. In some instances the covenants and undertakings are mixed, i.e. can not be separated in that case, they are joint together, words put for this as “The Parties aforesaid hereto hereby mutually agree with each other as follows:” Such covenants may be expressed or implied.

**Answer 7(c)**

The present day system of pleadings in our country is based on the provisions of the Civil Procedure Code, 1908 as amended/supplemented from time to time by Rules in that behalf by High courts of the States. There are rules of the Supreme Court and Rules by special enactments as well. Pleadings generally mean either a plaint or a written statement. The main objective behind formulating the rules of pleadings is to find out and narrow down the controversy between the parties. Provisions relating to pleadings in civil cases are meant to give each side intimation of the case of the other so that it may be met to enable courts to determine what is really at issue between parties, and to prevent deviations from the course which litigation on particular cause of action must take (*Canesh Trading* v. *Mojiram*, AIR 1978 SC 484. The whole object of pleading is that each side may be fully alive to the questions that are about to be argued in order that they may have an opportunity of bringing forward such evidence as may be appropriate (*Lakshmi Narayan* v. *State of Bihar*, AIR 1977 Patna 73.)

The fundamental rule of pleadings is contained in provisions of order 6 Rule 2 of the Civil Procedure Code, which enjoins:

1. “Every Pleading shall contain only a statement in a concise form of the material facts on which the party pleading relies for his claim or defence as the case may be, but not the evidence by which they are to be proved.

2. Every pleading shall, when necessary, be divided into paragraphs, numbered consecutively each allegation being, so far as is convenient, contained in a separate paragraph.
3. Dates, sums and numbers shall be expressed in a pleading in figures as well as in words.

Question 8

(a) Draft a specimen deed of sale of a business and assignment of goodwill. (8 marks)

(b) Make the most appropriate pairs from the following:

   (i) Company (a) Prohibition
   (ii) Firm (b) Application
   (iii) Trust (c) Relief sought
   (iv) Deed (d) Defense
   (v) Appeal (e) Promoter
   (vi) Written statement (f) Beneficiary
   (vii) Petition (g) Document
   (viii) Writ (h) Partner

(4 marks)

(c) Select the odd term out and briefly justify your answer:

   (i) Mandamus; certiorari; prohibition; cyrographum.
   (ii) Petitioner; plaintiff; rejoinder; defendant.
   (iii) Dilatory pleas; memorandum of appeal; grounds of appeal; relief sought for.
   (iv) Call on shares; liability of members; common seal; transfer of shares.

(1 mark each)

Answer 8(a)

A Specimen of Deed of Sale of a Business and Assignment of Goodwill

THIS SALE is made this……………… day of………………, between V (the vendor), of the one part and P (the purchaser) of the other part.

WHEREAS the said vendor is carrying on the business of………………;

AND WHEREAS the said purchaser has agreed with the said vendor for purchase by him of all the interest and goodwill in the said business, and the debts, stock-in-trade, effects and the premises on which the said business is being carried on, at the price of Rs……………… and upon the terms and conditions hereinafter mentioned:

AND WHEREAS the said vendor has delivered to the said purchaser the books of account and other books relating to the said business, and in the said books are set forth the accounts and particulars of the debts, respectively due and owing to and from the said vendor, and also the particulars of the contracts and engagements to which he is liable in respect of the said business.

NOW THIS DEED WITNESSES:

(1) In pursuance of the said agreement and in consideration of the sum of Rs……………… (Rupees………………) paid by the said purchaser to the said vendor (the receipt whereof the said vendor hereby acknowledges), and also in consideration of the agreement hereinafter contained on the part of the said
purchaser, the said vendor does hereby convey, assign and make over to the
said purchaser, all the beneficial interest and goodwill of the said vendor in the
said business ..................... so carried on by him as aforesaid, and also all the
books and other debts now due and owing to him on account of the said business
and all securities for the same, and also all contracts and engagements, benefits
and advantages which have been entered into with the said vendor and also all
the stock-in-trade, goods, fixtures, articles and things which, at the date of this
Deed belong to the said vendor on account of the said business and all the
rights, title and interest of the said vendor to and in the said premises, to have
and to hold the premises hereby conveyed to the said purchaser absolutely;

(2) The said vendor does hereby agree with the said purchaser that he, the said
vendor, will not at any time hereafter either by himself or in collaboration with
any other person or persons, carry on the said business of ..................
within ................... kilometers of ...................;

(3) The amounts and particulars of the debts respectively due and owing to and
from the said vendor on account of the said business and the particulars of the
contracts and engagements to which he is liable with respect to the said business,
are correctly stated and set forth in the books of account and other books
delivered by the said vendor to the said purchaser;

(4) The said vendor will pay all the sums (if any) which may now be due and owing
from the said business in excess of the amounts which in the said books appear
to be so due and owing;

(5) The said vendor has full right to sell and assign the said premises hereby sold
and assigned to the said purchaser and will not at any time hereafter revoke,
annul and make void the aforesaid power or authority hereby given to the said
purchaser, or do or execute or knowingly or willingly suffer any act, deed or
thing, whereby the said purchaser may be prevented from having and receiving
the said premises or any part thereof, to and for his own use and benefit, or by
means whereof the said purchaser shall be injured in the said business; and

(6) The said vendor will, from time to time and at all times hereafter, use his best
endeavours to promote the said business and to give to the purchaser full
advantage of the connections and customs of the said vendor, in the said
business.

AND THIS DEED ALSO WITNESSES, that in pursuance of the said agreement in
this behalf and in consideration of the premises, the said purchaser does hereby agree
with the said vendor that he, the said purchaser, will, from time to time and at all times
hereafter, keep harmless and indemnified the said vendor and his estate and effects
from and against the several sums of money which by the said books appear to be due
and owing from the said vendor in respect of the said business and also from and
against the contracts and engagements to which by the said books the said vendor
appears to be now liable, and also interests, costs, expenses, losses, claims and
demands on account of the said debts, contracts and engagements respectively.

It is further agreed that the names of the parties hereto shall, unless inconsistent
with the context, include as well the heirs, administrators or assigns of the respective
parties as the parties themselves.
IN WITNESS WHEREOF the said vendor and the said purchaser have hereto respectively signed on the day, month and the year above-written.

Witness : Vendor

Witness : Purchaser

Answer 8(b)

(i) Company     (e) Promoter
(ii) Firm       (h) Partner
(iii) Trust     (f) Beneficiary
(iv) Deed       (g) Document
(v) Appeal     (c) Relief Sought
(vi) Written Statement (d) Defense
(vii) Petition (b) Application
(viii) Writ (a) Prohibition

Answer 8(c)

(i) **Cyrographum** : It is a deed whereas others are different types of writs.
(ii) **Rejoinder** : It is a statement whereas others are parties to pleadings.
(iii) **Dilatory Pleas** : It is a kind of defense whereas other are parts of appeal.
(iv) **Liability of Members** : It is a content of Memorandum whereas other are contents of Articles.
GUIDE L I N E   A N S W E R S

PROFESSIONAL PROGRAMME

DECEMBER 2010

MODULE II
These answers have been written by competent persons and the Institute hopes that the **GUIDELINE ANSWERS** will assist the students in preparing for the Institute's examinations. It is, however, to be noted that the answers are to be treated as model answers and not as exhaustive and the Institute is not in any way responsible for the correctness or otherwise of the answers compiled and published herein.

The Guideline Answers contain the information based on the Laws/Rules applicable at the time of preparation. However, 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**

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<tr>
<td>2. Corporate Restructuring and Insolvency</td>
<td>19</td>
</tr>
</tbody>
</table>
NOTE: 1. Answer FIVE questions including Question No. 1 which is compulsory. All working notes should be shown distinctly.

2. Tables showing the present value of Re.1 and the present value of an annuity of Re.1 for 15 years are annexed.

Question 1

Comment on any four of the following:

(i) Dividend policy is strictly a financing decision and payment of cash dividend is a passive residual.

(ii) Depository system functions very much like banking system.

(iii) Accounting profit does not take into account all costs of capital invested in business.

(iv) The mark-to-market process is lengthy for index futures.

(v) Financial gearing is a fair weather friend. (5 marks each)

Answer 1(i)

Dividend policy is strictly a financing decision and payment of cash dividend is a passive residual

According to Ezra Solomon’s Residual Theory of Dividend Policy, dividend policy is strictly a financing decision; the payment of cash dividend is a passive residual. The amount of dividend payout will fluctuate from period to period in keeping with fluctuations in the amount of acceptable investment opportunities available to the firm. If the opportunities are in plenty, percentage of payout is likely to be zero; on the other hand, if the firm is unable to find out profitable investment opportunities, payout will be 100 per cent. The theory implies that investors prefer to have the firm retain and reinvest earnings rather than pay them out in dividends if the return on re-invested earnings exceeds the rate of return the investors could themselves obtain on other investments of comparable risks.

Answer 1(ii)

Depository system functions very much like banking system

Yes, the Depository system functions very much like the banking system. A bank holds funds in accounts whereas a Depository holds securities in account for its clients. A bank transfers fund between accounts whereas a Depository transfers securities between accounts. In both the systems, the transfer of funds or securities happens without the actual handling of funds or securities. Both the Banks and the Depository are accountable for the sale keeping of funds and securities respectively.
Answer 1(iii)

**Accounting profit does not take into account all costs of capital invested in business**

The conventional approach to measure profit will deduct cost of loan capital in arriving at profit; but there is no similar deduction for the cost of shareholders. Critics of the conventional approach point out that a business will not make a profit, in an economic sense, unless it covers the cost of all capital invested, including shareholders’ funds.

Answer 1(iv)

**The mark-to-market process is lengthy for index futures**

All open position in the index contracts are daily settled at the mark-to-market settlement price. The process of debit and credit by offsetting the transaction will continue till the final closure of the position. On the expiry, the settlement price is the spot index value as on expiry of any futures contract, the spot value and the futures value coverage. Mark-to-market settlement is made in cash.

Answer 1(v)

**Financial gearing is a fair weather friend**

When the EBIT is more than sufficient to meet the fixed charges like interest on debentures and dividend on preference shares, financial leverage would result in higher EPS compared to an unlevered company. Thus, a higher degree of financial leverage would result in higher EPS. However, a high degree of leverage may prove to be working in just the opposite direction if the EBIT level is not sufficient to cover the fixed charges, i.e., interest and preference dividend and the financial leverage would result in lower EPS compared to an unlevered company. Financial leverage thus helps in increasing the EPS of company which has more than sufficient EBIT to cover the fixed charges.

Question 2

(a) Following figures relate to Twinkle Ltd.: 

<table>
<thead>
<tr>
<th>Description</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales (at 3 months' credit)</td>
<td>45,00,000</td>
</tr>
<tr>
<td>Materials consumed (suppliers extend 1½ months credit)</td>
<td>11,25,000</td>
</tr>
<tr>
<td>Wages paid (1 month in arrear)</td>
<td>9,00,000</td>
</tr>
<tr>
<td>Manufacturing expenses outstanding at the end of the year (cash expenses are paid one month in arrear)</td>
<td>1,00,000</td>
</tr>
<tr>
<td>Total administration expenses for the year (cash expenses are paid one month in arrear)</td>
<td>3,00,000</td>
</tr>
<tr>
<td>Sales promotion expenses for the year (paid quarterly in advance)</td>
<td>6,00,000</td>
</tr>
</tbody>
</table>

The company sells its product on gross profit margin of 25% assuming depreciation as a part of cost of production. It keeps 2 months’ stock of finished goods and one month’s stock of raw materials as inventory. It keeps cash balance of Rs.1,25,000. Assume a safety margin of 5%.
Work out working capital requirements of the company on cash cost basis. Ignore work-in-process. (12 marks)

(b) Gel Corporation presently gives credit terms of ‘net 30 days’. It has Rs.600 lakh in credit sales and its average collection period is 45 days. To stimulate sales, the company may give credit terms of ‘net 60 days’ with sales expected to increase by 15%. After the change, the average collection period is expected to be 75 days with no difference in payment habits between old and new customers. Variable costs are Re.0.80 for every Re. 1 of sales; and the company’s before tax required rate of return on investment in receivables is 20%. Assume 360 days in a year. Should the company extend its credit period? (8 marks)

Answer 2(a)

Statement showing working capital requirements of Twinkle Ltd.

(A) Current Assets:

(i) Raw materials (1 month) = \( \frac{Rs.11,25,000 \times 1}{12} \) = 93,750

(ii) Finished goods (2 months) = \( \frac{Rs.32,25,000 \times 2}{12} \) = 5,37,500

(iii) Debtors at cost (3 months) = \( \frac{Rs.41,25,000 \times 3}{12} \) = 10,31,250

(iv) Cash balance = 1,25,000

(v) Prepaid sales promotion expenses (3 months) = \( \frac{Rs.6,00,000 \times 3}{12} \) = 1,50,000

Total current Assets = 19,37,500 (A)

(B) Current Liabilities:

(i) Creditors for goods (1.5 months) = \( \frac{Rs.11,25,000 \times 1.5}{12} \) = 1,40,625

(ii) Wages (1 month) = \( \frac{Rs.9,00,000 \times 1}{12} \) = 75,000

(iii) Manufacturing expenses (1 month) = 1,00,000

(iv) Administration expenses (1 month) = \( \frac{Rs.3,00,000 \times 1}{12} \) = 25,000

Total current liabilities = 3,40,625 (B)

Net working capital (A – B) = 15,96,875

Add: 5% safety margin = 79,844

Net working capital required = 16,76,719
Working Notes:

(i) Calculation of depreciation for the year:  

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>Rs. 45,00,000</td>
</tr>
<tr>
<td>Less: 25% Gross Profit on sales</td>
<td>Rs. 11,25,000</td>
</tr>
<tr>
<td>Total Manufacturing cost</td>
<td>Rs. 33,75,000</td>
</tr>
<tr>
<td>Less: Materials consumed</td>
<td>Rs. 11,25,000</td>
</tr>
<tr>
<td>Wages paid</td>
<td>Rs. 9,00,000</td>
</tr>
<tr>
<td>Total Manufacturing Expenses (A)</td>
<td>Rs. 13,50,000</td>
</tr>
<tr>
<td>Less: Cash manufacturing expenses (Rs. 1,00,000 x 12) (B)</td>
<td>Rs. 12,00,000</td>
</tr>
<tr>
<td>Depreciation for the year (A – B)</td>
<td>Rs. 1,50,000</td>
</tr>
</tbody>
</table>

(ii) Calculation of total cash cost for the year:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total manufacturing costs</td>
<td>Rs. 33,75,000</td>
</tr>
<tr>
<td>Less: Depreciation</td>
<td>Rs. 1,50,000</td>
</tr>
<tr>
<td>Cash manufacturing costs</td>
<td>Rs. 32,25,000</td>
</tr>
<tr>
<td>Add: Administration expenses</td>
<td>Rs. 3,00,000</td>
</tr>
<tr>
<td>Sales promotion expenses</td>
<td>Rs. 6,00,000</td>
</tr>
<tr>
<td>Total cash cost for the year</td>
<td>Rs. 41,25,000</td>
</tr>
</tbody>
</table>

Answer 2(b)

Gel Corporation

Evaluation of proposal to extend credit period

(a) Existing receivable turnover in times 360/45 = 8
(b) New receivable turnover in times 360/75 = 4.80
(c) Contribution on estimated additional sales of Rs. 90 lakhs @ 20% = Rs. 18 lakh
(d) Additional receivable \([(6,90,00,000 ÷ 360) × 75]\)

\[\begin{align*}
= [(1,43,75,000) – (75,00,000)] & = Rs. 68,75,000
\end{align*}\]
(e) Investment at cost of sales in additional receivables @ 80% \[(68,75,000 × 80/100) = Rs. 55 lakh\]
(f) Required rate of return before tax @ 20% = Rs. 11 lakh
(g) Increase in Profit (18 – 11) = Rs. 7 lakh

Recommendation: The Company should extend credit period to ‘Net 60 days’
Question 3

(a) Sushmita Ltd. produces an electronic component with a selling price of Rs.100. Fixed cost amounts to Rs.2 lakh. 5,000 Units are produced and sold each year. Annual profits amount to Rs.50,000. The company’s all equity-financed assets are Rs.5 lakh.

The company proposes to change its production process, adding Rs.4,00,000 to investment and Rs.50,000 to fixed operational costs. The consequences of such a proposal are —

(i) Reduction in variable costs per unit Rs.10;
(ii) Increase in output by 2,000 units; and
(iii) Reduction in selling price per unit to Rs.95.

Assuming an average cost of capital at 10%, examine the proposal and advise whether the company should make the change. Also, measure the degree of operating leverage and break-even point. (10 marks)

(b) You are given following information of Alpha Ltd. for the year ended 31st March, 2010:

<table>
<thead>
<tr>
<th>Rs. in Thousands</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
</tr>
<tr>
<td>Variable cost</td>
</tr>
<tr>
<td>Fixed cost</td>
</tr>
<tr>
<td>Interest</td>
</tr>
<tr>
<td>Income-tax @ 30%</td>
</tr>
</tbody>
</table>

On the basis of above information, you are required to calculate and interpret operating, financial and combined leverages. (6 marks)

(c) Security-A offers an expected rate of return of 14% with a standard deviation of 8%. Security-B offers an expected rate of return of 11% with a standard deviation of 6%. If an investor wishes to construct a portfolio with a 12.8% expected return, what percentage of the portfolio will consist of Security-A? (4 marks)

Answer 3(a)

<table>
<thead>
<tr>
<th>Present</th>
<th>New</th>
</tr>
</thead>
<tbody>
<tr>
<td>Production &amp; Sales (Units)</td>
<td>5000</td>
</tr>
<tr>
<td>Selling price per unit</td>
<td>100</td>
</tr>
<tr>
<td>Sales value</td>
<td>5,00,000</td>
</tr>
<tr>
<td>Annual Profit</td>
<td>50,000</td>
</tr>
<tr>
<td>Fixed costs</td>
<td>2,00,000</td>
</tr>
<tr>
<td>Contribution (4 + 5)</td>
<td>2,50,000</td>
</tr>
<tr>
<td>Variable costs (3 – 6)</td>
<td>2,50,000</td>
</tr>
<tr>
<td>Variable costs per unit</td>
<td>50</td>
</tr>
</tbody>
</table>
Additional fixed costs — 50,000
Total fixed costs (5 + 9) 2,00,000 2,50,000
Contribution per unit (2 – 8) 50 55
Contribution Rs.(5,000 x 50) & (7,000 x 55) 2,50,000 3,85,000
Operating Profit (EBIT) (12 – 10) 50,000 1,35,000
Additional Investment — 4,00,000
Cost of Capital 10% — 40,000
Profit before tax (13 – 15) 50,000 95,000

**Decision**: Since the proposal results into increased profits the company should accept the proposed changes

Operating leverage (12 ÷ 13) = \( \frac{\text{Contribution}}{\text{EBIT}} \) = 5.00 2.8519
Break even point (10 ÷ 11) = \( \frac{\text{Total fixed costs including interest}}{\text{Contribution per unit}} \) = 4,000 4,545

Answer 3(b)

**Calculation of Earnings of Alpha Ltd.**

\( Rs. \text{(in '000)} \)

Sales 1,05,000
Less : Variable cost 76,700
Contribution 28,300
Less : Fixed cost 7,500
Earnings before interest & tax (EBIT) 20,800
Less : Interest 11,000
Earnings before tax (EBT) 9,800
Less : Income tax @ 30% 2,940
Earnings after tax (EAT) 6,860

**Calculation of Leverages** :

(i) Operating Leverage = \( \frac{\text{Contribution}}{\text{EBIT}} \) = \( \frac{\text{Rs. 28,300}}{\text{Rs. 20,800}} \) = 1.36

*Interpretation*: Operating leverage shows that 1% change in sales revenue is expected to result in 1.36% change in EBIT.

(ii) Financial Leverage = \( \frac{\text{EBIT}}{\text{EBT}} \) = \( \frac{\text{Rs. 20,800}}{\text{Rs. 9,800}} \) = 2.12

*Interpretation*: Financial leverage represents that 1% change in EBIT is expected to result in 2.12% change in net income of Alpha Ltd.
(iii) **Combined Leverage**: Operating Leverage x Financial Leverage = $1.36 \times 2.12 = 2.88$

Alternatively, contribution to EBT = \[
\frac{\text{Rs. 28,300}}{\text{Rs. 9,800}} = 2.88
\]

*Interpretation*: The combined leverage of 2.88 means that 1% change in sales is expected to change Net Income by 2.88%.

**Answer 3(c)**

Expected Rate of Return of Security A : \( E(R_A) = 14\% \)

\( \sigma_A = 9\% \)

Expected Rate of Return of Security B : \( E(R_B) = 11\% \)

\( \sigma_B = 6\% \)

Expected Return of Portfolio \( E(R_p) = 12.8\% \)

Assume proportion of investment in security A = \( W_A \)

Investment in security B = \( (1 - W_A) \)

Expected return on a portfolio

\[ E(R_p) = W_A \cdot E(R_A) + W_B \cdot E(R_B) \]

Where \( W_A \) & \( W_B \) are the respective weights of security A & B

\[
12.8 = W_A \times 14 + (1 - W_A) \times 11
\]

\[
12.8 = 14W_A + 11 - 11W_A
\]

\[
1.8 = 3W_A
\]

\[
W_A = 0.6 = 60\%.
\]

Thus, investment in security A = 60%

Investment in security B = 40%.

**Question 4**

*Distinguish between any four of the following*:

(i) ‘Financial distress’ and ‘insolvency’,
(ii) ‘Leasing’ and ‘hire-purchase’.
(iii) ‘Financial viability of a project’ and ‘commercial viability of a project’.
(iv) ‘Clearing mechanism’ and ‘settlement mechanism’.
(v) ‘Return on capital employed’ and ‘return on net worth’.

(5 marks each)

**Answer 4(i)**

**Financial distress and insolvency**

Generally the affairs of a firm should be managed in such a way that the total risk-business as well as financial-borne by equity holders is minimized and is manageable, otherwise, the firm would obviously face difficulties. If cash inflow is inadequate the
A firm will face difficulties in payment of interest and repayment of principal. If the situation continues long enough, a time will come when the firm would face pressure from creditors. Failure of sales can also cause difficulties in carrying out production operations. The firm would find itself in a tight spot. Investors would not invest further. Creditors would recall their loans. Capital market would heavily discount its securities. Thus, the firm would find itself in a situation called distress. It may have to sell its assets to discharge its obligations to outsiders at prices below their economic values i.e., resort to distress sale. So when the sale proceeds are inadequate to meet outside liabilities, the firm is said to have failed or become bankrupt or (after due processes of law are gone through) insolvent.

**Answer 4(ii)**

**Leasing and hire-purchase**

In case of leasing, the asset is handed over by the lessor to the lessee in return for a lease rental. The ownership and the title to the assets remain with the lessor. The lessor, however, recovers the cost of the assets as well as a reasonable return in form of rental income. The lessor also gets the deduction in taxable income for the depreciation of the assets (though not using the assets). The lessee gets the opportunity for using the assets in its entirety without owning it. Further, the rental, paid by the lessee gets fully deducted from the taxable income of the lessee.

In case of hire-purchase, the seller hands over the assets to the buyer but the title to goods is not transferred. The buyer becomes the owner of the goods and acquires the title to the goods only when he makes the payments of all the installments. In case of default in payment by the buyer, the sellers can repossess the goods. The installments already paid by the buyer upto the date of repossession, in such a case, are treated as ‘hire’ towards using the assets by the buyer. The hire-purchaser shows the assets in his balance sheet and can claim depreciation from taxable income, although he may not be the owner at that time. The interest part of the installment can also be claimed as deduction from the taxable income.

**Answer 4(iii)**

**Financial viability of a project and commercial viability of a project**

**Financial Viability**: A project is considered to be financially viable if the earnings are expected to be sufficient to meet the burden of servicing debt, to cover fixed charges, operating and maintenance costs, and, in addition, yield a reasonable return on the investment made. Profitability projections are made to judge the financial viability of the project.

The profitability projections are made taking into account the various concessions/subsidies which may be available to the project and the tax burden associated with the project.

Broadly, assessment of financial viability of the project involves consideration of following aspects:

(i) Cost of the Project.

(ii) Financing Plans, Financial Collaboration arrangements and the terms there- for.
(iii) Requirements of working capital.
(iv) Projections of future profitability.
(v) Projections of cash flow.
(vi) Break-even and sensitivity analysis of the project.
(vii) Assessment of financial rates of return, financial ratios, cost benefit analysis etc.
(viii) Debt-equity Ratio.
(ix) Promoters’ contribution.

Commercial Viability: A project is considered to be commercially viable if it is able to market its products competitively in the domestic or international markets at a reasonable margin of profit. The appraisal takes into account the aggregate demand (projected) for the proposed product service and the expected share of the market the project expects to capture.

The commercial broadly involves market analysis to cover:
— Consumption trends in the past and present consumption level;
— Past and present supply position;
— Production possibilities and constraints;
— Cost structure;
— Imports and Exports;
— Structure of competition;
— Elasticity of Demand;
— Consumer behaviour, intention, motivation, attitudes, preferences and requirements;
— Distribution channel and marketing policies in use;
— Administrative, technical and legal constraints.

Answer 4(iv)

Clearing Mechanism and Settlement Mechanism

Clearing Mechanism

Clearing Corporation of Stock Exchange carries out clearing and settlement cycles of different sub-segments in the Equities segment. The clearing function of the clearing corporation is designed to work out (a) what counter parties owe and (b) what counter parties are due to receive on the settlement date.

Settlement Mechanism

Settlement is a two way process which involves legal transfer of title to funds and securities or other assets on the settlement date.
For administrative convenience, a stock exchange divides the year into a number of settlement periods so as to enable members to settle their trades. All transactions executed during the settlement period are settled at the end of the settlement period.

**Answer 4(v)**

**Return on capital employed and Return on net worth**

*Return on Capital Employed*: The profitability of the firm can also be analysed from the point of view of the total funds employed in the firm. The term funds employed or the capital employed refers to the total long term sources of funds. It means that the capital employed comprises of shareholders funds plus long term debts. Alternatively, it can also be defined as fixed assets plus net working capital.

\[
\text{RCE} = \frac{\text{PAT} - \text{Preference Dividend}}{\text{Equity Shareholders Funds or Net Worth}} \times 100
\]

*Return on net worth*: The ROE examines profitability from the perspective of the equity investors by relating profits available for the equity shareholders with the book value of the equity investment. The return from the point of view of equity shareholders may be calculated by comparing the net profit less preference dividend with their total contribution in the firm.

\[
\text{Return on Net Worth} = \frac{\text{PAT} - \text{Preference Dividend}}{\text{Equity Shareholders Funds or Net Worth}} \times 100
\]

**Question 5**

India Inc.'s dependence on banks for funding appears to be showing decline. With the Reserve Bank of India blocking sub-benchmark prime lending rate route for cheap financing from banks, corporates are looking at non-bank alternatives.

Under the earlier below prime lending rate (BPLR) regime, while large corporates could borrow at low interest rates from banks, the small and medium enterprises (SMEs) and retail borrowers ended up paying high interest rates. The new lending regime is aimed at enhancing transparency in lending rates of banks.

Highly rated corporates are replacing their earlier short-term sub-BPLR loans, by taking recourse to the debt market to keep a lid on borrowing costs and have been able to raise resources around the base rate of banks. However, corporates may not be able to supplant bank finance with funds from the debt capital market. Funding could dry up from debt markets in case of a liquidity crisis in the financial system.

Although, a bit costly as compared to the debt markets, banks are a steady source of funds for corporates. A bank is unlikely to jeopardize its long-standing relationship with a corporate by choking off funds during a liquidity crisis.

Answer the following questions:

(i) List and describe features of sources of finance other than banks and equity for corporates. (10 marks)

(ii) How is base rate system more expensive than prime lending rate for corporates? (5 marks)

(iii) How is bank finance superior to funding from debt market for corporates? (5 marks)
Answer 5(i)

Source of finance available other than banks and equity for raising funds by Corporates include the following:

(a) **Deposits**

Public deposits are a prominent source of finance to the companies. Salient features of deposits are as follows:

(i) Funds are available at low cost;
(ii) There is no need to provide security;
(iii) Process is simple and no restrictive covenants are involved;
(iv) Restrictions put by the RBI on financial institutions to advance, to prevent hoarding and black marketing leads to the companies accept deposits from the public;
(v) Tax deductibility of interest paid on deposits.

(b) **Debentures and Bonds**

Debentures as a source of finance suit companies which have regular earnings to service the debt, have higher proportion of fixed assets in their assets structure which offers adequate security and motivate investors. The company has to ensure maintenance of prudent debt equity ratio. Importance of debentures and bonds in the capital structure due to the following features:

(i) Debenture holders or suppliers of loan capital have no controlling interest in the company.
(ii) Finance is available for a fixed period.
(iii) It enhances the earnings of equity holders through the operation of financial leverage.
(iv) It provides long term finance to company on easy and cheap term.
(v) The cost of debt is lower than cost of equity or preference shares as interest is tax deductible.

(c) **Mortgage Backed Securities**

In Mortgage backed securities the issuer can generate cash from assets immediately enabling funds to be deployed in other projects. The assets to be securitized shall have the following features:

(i) The cash flow generated from the assets should be received periodically in accordance with a pre-determined schedule.
(ii) The assets should be large in number and total value to be issued in securitized form.
(iii) The asset should be sufficiently similar in nature and total value to be issued in cash flows.
(iv) The asset should be marketable.
(d) **Foreign Currency Convertible Bonds (FCCBs)**

A Foreign Currency Convertible Bond (FCCB) is a quasi debt instrument which is issued by any corporate entity, international agency or sovereign state to the investors all over the world.

**Features:**

(i) FCCB are denominated in any freely convertible foreign currency.

(ii) The FCCB by virtue of convertibility offers to issuer a privilege of lower interest cost than that of similar non convertible debt instrument.

(iii) FCCB can be marketed conveniently and the issuer company expects that the number of its shares will not increase until investors see improved earnings and prices for its common stock.

**Answer 5(ii)**

The base rate system has, in a way, put an end to this practice of cross-subsidization. Banks, on the other hand, cannot lend below or at the base rate. They add risk and tenor premium to the base rate to lend to a corporate. The base rate is arrived at by taking into account cost of deposits/funds, the negative carry on the cash reserve ratio and statutory liquidity ratio, overhead costs, and average return on net worth.

**Answer 5(iii)**

A bank is unlikely to jeopardize its long-standing relationship with a corporate by choking off funds during a liquidity crisis. In sharp contrast, funding could dry up from debt markets in case of a liquidity crisis in the financial system.

**Question 6**

(a) **Sushant Ltd. has the following capital structure:**

<table>
<thead>
<tr>
<th></th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity shares</td>
<td>50,00,000</td>
</tr>
<tr>
<td>10% Preference shares</td>
<td>10,00,000</td>
</tr>
<tr>
<td>14% Debentures</td>
<td>20,00,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>80,00,000</strong></td>
</tr>
</tbody>
</table>

**Equity shares of the company are sold at Rs.25 per share in the market. It is expected that the company will pay next year a dividend of Rs.4 per share which will grow at 8% forever. Assume a tax-rate of 30%**.

(i) **Compute weighted average cost of capital based on the existing capital structure.**

(ii) **Compute the new weighted average cost of capital, if the company raises an additional Rs.20,00,000 debt by issuing 15% debentures. This would increase the expected dividend to Rs.5 per share with dividend growth rate unchanged, but the price of share will fall to Rs. 20 per share.**

(12 marks)
A company is considering three methods of attracting customers to expand its business by undertaking — (A) advertising campaign; (B) display of neon signs; and (C) direct delivery service. The initial outlay for each alternative is as under:

- A Rs. 1,00,000
- B Rs. 1,50,000
- C Rs. 1,50,000

If A is carried out, but not B, it has an NPV of Rs.1,25,000. If B is done, but not A, B has an NPV of Rs.45,000. However, if both are done, then NPV is Rs.2,00,000. The NPV of the delivery system C is Rs.90,000. Its NPV is not dependent on whether A or B is adopted and the NPV of A or B does not depend on whether C is adopted.

Which of the investments should be made by the company if (i) firm has no budget constraint; and (ii) the budgeted amount is only Rs. 2,50,000?

Answer 6(a)

(i) Weighted Average Cost of Capital (based on existing capital structure)

<table>
<thead>
<tr>
<th>Source</th>
<th>Amount (Rs.)</th>
<th>After Tax Cost</th>
<th>Weights</th>
<th>Weight Average Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity Share Capital</td>
<td>50,00,000</td>
<td>0.24</td>
<td>.625</td>
<td>0.15</td>
</tr>
<tr>
<td>10% Preference Share Capital</td>
<td>10,00,000</td>
<td>0.10</td>
<td>.125</td>
<td>.0125</td>
</tr>
<tr>
<td>14% Debentures</td>
<td>20,00,000</td>
<td>0.098</td>
<td>.250</td>
<td>0.0245</td>
</tr>
<tr>
<td></td>
<td>80,00,000</td>
<td>1.000</td>
<td>1.000</td>
<td>0.187</td>
</tr>
</tbody>
</table>

∴ Weighted average cost of Capital = 0.187 or 18.7%.

Working Notes:

(i) Cost of Equity = \[ g = \frac{\text{Rs.} 4}{\text{Rs.} 25} + 0.08 = 0.24 \text{ or } 24\% \]

(ii) Cost of 14% Debentures
- \[ 14\% \times (1 - \text{tax rate}) \]
- \[ 14\% \times (1 - 0.30) \]
- \[ 14\% \times 0.70 \]
- \[ 9.8\% \]
(ii) **Weighted Average Cost of Capital (based on New capital structure)**

<table>
<thead>
<tr>
<th>Source</th>
<th>Amount (Rs.)</th>
<th>After Tax Cost</th>
<th>Weights</th>
<th>Weight Average Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity Share Capital</td>
<td>50,00,000</td>
<td>0.33</td>
<td>.50</td>
<td>0.165</td>
</tr>
<tr>
<td>10% Preference Share Capital</td>
<td>10,00,000</td>
<td>0.10</td>
<td>.10</td>
<td>0.01</td>
</tr>
<tr>
<td>14% Debentures</td>
<td>20,00,000</td>
<td>0.098</td>
<td>.20</td>
<td>0.0196</td>
</tr>
<tr>
<td>15% Debentures</td>
<td>20,00,000</td>
<td>0.105</td>
<td>.20</td>
<td>0.021</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>1.00</td>
</tr>
<tr>
<td></td>
<td>1,00,00,000</td>
<td></td>
<td>1.00</td>
<td>0.2156</td>
</tr>
</tbody>
</table>

∴ New Weighted average Cost of Capital = 0.2156 or 21.56%.

**Working Notes:**

(i) Cost of Equity = \( \frac{Rs. 5}{Rs. 20} + 0.08 = 0.33 \) or 33%

(ii) Cost of 15% Debentures = (Interest Rate – Tax)
    = 15% (1 – 0.30)
    = 15% (0.70)
    = 10.5%

**Answer 6(b)**

**Calculation of expected NPVs**

<table>
<thead>
<tr>
<th>Mode of attracting customers</th>
<th>Initial Outlay (Rs.)</th>
<th>Expected NPV (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advertisement Campaign (A)</td>
<td>1,00,000</td>
<td>1,25,000</td>
</tr>
<tr>
<td>Display of neon signs (B)</td>
<td>1,50,000</td>
<td>45,000</td>
</tr>
<tr>
<td>Direct delivery service (C)</td>
<td>1,50,000</td>
<td>90,000</td>
</tr>
<tr>
<td>(A) + (B) + (C)</td>
<td>4,00,000</td>
<td>2,90,000</td>
</tr>
<tr>
<td>(A) + (C)</td>
<td>2,50,000</td>
<td>2,15,000</td>
</tr>
<tr>
<td>(B) + (C)</td>
<td>3,00,000</td>
<td>1,35,000</td>
</tr>
<tr>
<td>(A) + (B)</td>
<td>2,50,000</td>
<td>2,00,000</td>
</tr>
</tbody>
</table>

(i) **No Budget Constraint:** The firm should adopt all the three modes of attracting customers. Its outlay in this case would be Rs.4,00,000 and the expected NVP would be Rs.2,90,000.

(ii) **Budget Constraint:** If the budget constraints are limited to Rs.2,50,000 then the
firm should adopt mode (A) and (C) only. In this case, the outlay would be Rs. 2,50,000 and the total NPV would be Rs. 2,15,000.

Question 7

Write notes on any four of the following:

(i) Secured premium note
(ii) Important motives to hold cash
(iii) Domestic resource cost
(iv) Purchasing power parity
(v) Factoring. (5 marks each)

Answer 7(i)

Secured Premium Notes (SPN)

These instruments are issued with detachable warrants and are redeemable after a notified period say 4 to 7 years. The warrants enable the holder to get equity shares allotted provided the secured premium notes are fully paid. During the lock in period no interest is paid. The holder has an option to sell back the SPN to the company at par value after the lock in period. If the holder exercises this option, no interest/premium is paid on redemption. In case the holder keeps it further, he is repaid the principal amount along with the additional interest/premium on redemption in installments as per the terms of issue. The conversion of detachable warrants into equity has to be done within the specified time.

Answer 7(ii)

Important motives to hold cash

Three important motives for holding cash are as under:

(a) Transactional Motive

This is the most essential motive for holding cash because cash is the medium through which all the transactions of the firm are carried out. These transactions are paid for from the cash pool or cash reservoir which is all the time being supplemented by inflows.

(b) Speculative Motive

Since cash is the most liquid current asset, it has the maximum potential of value addition to a firm’s business. Therefore, efficient firms seek to deploy surplus cash in short term investments to get better returns. Since this deployment of cash needs to be done skillfully, not all the firms hold cash for speculative motive. Further the amount of cash held for speculative motive should not cause any strain upon the operating cycle.

(c) Contingency Motive

This motive of holding cash takes into account the element of uncertainty associated with any form of business. The uncertainty can result in prolongation
of the working capital operating cycle or even its disruption. It is possible that cost of raw materials or components might go up or the time taken for conversion of raw materials into finished goods might increase. For such contingencies, some amount of cash is kept by every firm.

Answer 7(iii)

Domestic Resource Cost

DRC measures the resource cost of manufacturing a product as against the cost of importing/exporting it. It indicates the long-term comparative advantage a country enjoys in the production of a particular product.

The output from any project adds to domestic availability implying a notional reduction in imports to the extent of output of the project or an addition to exports if the product is being exported. This in turn implies that foreign exchange is saved to the extent there is reduced imports or foreign exchange is earned to the extent there is increased exports.

However, in the setting up of the project itself and in the manufacturing of the product, foreign exchange outflows may be incurred in order to procure machinery, raw materials etc. The foreign exchange saved or earned thus has to be adjusted for such outflow.

Answer 7(iv)

Purchasing Power Parity

According to the Purchasing Power Parity (PPP) Principle, the currency of a country will depreciate vis-a-vis the currency of another country on the basis of differential in the rates of inflation between them. The rate of depreciation in the currency of a country would roughly be equal to the excess inflation rate in the country over the other country.

It maintains that free international trade equalizes prices of tradable goods in different countries. So, a product will sell for the same price in common currency in all countries. Different rates of changes in prices i.e. different inflation rates must eventually induce offsetting changes in exchange rates in order to restore approximate price equality.

Answer 7(v)

Factoring

Factoring is a type of financial service which involves an outright sale of the receivables of a firm to a financial institution called the factor which specializes in the management of trade credit. Under a typical factoring arrangement, a factor collects the accounts on the due dates, effects payments to the firm on these dates (irrespective of whether the customers have paid or not) and also assumes the credit risks associated with the collection of the accounts. As such factoring is nothing but a substitute for in-house management of receivables. A factor not only enables a firm to get rid of the work involved in handling the credit and collection of receivables, but also in placing its sales in effect on cash basis.
PART A

(Answer Question No.1 which is compulsory and any three of the rest from this part)

Question 1

(a) It is widely believed that there are several reasons for business growth and expansion for a merged company. Explain at least three such reasons for business growth and expansion which may be achieved by a merged company. (9 marks)

(b) A company is over-capitalised due to rights issue, bonus issue and allotment of shares to the shareholders of transferor companies. Its share prices have plunged due to floating shares and do not represent its fair value in the market. The management is now thinking to take some corrective measures. The company has sufficient liquid cash at its disposal. State briefly the corrective measures. (6 marks)

(c) In a scheme of reconstruction, a company may, if its memorandum of association permits, carry out reconstruction following the procedure laid down under section 494, by incorporating a new company specifically for that purpose.

In the given case, the new company bears features which are substantially the same as of the earlier company.

But the shareholders of a transferor company objected to the scheme of reconstruction that the directors were actuated by sinister motive by doing so.

Is the objection sustainable if the objecting shareholders fulfil the formalities of minimum percentage for doing so? State your answer with case law. (5 marks)

(d) What is ‘strategic planning’? State its salient features. (5 marks)

Answer 1(a)

Market Leadership

The amalgamation can enhance value for shareholders of both companies through the amalgamated entity’s access to greater number of market resources. With the addition to market share, a company can afford to control the price in a better manner with a consequent increase in profitability. The bargaining power of the firm vis-a-vis labour, suppliers and buyers is also enhanced.

In the case of the amalgamation of Reliance Petroleum Limited with Reliance Industries Limited, the main consideration had been that the amalgamation will contribute towards strengthening Reliance’s existing market leadership in all its major products. It
was foreseen that the amalgamated entity will be a major player in the energy and petrochemical sector, bringing together Reliance’s leading positions in different product categories.

Operating Economics

A combination of two or more firms may result in reduction of costs due to operating economies. A combined firm may avoid overlapping of function and facilities. Various functions may be consolidated and duplicate channels may be eliminated by implementing an integrated planning and control system.

The merger of Sundaram Clayton Ltd. (SCL) with TVS Suzuki Ltd. (TSL) was motivated by operating economies and by virtue of this, TSL became the second largest producer of two wheelers. TSL needed to increase its volume of production but also needed a large manufacturing base to reduce its production costs. Large amount of funds would have been required for creating additional production capacity. SCL was also required to upgrade its technology and increase its production. Both the firms’ plants were closely located offering various advantages, the most versatile being the capability to share common research and development facilities.

Diversifying the Portfolio

Another reason for business growth and expansion due to merger is to diversify the company’s dependence on a number of segments of the economy. Diversification implies growth through the combination of firms in unrelated businesses. All businesses go through cycles and if the fortunes of a company were linked to only one or a few products then in the decline stage of their product life cycles, the company would find it difficult to sustain itself. The company therefore looks for either related or unrelated diversifications, and may decide to do so not internally by setting up new projects, but externally by merging with companies of the desired product profile. Such diversification helps to widen the growth opportunities for the company and smoothen the ups and downs of their life cycles.

Financial Benefits

A merger or amalgamation is capable of offering various financial synergies and benefits such as eliminating financial constraints, deployment of surplus cash, enhancing debt capacity and lowering the costs of financing. Mergers and amalgamations enable external growth by exchange of shares releasing thereby, the financial constraint. Also, sometimes cash rich companies may not have enough internal opportunities to invest surplus cash. Their wealth may increase through an increase in the market value of their shares if surplus cash is used to acquire another company. A merger can bring stability of cash flows of the combined company, enhance the capacity of the new entity to service a larger amount of debt, allowing a higher interest tax shield thereby adding to the shareholders wealth. Also, in a merger since the probability of insolvency is reduced due to financial stability, the merged firm should be able to borrow at a lower rate of interest. Apart from this, a merged firm is able to realize economies of scale in floatation and transaction costs related to an issue of capital i.e. issue costs are saved when the merged firm makes a larger security issue.

Strategic integration

Considering the complementary nature of the businesses of the concerned companies, in terms of their commercial strengths, geographic profiles and site integration,
the amalgamated entity may be able to conduct operations in the most cost effective and efficient manner. The amalgamation can also enable optimal utilization of various infrastructural and manufacturing assets, including utilities and other site facilities.

**Answer 1(b)**

Some of the corrective measures for over capitalization includes the following:

(a) Buy back of its own shares.

(b) Paying back surplus share capital to shareholders.

(c) Repaying of loans to Financial Institutions, Banks, Fixed deposit of Public if any.

(d) Redemption of debentures, bonds etc.

(e) Redemption of preference shares, if any.

**Answer 1(c)**

A company may, if its memorandum of association permits, carry out reconstruction following the procedure laid down in Section 494 of the Companies Act, 1956 by incorporating a new company specifically for that purpose.

This is a well recognised method of reorganisation and restructuring of a company. Where the shareholders of a company approve of such a method of reconstruction or reorganisation of a company, it cannot be said that the directors of the company were actuated by any sinister motive in doing so. [United Bank of India Ltd. v. United India Credit & Development Co. Ltd. (1977) 47 Comp. Cas. 689 (Cal.)]

A conjoint reading of sections 391 and 393 makes it clear at once that the Company Court which is called upon to sanction a scheme has not merely to go by the *ipse dixit* of the majority of the shareholders or creditors or their respective classes who might have voted in favour of the scheme by requisite majority but the court has to consider the pros and cons of the scheme with a view to finding out whether the scheme is fair, just and reasonable and is not contrary to any provisions of law and it does not violate any public policy.

No court of law would ever countenance any scheme of compromise or arrangement arrived at between the parties and which might be supported by the requisite majority if the court finds that it is an unconscionable or an illegal scheme or is otherwise unfair or unjust to the class of shareholders or creditors for whom it is meant. It is right to say that once the scheme gets sanctioned by the court it would bind even the dissenting minority shareholders or creditors. Therefore, the fairness of the scheme qua them also has to be kept in view by the Company Court while putting its seal of approval on the concerned scheme. *Miheer H. Mafatlal v. Mafatlal Industries Ltd.*, (1996) 87 Com Cases 792 at 812 (SC).

**Answer 1(d)**

Strategic planning is a management tool, used to help an organisation do a better job to assess and adjust the organisation's direction in response to a changing environment. It is a disciplined effort to produce fundamental decisions and actions that shape and
guide as to what an organisation is, what it does, and why it does, with a focus on the future at the same time.

Strategic planning enables management to improve the chances of making decisions which will stand the test of time, and revising the strategy on the basis of monitoring the progress of R&D and the changes in product-market conditions. A strategic plan is visionary, conceptual and directory in nature.

The salient features of strategic planning are as under:

1. It involves participation of responsible persons at different levels, either directly or indirectly (shared ownership).
2. It is a key ingredient of effective management.
3. It prepares the firm not only to face the future but also to shape the future in its favour.
4. It is based on quality data.
5. It accepts accountability to the community.
6. It helps to avoid haphazardous response to environment.
7. It ensures optimum leveraging of firm’s resources at every opportunity.

Question 2

(a) Can a lending bank file an appeal/revision application for modification of sanctioned scheme of amalgamation on the basis of the fact that there is a provision in the loan agreement executed between the company and the bank requiring prior approval of the bank before undertaking any steps for amalgamation or reconstruction? Explain. (4 marks)

(b) Acquirer, target company and merchant banker are duty bound to comply with the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 both in letter and spirit. Explain, with relevant provisions of law, consequences in case of violation of provisions of the SEBI regulations. (4 marks)

(c) State, with reasons in brief, whether the following statements are true or false:

(i) Provisions of the Specific Relief Act, 1963 override the provisions of sections 391 and 392.

(ii) A scheme, apparently made to merge the profit making company with a loss making company and to take tax advantage, is a valid scheme.

(iii) Amalgamation between two banking companies is governed solely by the Companies Act, 1956.

(iv) The transferee company after effecting merger is able to charge to profit and loss account the expenditure incurred wholly and exclusively for the purposes of amalgamation.

(v) Persons acting in concert (PAC) are individuals/company(ies)/any other legal entities who are acting together for an uncommon objective.

(vi) Under the SEBI (Substantial Acquisition of Shares and Takeovers)
Regulations, 1997, it is a voluntary requirement to appoint a merchant banker for acquisition of shares.

(vii) The shares of a target company are deemed as ‘frequently traded’ for pricing purpose if the annualised trading turnover in those shares is more than 5% (by number of shares). (1 mark each)

Answer 2(a)

In the matter of Ramco Super Leathers Ltd. v. Dhanlakshmi Bank Limited (2009) Madras High Court. It was held as follows:

The provisions of Section 391 of the Companies Act 1956 did not mandate holding of the meeting of the creditors in a scheme of arrangement between the company and its members and equally a meeting of the members in a scheme of arrangement between the company and its creditors. Though no specific provision had been made for ascertaining the wishes of the creditors in a scheme of arrangement between the company and its members, the court was entrusted with the duty to ascertain whether the scheme would affect the interest of the creditors to such an extent that the holding of their meeting was essential, and if the court, in appraisement of the facts and circumstances, opined that the interest of the creditors would be adversely affected if the scheme was approved, then it had to refuse to sanction the scheme since what was involved was public interest.

The banking institutions from which the appellant-company availed different kinds of loan facilities were nationalised banks and also public sector undertaking. Hence, if any loss occasioned to these institutions, it would ultimately affect the public interest.

In the instant case having flouted the binding clauses in the agreement creating the charge and having kept the creditors under darkness as to the entire proceedings of the scheme despite their request for the consortium meeting and also having not placed before the court all material facts, which would enable the court to or not to approve the scheme and all the more when it was apparently clear that the scheme of amalgamation, if approved, would certainly affect the public interest, naturally the secured creditors should have been heard before approval.

The high court refused to interfere with the original order modified by the single judge that the approval to the scheme would be valid and effective subject to the approval by the secured creditors.

Answer 2(b)

Penalty for non-compliance of the provisions of SEBI (Substantial Acquisition of Shares & Takeover) Regulations, 1997, are covered under Regulation 45.

As per regulation 45, failure to carry out obligations under this regulations, may result in the following consequences:

1. The acquirer or any person acting in concert faces the consequences of the escrow amount being forfeited besides penalties.

2. The Board of Directors of Target Company shall be liable for action in terms of regulation and Act.
3. The intermediary (which includes merchant banker) would face suspension or cancellation of registration as member of stock exchange.

4. For any mis-statement to the shareholders or for concealment of material information required to be disclosed to the shareholders, the acquirers or the directors where the acquirer is a body corporate, the directors of the target company, the merchant banker to the public offer and the merchant banker engaged by the target company for independent advice would be liable for action in terms of the regulations and the Act.

5. The penalties stated above may include:
   (i) Criminal prosecution under section 24 of the SEBI Act.
   (ii) Monetary penalties under section 15H of the SEBI Act.
   (iii) Directions under section 11B of the SEBI Act.
   (iv) Directions under section 11(4) of the Act;
   (v) Cease and desist order in proceedings under section 11D of the Act;
   (vi) Adjudication proceedings under section 15HB of the Act.

**Answer 2(c)**

(i) **False.** Provisions of the Specific Relief Act does not override the provision of section 391 & 392 of the companies act. In case of *Divya Vasundhara Financier Limited v. KN Samant (1990) 69 Comp. Cases*, it was held that the court while passing an scheme of arrangement under section 391 can also pass order of eviction against a person who prima facie does not have any right, title or interest in the property by issuing suitable directions.

(ii) **True.** In case of *Bihari Mills Ltd. (1985) Comp Cas Guj.*, it appeared to the court that the scheme was by way of, what is known as commercial world as a reverse takeover which means that a profit making company merges itself into a loss making company for the purpose of having advantage for tax purpose of examining that the scheme is not that reason against public interest and for evasion of taxes. On the facts court found that the scheme was bona fide commercial nature, reasonable and fair.

(iii) **False.** Amalgamation of one banking company with another banking company is governed by the provisions of Banking Regulation Act, 1949. Section 44A of the Banking Regulation Act, 1949 provides for procedure of amalgamation of two banking companies.

(iv) **False.** Section 35DD of Income Tax Act, 1961 provides that, expenditure, wholly and exclusively for the purposes of amalgamation, the assessee is only allowed a deduction of an amount equal to 1/5th of such expenditure for each of the 5 successive previous years in which the amalgamation takes place.

(v) **False.** Persons acting in concert (PAC) are acting for common objectives. As per SEBI( Substantial Acquisition of shares and takeovers) Regulations 1997, person acting in concert comprises persons who, for a common objective or
purpose of substantial acquisition of shares or voting rights or gaining control over the target company, pursuant to an agreement or understanding (formal or informal), directly or indirectly co-operate by acquiring or agreeing to acquire shares or voting rights in the target company or control over the target company.

(vi) **False.** It is a mandatory requirement to appoint category I merchant banker who is not associate of or group of acquirer or target company.

(vii) **True.** Shares shall be deemed to be infrequently traded if on the stock exchange, the annualised trading turnover in that share during the preceding six calendar months prior to the month in which the public announcement is made is less than five per cent (by number of shares) of the listed shares. Thus if turnover is more than 5% by number of such shares, it is deemed as frequently traded.

**Question 3**

(a) By analysing a balance sheet of Aadarsh Ltd., it was found that there are plethora of reserves in the balance sheet for the year ended 31st March, 2009, and the reserves are summarised below:

   (i) **Investment fluctuation reserve**
   (ii) **Statutory reserve**
   (iii) **Securities premium account**
   (iv) **General reserve**
   (v) **Foreign currency fluctuation reserve**
   (vi) **Dividend equilisation reserve**
   (vii) **Dividend redemption reserve (preference shares)**
   (viii) **Capital, redemption reserve.**

Now, the Chairman of Aadarsh Ltd. asks you as a Company Secretary to know which of the above reserves can be utilised for the proposed buy-back of shares of the company. Advise. **(4 marks)**

(b) A company wants to demerge its unrelated business to a newly formed company with a purpose of selling the demerged company. However, the company presented a scheme of arrangement/demerger before the court and fixed an ‘appointed date’ before incorporation of the new company to which unrelated business will go. The Central Government raised objection that the ‘appointed date’ (i.e., on which date all assets and liabilities will transfer to the demerged company) cannot be transferred before the incorporation of the resulting company. Is the objection of the Central Government sustainable? State your answer with case law. **(4 marks)**

(c) Regulation 22 of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 puts certain obligations upon the acquirer. At the same time, the duty of SEBI is to issue directions only. An aggrieved person applied to the court for writ of mandamus to SEBI to conduct enquiry for irregularities committed by the acquirer. Will the petitioner succeed? State with relevant case law. **(4 marks)**
(d) State government has power to impose stamp duty on transfer of properties under the order of amalgamation. Briefly comment with case law. (3 marks)

Answer 3(a)

Aadarsh Ltd., can utilize the following reserves for the proposed buy-back of shares:

(i) Investment fluctuation reserve
(ii) Securities premium account
(iii) General reserve
(iv) Foreign currency fluctuation reserve (provided it is not in the nature of provision)
(v) Dividend equalization reserve.

Answer 3(b)

Appointed date means the date for identification of assets and liabilities of existing company for transfer to new company. This identification is done on the basis of the audited balance sheet of the existing company for the financial year.

In the case of HCL Hewlett-Packard Ltd., the Central Government had raised the objection in approving of the scheme of arrangement for spin-off the company’s division with new company that the “appointed date” under the scheme for transfer of division was falling prior to incorporation of new company. The court over ruled the objection by distinguishing the “appointed date” from “effective date”. This appointed date is relevant for fixation of the share valuation/share exchange rate which the company would offer to the existing shareholders after bifurcation and spinning off of the divisions.

All the assets are sought to be transferred to the new company as were on the ‘appointed date’. The appointed date is to be distinguished from the ‘effective date’, which was the date on which all consents and approvals required under the scheme were to be obtained and transfer effected. Hence, objection that the appointed date under the scheme is falling prior to incorporation of new company is not sustainable, and the scheme was approved.

Answer 3(c)

In a similar case, the High Court of Andhra Pradesh in the case of M.V. Subramanyam v. Union of India (2001) 33 SCL-III (A.P.) considered the open offer made by Damanis and counter offer made by British American Tobacco P/c UK (BAT group) for acquisition of 20 percent of equity share capital of VST.

In this case, the petitioners sought a writ of mandamus directing SEBI to conduct investigation into statutory violations and thereby deny permission to the two acquirers to proceed with public offer. It was held that Regulation 22 dealing with general obligations of acquirer was only directory in nature and there was no merit in contention that non-adherence to time schedule would invalidate letter of offer.

It was further stated that the petitioners having failed to establish prejudice caused to shareholders in extending letters of offers or allowing acquirers to acquire would result in unforeseen circumstances, jeopardizing industrial growth or interest of shareholders,
petitioners were disentitled to seek mandamus from court. The acquirer and the persons acting in concert with him are jointly and severally responsible for fulfilment of obligations under the regulations.

Answer 3(d)

The Supreme Court has held in *Hindustan Lever v. State of Maharashtra* (2004) CLC 166 : (2004) 1 Comp LJ 148 (SC), that the amalgamation scheme sanctioned by the court would be an “Instrument”, within the meaning of Section 2(i) of the Bombay Stamp Act, 1958, which transfers the properties from the transferor company to the transferee company and the State Legislature has the legislative competence to impose stamp duty on the order of amalgamation passed by a court. Further, it was held that the word “*inter vivos*” appearing in Section 5 of the Bombay Stamp Act, in the context of Section 394 of the Companies Act would include within its meaning a transfer between two ‘juristic persons’ or a transfer in which a ‘juristic person’ is one of the parties.

Question 4

(a) What are the safeguards incorporated in the takeover process so as to ensure that shareholders get their payments under the offer/receive back their share certificates ? (4 marks)

(b) Can the Central Government amalgamate two companies in the public interest? Explain with the relevant provisions of law and process. (4 marks)

(c) What should be the minimum price for creeping acquisition ? Explain with relevant provisions of law. (4 marks)

(d) Can an acquirer withdraw the offer once made ? Give reasons. (3 marks)

Answer 4(a)

Regulation 28 requires the acquirer to open an escrow account as a security for performance of his obligations in terms of the public offer. The merchant banker is required to confirm that the financial arrangements are in place for fulfilling the obligations. The amount will be refunded or used for timely fulfilment of the obligations and forfeited if offer is not completed. This is a strong deterrent against frivolous takeover offers and secures interest of the public shareholders. The acquirer can exercise the option of tendering bank guarantee or approved securities in escrow account instead of cash. Similarly, approved securities with appropriate margins are to be deposited with the merchant banker with the authority to realize the value of such escrow account, by sale or otherwise and if any deficit occurs, the merchant banker shall be liable to make good such deficit. If the acquirer deposits cash with a scheduled bank, acquirer has to authorize the bank to act on any instructions given by merchant banker in respect of said account. SEBI has been empowered to forfeit the escrow account, either in full or in part in the event of non-fulfilment of obligations by the acquirer.

Answer 4(b)

Section 396 confers on the Central Government special power to order amalgamation of two or more companies into a single company, if the Government is satisfied that it is essential in the public interest that two or more companies should amalgamate. If the
The Central Government may exercise the power under section 396, of its own motion without any application being received from the companies wanting to amalgamate. There is no bar to the exercise of that power by the Government on such application.

The order of the Central Government under this section may provide for amalgamation of companies into a single company with such constitution, such property, powers, rights, interests, authorities and privileges; and such liabilities, duties, and obligations as may be specified in the order. The order passed by the Government must be published in the Official Gazette.

If the Government decides to order amalgamation of companies under this section, it must ensure that the following requirements are complied with in regard to the proposed order:

(a) a copy of the proposed order has been sent in draft to each of the companies concerned;
(b) the time for preferring an appeal under sub-section (3A) has expired, or where any such appeal has been preferred, the appeal has been finally disposed of; and
(c) the Central Government has considered, and made such modifications, if any, in the draft order as may seem to it desirable in the light of any suggestions and objections which may be received by it from any such company within such period as the Central Government may fix in that behalf, not being less than two months from the date on which the copy aforesaid is received by that company, or from any class of shareholders therein, or from any creditors or any class of creditors thereof. [Section 396(4)].

Copies of every order made under this section shall, as soon as may be after it has been made, be laid before both Houses of Parliament. [Section 396(5)].

**Answer 4(c)**

As per Section 20A of Substantial Acquisition of Shares and Takeovers (SAST) Regulations, 1997, an acquirer who has made a public offer and seeks to acquire further shares under sub-regulation (1) of regulation 11 shall not acquire such shares during the period of 6 months from the date of closure of the public offer at a price higher than the offer price.

**Answer 4(d)**

As per Regulation 27 of SEBI Substantial Acquisition of Shares and Takeovers (SAST) Regulations the offer once made cannot be withdrawn except in the following circumstances:

1. Statutory approval(s) required have been refused;
2. The sole acquirer being a natural person has died;
3. Such circumstances as in the opinion of the Board merits withdrawal.
Question 5

(a) Describe any three of the following:
   (i) Cross border takeover
   (ii) Demerger by agreement
   (iii) Non-performing assets
   (iv) Accounting Standard-14. 

(b) Distinguish between any two of the following:
   (i) ‘Reduction of capital’ and ‘diminution of capital’.
   (ii) ‘Split-off and ’split-up’,
   (iii) ‘Mandatory bid’ and ‘competitive bid’.

Answer 5(a)(i)

Cross border takeover

Cross border takeovers are takeovers beyond national territory. There has been a substantial increase in the quantum of funds flowing across nations in search of takeover candidates. The UK has been the most important foreign investor in the USA in recent years, with British companies making large acquisitions. With the advent of the Single Market, the European Union now represents the largest single market in the world. European as well as Japanese and American companies have sought to increase their market presence by acquisitions.

Companies go in for international acquisitions for a number of strategic or tactical reasons such as the following:

— Growth orientation: To escape small home market, to extend markets served, to achieve economy of scale.
— Access to inputs: To access raw materials to ensure consistent supply, to access technology, to access latest innovations, to access cheap and productive labour.
— Exploit unique advantages: To exploit the company’s brands, reputation, design, production and management capabilities.
— Defensive: To diversify across products and markets to reduce earnings volatility, to reduce dependence on exports, to avoid home country political and economic instability, to compete with foreign competitors in their own territory, to circumvent protective trade barriers in the host country.
— Response to client needs: To provide home country clients with service for their overseas subsidiaries, e.g. banks and accountancy firms.
— Opportunism: To exploit temporary advantages, e.g. a favourable exchange rate making foreign acquisitions cheap.

Answer 5(a)(ii)

Demerger by agreement

Demerger by agreement: A demerger may be affected by agreement where the
demerged company spins off its specific undertaking to a resulting company, formed with another name in such a manner that –

1. All the property of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the property of the resulting company by virtue of the demerger.

2. All the liabilities relatable to the said undertaking, being transferred by the demerged company, immediately before the demerger, becomes the liabilities of the resulting company by virtue of the demerger.

3. The resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportional basis.

Answer 5(a)(iii)

Non-performing assets

Non-performing assets means an asset or account of a borrower which has been classified by a bank or financial institution as sub-standard, doubtful or loss assets:

— In case such bank or financial institution is administered or regulated by an authority or body established by any law for the time being in force, in accordance with the directions or guidelines relating to assets classifications issued by such authority or body.

— In any other case, in accordance with the directions or guidelines relating to asset classifications issued by the Reserve Bank.

Answer 5(a)(iv)

Accounting Standard-14

Accounting Standard-14: ‘Accounting for Amalgamations’ lays down the accounting and disclosure requirements in respect of amalgamations of companies and the treatment of any resultant goodwill or reserves.

Accounting Standard (AS)-14 recognizes two types of amalgamation:

(a) Amalgamation in the nature of merger.

(b) Amalgamation in the nature of purchase.

Answer 5(b)(i)

‘Reduction of capital’ and ‘diminution of capital’

Reduction of Capital means reduction of issued, subscribed and paid up capital of the Company. Section 100 provides for reduction of share capital, if there is an enabling provision in the Articles of Association of the company. A company may resort to reduction of capital to restructure its capital to clean balance sheet by reducing business losses, heavy capital expenditures etc. The company need to seek confirmation of the Court to reduce its capital. There are following ways to reduce capital of the company, namely:

1. By reducing or extinguishing the liability of members in re. of uncalled or unpaid capital;
2. By paying off or returning paid up capital not wanted for the company;
3. By conditional pay off of un paid capital;
4. By combination of any of the above method;
5. By writing off or cancelling the capital lost or unrepresented by assets of the company.

In following cases diminution of Capital shall not mean reduction of capital such as

1. Cancellation of shares which have not been taken or agreed to be taken by any person under section 94(l)(e);
2. Redemption of redeemable preference shares u/s 80;

**Answer 5(b)(ii)**

**‘Split-off’ and ‘split-up’**

In a split-off, some of the shareholders in the parent company are given shares in a division of the parent company, (usually a subsidiary) which is split-off in exchange for their shares in the parent company. It alters ownership proportions in both companies. Part of subsidiaries equity shares could also be sold of to public.

A corporate action in which a single company splits into two or more separately run companies. Shares of the original company are exchanged for shares in the new companies. This is an effective way to break up a company into several independent companies. After a split-up, the original company ceases to exist.

**Answer 5(b)(iii)**

**‘Mandatory bid’ and ‘competitive bid’**

*Mandatory Bid*: SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, requires conditional bidding for acquisition of certain level of holdings. Relevant Regulations are Regulation 10, 11 and 12 of SEBI Substantial Acquisition of Shares and Takeovers (SAST) Regulations, 1997. A takeover bid is required to be made through newspaper announcement in the following cases namely: 1. acquisition of 15% or more shares or voting rights; 2. acquiring additional shares or voting rights to the extent of 5% of the voting right in any Financial year ending March 31, if such person already hold not less than 15% but not more than 55% of the shares or voting right in the company; 3. acquiring shares or voting rights along with person acting in concert to exercise more than 55% but less than 75% of the voting rights in a company; 4. acquiring control over a company.

*Competitive Bid*: According to Regulation 25 of the SAST, if any person wants to make a competitive bid, the same need to be made within 21 days of the public announcement of the offer made by the acquirer. Any competitive offer by the bidder shall be such number of shares which taken together with the shares held by person acting in concert, shall be at least equal to the holding of the first bidder.
(Answer ANY TWO questions from this part)

**Question 6**

(a) “A company is also a person in the eye of law and can be adjudged as insolvent.”
   Comment. \( \text{(5 marks)} \)

(b) Is the Registrar of Companies capable of making a petition for winding-up of a company? If so, on what grounds? \( \text{(5 marks)} \)

(c) Explain the immunities provided to a sick industrial company under the Sick Industrial Companies (Special Provisions) Act, 1985. \( \text{(5 marks)} \)

**Answer 6(a)**

As a general rule of law, a company cannot be adjudged as insolvent like a person, but a company may be wound up if the company is unable to pay its debts.

Apart from that, if the members of a company desires that the company should be dissolved or if it becomes insolvent or is otherwise unable to pay its debts or if for any reason it seems desirable that it should cease to exist, it may wound up.

Therefore, it is obvious that a company may be wound up even when it is perfectly solvent, e.g. for purpose of reconstruction. Further more, a company can never be declared as bankrupt, although it is unable to pay its debts.

**Answer 6(b)**

The Registrar may, with the previous sanction of the Central Government present a petition for winding up of a company but only on the following grounds, namely:

(i) if default is made by the company in delivering the statutory report to him or in holding a statutory meeting. It may be reiterated that on this ground no one except the Registrar or a contributory can petition:

(ii) if the company does not commence its business within one year from its incorporation or suspends its business for a whole year;

(iii) if it appears to him either from the financial condition of the company as disclosed in the balance sheet or from the report of a special auditor or an inspector that the company is unable to pay its debts;

(iv) where the Registrar is authorized by the Central Government under Section 243 to present a petition for winding up;

(v) where the number of members of the company has fallen below the statutory minimum; i.e., below seven in case of public company and below two in case of private company.

(vi) where it is just and equitable that the company be wound up.

In all these cases the Registrar has to obtain previous sanction of the Central Government to the presentation of a petition. With regard to previous sanction, the
Central Government will not grant it to the Registrar to present petition for the winding up of a company without first giving the company an opportunity to make its representation, if any.

**Answer 6(c)**

Immunities to a sick industrial company has been granted under the provisions of section 22 of the SICA, 1985.

They include the followings namely: 1. no fresh proceeding and stay of existing proceedings for the winding up or for execution, distress or the like against the company; 2. no enforcement of any security or guarantee given in relating to the sick industrial company. 3. no suit for recovery of money, stay on fresh or existing a properties of the industrial company or for appointment of receiver. Above protections/immunities are available to sick industrial company in the following circumstances namely-

1. an inquiry under section 16 is pending,
2. any scheme is referred under section 17 for preparation or consideration;
3. scheme is under implementation or
4. where an appeal is pending under section 25 of the Act.

The Sick industrial company fulfilling any of the above criterion becomes eligible for the protection, unless ordered by the BIFR otherwise. BIFR also have authority to pass an order and declare with respect to the sick industrial company that the operation of all or any contracts, awards, instruments etc shall remain suspended or that all or any rights, privileges, obligations and liabilities accruing or arising there under before the said date, shall remain suspended or shall be enforceable with such adaptations and in such a manner as may be specified by BIFR. Such declaration shall not be made for a period of two (2) years and may be extended for one (1) year at a time, for a total period of seven (7) years in aggregate. Immunities and protections have superseding effect against the provisions of, order made under and operation of the companies and other Act. However, section 22 does not grant immunity against the criminal proceedings against the company or its directors.

**Question 7**

(a) Briefly explain the mechanism for the enforcement of security interest by a secured creditor under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002. (7 marks)

(b) Briefly describe the role of professionals in the insolvency process. (4 marks)

(c) Briefly describe the insolvency or bankruptcy laws as applicable in United States of America. (4 marks)

**Answer 7(a)**

Under Section 13 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (hereinafter Securitisation Act) Secured creditor can enforce his security interest without intervention of the court. Secured creditors have been defined to mean banks or financial Institutions or any consortium or group of
banks or financial institutions and includes debenture trustees appointed by any bank or financial institution or securitisation company or reconstruction company or any other trustee holding security on behalf of bank or financial institution in whose favour due interest has been created for repayment by any borrower of any financial assistance. In case of the default in instalment by the borrower and debts becoming Non-performing Asset (NPA), Secured creditor has two options. It can, after giving opportunity to repay debts with interest and other charges, either transfer the assets to a securitisation or reconstruction company or exercise the powers under the Act. Section 13(4) prescribes the recourses, which secured creditor can invoke namely:

1. take possession of the secured assets of the borrower including right to transfer by way of lease, assignment, or sale for realizing the debts;
2. takeover the management of secured assets of the borrower including right to transfer by way of lease, assignment or sale;
3. appoint any person to manage the secured assets;
4. recover any actionable claims of the borrower for recovery of secured debts.

In case of joint or multiple lending arrangements, 75% of the secured creditors need to agree for the initiation of the aforesaid proceedings. In case of a company under liquidation, secured creditor either participate in the proceeding and recover after overriding preferential payment of workers or he may opt for retention of the sale proceed after depositing the workers dues under section 529A. In case, dues of the secured creditors could not be satisfied in full, secured creditor may file application before Debt Recovery Tribunal (DRT) for recovery of balance amount. Secured creditor is also entitled to proceed against the guarantor or sale of pledge assets for its recovery.

Answer 7(b)

The concept of insolvency practitioners was recommended by the Irani Committee. Currently the law does not support effective participation of professionals and experts in the insolvency process. Disciplines of chartered accountancy, company secretaryship, cost and work accountancy, law etc. can act as feeder streams, proving high quality professional for this new activity.

In fact private professionals can play a meaningful role in all aspects of process. Insolvency practice can also open up a new field of activity for service professionals while improving the quality of intervention at all levels during rehabilitation/ winding up/ liquidation proceedings. Law should encourage and recognize the concept of Insolvency Practitioners, Greater responsibility and authority should be given to them under the supervision of the Tribunal to maximize resource use and application of skills.

The committee observed that by incorporating this recommendation, there would be a revolutionary change in the Indian Insolvency System by bringing it at par with the international standards and provide opportunities to participate and perform various roles in the insolvency process.

Answer 7(c)

The US has parallel system of insolvency/bankruptcy laws, one at federal level and another at state level. Federal Law (Bankruptcy code) prohibits domestic or foreign
insurance companies, banks, saving/loan associations, small business investment companies and similar insured institutions from filing their bankruptcy application. Consequently, they can file their application under the concerned State Law. Bankruptcy code establishes mainly two types of cases namely:

1. liquidation or straight bankruptcy;
2. reorganisation or rehabilitative cases.

Under liquidation, a trustee is automatically appointed by the office of the US Trustee. However, in reorganisation cases, debtor remains in possession of the business and manages its affairs as it did prior to filing of bankruptcy. A plan of reorganisation may be confirmed by the Bankruptcy court, subject to certain conditions/exception, in the following cases namely:

When creditors or equity holders of each class accept the plan by two third in value of the claim/equity and half of the claims/equity interest in number, or when at least one impaired class votes in favour of the plan and the plan is fair and equitable with respect to the remaining classes.

**Question 8**

(a) Though UNCITRAL Model Law is not a substantive law, yet it recommends protection to creditors and other interested persons. Briefly describe the protections provided under the UNCITRAL Model Law. (4 marks)

(b) Main object of ‘asset reconstruction company’ (ARC) is to act as an agent for banks and financial institutions. Briefly explain with relevant provisions of law. (4 marks)

(c) Can a company make winding-up petition? If so, what is the procedure of making petition for winding-up? (4 marks)

(d) Define ‘securitisation’ and explain its motives. (3 marks)

**Answer 8(a)**

UNCITRAL Model Law (hereinafter “the Model Law”) in its preamble mention that objects of the Model Law is not to create substantive rights but to give general orientation for users of the Model Law and to provide effective mechanism to deal with cross border insolvency. Model Law contains following provisions for protection of the creditors, the debtors and other affected persons:

1. temporary relief upon application for recognition of a foreign proceeding or upon recognition, which is at the discretion of the Court, on being satisfied that interest of the creditors and other interested persons are adequately protected;
2. the court may grant relief subject to the conditions, as it thinks fit;
3. the Court may modify or terminate the relief granted, if so requested by a person affected thereby.

Model Law further provides that in case of actions are manifestly contrary to the public policy of the enacting state, the court may refuse taking any action under the Model Law.
**Answer 8(b)**

Reconstruction company means a company incorporated under provisions of Companies Act, 1956 for purpose of assets reconstruction.

The problem of non-performing loans created due to systematic banking crisis world over has become acute. Focused measures to help the banking systems to realise its NPAs has resulted into creation of specialised bodies called asset management companies which in India have been named asset reconstruction companies (‘ARCs’). The buying of impaired assets from banks or financial institutions by ARCs will make their balance sheets cleaner and they will be able to use their time, energy and funds for development of their business. ARCs may be able to mix up their assets, both good and bad, in such a manner to make them saleable.

The main objective of asset reconstruction company (‘ARC’) is to act as agent for any bank or financial institution for the purpose of recovering their dues from the borrowers on payment of fees or charges, to act as manager of the borrowers’ asset taken over by banks, or financial institution, to act as the receiver of properties of any bank or financial institution and to carry on such ancillary or incidental business with the prior approval of Reserve Bank wherever necessary. If an ARC carries on any business other than the business of asset reconstruction or securitisation or the business mentioned above, it shall cease to carry on any such business within one year of doing such other business.

**Answer 8(c)**

**Winding up Petition by Company**

The company may make a petition through its directors with the authority of a special resolution passed at a general meeting. It may also, apply to liquidator if it is being wound up voluntarily. The directors may, on their authority present a petition on behalf of the company. However, when the ground for winding up is that the company has passed special resolution, the petition must be presented by the company itself.

**Answer 8(d)**

“Securitization” means acquisition of financial assets by any securitization company or reconstruction company from any originator, whether by raising of funds by such securitization company or reconstruction company from qualified institutional buyers by issue of security receipts representing undivided interest in such financial assets or otherwise [Section 2(1)(Z)]. Securitization company means any company formed and registered under the Companies Act, 1956 for the purpose of securitization [Section 2(l)(Za)].

Securitization is the issuance of marketable securities backed not by the expected capacity to repay of a private corporation of public sector entity but by the expected cash flows from specific assets.

Simply stating securitization is the process by which the ‘originators’ of assets like loans which are illiquid are able to transfer such assets to a ‘special purpose vehicle (SPV), which in turn, issues tradable liquid securities to the investors. These transactions can be structures with a wide variety of ‘credit enhancement’ to make the deals attractive for investors.
There are two motives for securitization. One the securitized assets go off the balance sheet of the originator and so the asset base is pruned down to that extent thereby reducing the regulatory capital requirements to support the assets. Second, the asset portfolio is liquidated, releasing cash which in turn reduces the need for demand and time liabilities that are subject to statutory reserves.
These answers have been written by competent persons and the Institute hopes that the **GUIDELINE ANSWERS** will assist the students in preparing for the Institute's examinations. It is, however, to be noted that the answers are to be treated as model answers and not as exhaustive and the Institute is not in any way responsible for the correctness or otherwise of the answers compiled and published herein.

The Guideline Answers contain the information based on the Laws/Rules applicable at the time of preparation. However, students are expected to be well versed with the amendments in the Laws/Rules made upto **six** months prior to the date of examination.

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PROFESSIONAL PROGRAMME

UPDATING SLIP

STRATEGIC MANAGEMENT, ALLIANCES AND INTERNATIONAL TRADE

MODULE – III – PAPER 1

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<td></td>
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<td>(iii) The levy of Gift Tax has been suspended w.e.f. 1st October, 1998 by insertion of clause (3) to Section 3 of Gift Tax Act, 1958 by Finance (No.2) Act, 1998. Therefore, Gift Tax Act has been excluded from the scope of examination unless otherwise informed.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>The questions based on case laws, in conflict with the latest law be treated as of academic interest only.</td>
</tr>
</tbody>
</table>
Question 1
(a) In the context of strategic management, discuss, with reasons in brief, any five of the following statements:

(i) Napoleon used to say, “It is all in the execution”.

(ii) There is often a fight to finish in the modern business world. Individual units and companies either die (fold up) or get ‘eaten up’ (acquired, etc.) while in animal world, once a contestant accepts defeat, he is left to lick his wounds alone.

(iii) Strategic management is a term broader than strategy itself.

(iv) There are no foreign lands. It is the traveller only who is foreign.

(v) A company faced with decline in fortunes has only one option of adopting liquidation strategy.

(vi) Benchmarking is the break-in-process of measuring products, services and practices against the competitors and companies recognised as industry leaders. (2 marks each)

(b) Write notes on the following:

(i) Stability strategies

(ii) Decision support system (DSS). (5 marks each)

Answer 1(a)

(i) In the context of strategic management, execution or implementation is really important. Strategies, by themselves, do not lead to action. It is implementation that translates intents into action. In simple words, one can have a great plan, but unless it’s implemented properly, it won’t lead to the desired result. Therefore, in order to achieve the desired objectives, execution is everything.

(ii) Firms compete not merely because they have to survive, but because they wish to acquire good things such as money, wealth, and power—well beyond what they need for survival and provisioning.

(iii) Strategic management is a process that includes top management’s analysis of the environment in which the organization operates prior to formulating a strategy, as well as the plan for implementation and control of strategy. Strategy is defined
as a long-term course of action through which an organization relates itself the environment so as to achieve its objectives whereas strategic management combines the activities of the various functional areas of a business to achieve organizational objectives. It is the highest level of managerial activity, usually formulated by the Board of directors and performed by the organization’s Chief Executive Officer (CEO) and his executive team. Strategic management provides overall direction to the enterprise.

(iv) Every country has its own cultural, administrative (political), geographical and economic (CAGE) environments. And, a foreigner, brought up in a different CAGE feels stranger to the values and the practices of the land.

(v) If the organization chooses to focus on ways and means to reverse the process of decline, it adopts turnaround strategy. If it cuts off the loss-making units, divisions or Strategic Business Units, curtails its product line or reduces the functions performed, it adopts a divestment strategy. If none of these actions work, then it may choose to abandon the activities totally, resulting a liquidation strategy.

(vi) Benchmarking is the continuous process of measuring products, services and practices against the competitors and those companies recognized as industry leaders. It is based on the concept that it makes no benefit to reinvent something that someone else is already using. It involves open learning how others do something better than one’s own company so that one not only can intimate, but perhaps even improve on their current technique.

Answer 1(b)(i)

Stability Strategy

A Stability Strategy arises out of a basic recognition by management that the firm should concentrate on utilizing its present resources so as to develop its competitive strength within a restricted product-market configuration. In other words, stability strategy implies that the company will continue in the same or a similar business as it now pursues, and with the same or similar objectives. This is not to be misunderstood as a ‘do-nothing’ strategy. For, stability strategy also implies focusing on improvements of functional performance and maintaining the level of achievements as in the immediate past. If the company had sales revenue or net earnings increasing at a certain rate per annum, it is required that the same performance should be evidenced in the years to come.

The distinctive elements of a stability strategy are:

(i) There is no major change in the product or service line, markets or functions;
(ii) The focus is on maintaining and developing competitive advantages, consistent with the present resources and market requirements;
(iii) The policy thrust is aimed at not only the maintenance of the present level of performance but also to ensure that the rate of improvement continuing in the past is sustained.

Usually followed by small and medium-sized organizations, these strategies can be useful in the short run when such organizations are satisfied with their current performance.
Stability strategies can be of various types. They are as follows:

(i) No change strategy
(ii) Profit Strategy
(iii) Pause-Proceed- with-Caution strategy

Answer 1(b)(ii)

Decision Support System (DSS)

A decision support system is an information system application which assists decision making. DSS tend to be used in planning, analyzing alternatives and trial and error search for solutions. They are generally operated through terminal based interactive dialogues with users. They incorporate a variety of decision models.

In other words, decision support system is a computer system that combines data, analytical tools, user-friendly software to support decision-making at the management level. DSS are slightly focused on a specific decision of classes of decision such as routing, querying, on three basic parameters which are given below:

(i) Philosophy : DSS provides integrated analytical tools, data, model base (a collection of mathematical and analytical models), and a interface to the user in the form of a user friendly software.
(ii) System Analysis : DSS establish what tools are used to incorporate the decision making process of an organization.
(iii) Design : The design of DSS is based on iterative process and keep on changing with every feedback of the user.

A DSS is required to possess the following core capabilities:

(i) Representations : It includes the presentation of the information in the form of graphs, charts, lists, reports, formatted reports, symbols etc.
(ii) Operations : It includes logical and mathematical manipulation of data.
(iii) Memory Aids : It also provides updation of databases and memory, viewing of data, work spaces, libraries etc.
(iv) Control Aids : It provides the facility to user to control the activity of DSS. It includes a language permitting user control of operations, representations and memory.

Question 2

(a) Discuss the constraints that exist in operating a ‘management information system’ (MIS). (8 marks)

(b) “McKinsey framework shows that there is a multiplicity of factors that influence an organisation’s ability to change.” Discuss. (8 marks)

(c) “The function of the internal control is to enable the adopted plan to operate efficiently, profitably and economically.” Comment. (4 marks)
Management Information System:

The main purpose of MIS is to provide timely, specific and accurate information at all levels in an organization. To achieve this goal, different types of information systems are devised by the organizations. The MIS is derived from these information systems used in the organizations.

MIS refers broadly to a computer-based system that provides managers with the tools for organizing, evaluating and efficiently running their departments.

Constraints in operating a Management Information System (MIS)

Major constraints which come in the way of operating an information system are:

1. Non-availability of experts, who can diagnose fully the objectives of the organization and give a desired direction needed for operating information system.

2. Difficulty usually faced by experts, in selecting the sub-systems of MIS, to be designed and operated upon first.

3. Source of availability of experts for running MIS effectively, is not always known to management.

4. Due to varied objectives of business concerns, the approach adopted by experts for designing and implementing MIS is non-standardized one.

5. Non-availability of co-operation from staff.

6. Non-availability of heavy financial resources required for running the MIS effectively.

7. Turnover of experts is quite high.

8. It is difficult to quantify the benefits of MIS, so that it can be easily comparable with cost.

9. Perceptual problems as its utility are not readily perceptible by many users.

Answer 2(b)

McKinsey framework shows that there is a multiplicity of factors which influence an organization’s ability to change is correct. McKinsey developed the 7-S framework management model which organize seven factors to organize a company in an holistic and effective way with the objective to diagnose the causes of organization problem and formulate program for improvement due to the implementation of the strategy which are associated with change in the organization.

The framework rests on the proposition that effective organizational change is best understood in terms of the complex relationship between strategy, structure, systems,
style, skills, staff and shared values (super ordinate goals)- the seven S’s. The relationship is diagrammatically presented as follows:

**McKinsey 7 Framework**

The above framework shows that there is a multiplicity of factors which influence an organization’s ability to change and understand as to how the 7-S model mechanism works. In general terms, the proposition of the 7-S model suggests that there are multiple factors which influence an organization’s ability to change and its proper mode of change. Since the variables are interconnected, significant progress cannot be made in one area unless corresponding progress is made in other areas too. It is imperative to know what each ‘S’ means and what is its implication. The 3S’s across the top of the model are described as Hard S’s and 4S’s across the bottom of the model are less tangible, more cultural in nature and some time neglected in major change efforts and mergers and were termed as soft Ss by McKinsey.

Shared values will be in the center surrounded by other factors that influence the organization’s ability to change and understand as to how the 7-S model mechanism works. It combines rational and hard elements into emotional and soft elements and thereby helps guide organizational change.

**Answer 2(c)**

**Internal Control**

Internal control refers to the whole of measures taken, procedures introduced and methods established in an organization for obtaining timely information about the orderly conduct of the business to achieve the organizational objectives. Internal control can be described as any action taken by an organization to help enhance the likelihood that the
objectives of the organization will be achieved. The measures, procedures and methods as whole are referred as internal controls.

The function of the internal control is to enable the adopted plan to operate efficiently, profitably and economically so that:

(i) Duties and responsibilities for operations to individual employees are assigned to achieve the established policy of the company.

(ii) Feed back to the management of the results periodically, particularly in regard to abnormal or unusual situations both favourable and unfavourable and deviation from the standards.

(iii) To safeguard the interest of the company against fraud, waste and loss of efficiency or carelessness, fire, accident, theft, etc.

(iv) To promote efficiency of personnel and operations.

(v) To lay and circumscribe the definite units for performance of duties.

(vi) To establish and circumscribe the definite limits within which the internal routines of the business must be conducted. The individual who violates the limits will have to explain and justify his action.

**Question 3**

*Distinguish between any four of the following:*

(i) ‘Corporate strategies’ and ‘business strategies’.

(ii) ‘Market value added concept’ and ‘economic value added concept’.

(iii) ‘Vision’ and ‘mission’.

(iv) ‘Internal audit’ and ‘internal check’.

(v) ‘Market risk’ and ‘business risk’.  

*Answer 3(i)*

**Distinction between Corporate Strategies and Business Strategies**

The main points of distinction between the two are:

<table>
<thead>
<tr>
<th>Sl. No</th>
<th>Basis</th>
<th>Corporate Strategies</th>
<th>Business strategies</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Decision</td>
<td>It is decided by the top management team in consultation with the Board of Directors</td>
<td>It is decided by the business unit managers in consultation with the top management team</td>
</tr>
<tr>
<td>2</td>
<td>Objectives</td>
<td>Shareholders return, economic profit, growth, net income, income diversity, synergy, corporate citizenship</td>
<td>Growth, Economic profit, quality, market share, employee development, productivity, knowledge generation.</td>
</tr>
</tbody>
</table>
Scope
An overarching plan of action covering various functions, performed by different SBUs; deals with the objective of the company, allocation of resources and coordination of the SBUs for optimal performance.

Types
Its various types are: Expansion (concentration, integration and diversification), stability, retrenchment and combination strategies.

Answer 3(ii)
Distinction between Market Value Added and Economic Value Added

The main points of distinction between the two are:

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Market Value Added</th>
<th>Economic Value Added</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>It is difference between current market value of a firm and the capital contributed by investors</td>
<td>It is the net earnings in excess of cost of capital employed.</td>
</tr>
<tr>
<td>2</td>
<td>Value is the estimated amount at which it can be exchanged</td>
<td>It is the return firm is said to have earned over a period of time.</td>
</tr>
<tr>
<td>3</td>
<td>Value is the estimated amount at which it can be exchanged</td>
<td>It is the return firm is said to have earned over a period of time.</td>
</tr>
<tr>
<td>4</td>
<td>It is market centric</td>
<td>It is business centric</td>
</tr>
<tr>
<td>5</td>
<td>MVA is the real wealth that is available right now for total investment</td>
<td>This has nothing to do with the price business can be sold or exchanged at</td>
</tr>
<tr>
<td>6</td>
<td>The higher the MVA better it is.</td>
<td>It should ideally be positive.</td>
</tr>
</tbody>
</table>
Answer 3(iii)

**Distinction between Vision and Mission**

The main points of distinction between the two are:

<table>
<thead>
<tr>
<th>Sl. No</th>
<th>Vision</th>
<th>Mission</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Vision is the mental perception of the kind of environment that the organization strives to achieve in the long run.</td>
<td>It is the general statement that distinguishes the organization from all others</td>
</tr>
<tr>
<td>2</td>
<td>A vision statement concentrates on future and should answer, “What we want to become?”.</td>
<td>It addresses the basic purpose of the firm and the reasons for which it exists. It answers the question, “What is our business?”</td>
</tr>
<tr>
<td>3</td>
<td>It provides clear decision making criteria.</td>
<td>A clear mission statement is essential for effectively establishing objectives and formulating strategies.</td>
</tr>
<tr>
<td>4</td>
<td>It relates to an organization’s broadest and most desirable goal.</td>
<td>It is the guiding principle that drives the processes of goal and action plan formulation.</td>
</tr>
</tbody>
</table>

Answer 3(iv)

**Distinction between Internal Check and Internal Audit**

The main points of distinction between the two are:

<table>
<thead>
<tr>
<th>Sl. No</th>
<th>Internal Check</th>
<th>Internal Audit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>It is an arrangement of duties allocated in such a way that the work of one person is automatically checked by another.</td>
<td>It is an independent review of operations and records.</td>
</tr>
<tr>
<td>2</td>
<td>There is no special staff to carry-out the system of internal check. It represents the arrangements of duties of the staff in a particular manner.</td>
<td>For carrying out internal audit, normally separate staff is engaged specially for the purpose.</td>
</tr>
<tr>
<td>3</td>
<td>The objective of internal check is to reduce the errors and frauds.</td>
<td>The objective of internal audit is to discover the errors and frauds, if any.</td>
</tr>
<tr>
<td>4</td>
<td>It represents a process under which the work goes on uninterrupted and checking too is more or less automatic.</td>
<td>The internal auditor has to see as to how far the work is correct and done according to the specified rules.</td>
</tr>
</tbody>
</table>
Answer 3(v)

**Distinction between Market Risk and Business Risk**

The main points of distinction between the two are:

<table>
<thead>
<tr>
<th>Sl. No</th>
<th>Market Risk</th>
<th>Business Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>This risk is also called the un-diversifying risks and cannot be avoided no matter how many different stocks be present in the portfolio.</td>
<td>It refers to the situation of uncertainty associated with operating cash flow of a business.</td>
</tr>
<tr>
<td>2</td>
<td>Market risk is the day-to-day fluctuations in a stock's price.</td>
<td>Business risk does not fluctuate on the basis of prices of securities</td>
</tr>
<tr>
<td>3</td>
<td>Factors affecting it are equity price movement; interest rate, currency fluctuation, commodity prices and credit</td>
<td>Factors affecting it are raw material and end product pricing, credit availability and interest rates, pure risk—competition and imports/exports labor unrest etc.</td>
</tr>
</tbody>
</table>

**PART B**

*(Answer ANY ONE question from this part)*

**Question 4**

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

*Tata Tea and PepsiCo appear to have agreed in-principle to set-up a joint venture (JV) for non-carbonated, health and wellness beverages to explore the low cost, bottom of pyramid segment beverages. The JV is considering leveraging the Tata brand and expertise in low-cost consumer products and coupling it with PepsiCo’s distribution muscle, go-to-market expertise and R&D strength in beverages. The proposed JV may consider wellness packaged water initially followed by other beverages. The JV’s focus on the lower end of the market will ensure that PepsiCo’s existing alliance with Hindustan Unilever to sell Lipton ice tea, which focuses on mid-to-premium segment, will not be impacted. The new tie-up will give PepsiCo the opportunity to be perceived as a wholesome beverages company making fizzy drinks. Tata Tea will get a larger foothold in the wellness beverages segment after an earlier attempt to foray in the category had to be aborted within a year. Tata Tea, through its indirect UK subsidiary, Tata Tea (GB) Investments, has picked up 30% stake in the US based maker of vitamin water ‘Glaceau’ in mid 2006 for $677 million. But in 2007, Tata Tea had to sell off its 30% stake in Energy Brands Inc., which owns Glaceau—to beverage giant Coca-cola for $1.2 billion, less than a year after it acquired the stake. Though, Tata Tea has been aggressive in acquiring companies in the beverages sector including Tetley, Eight O’clock Coffee and Good Earth, its wellness and health beverages portfolio in India so far is limited to Himalayan packaged water and Ti’ON, an energy drink made from fruit juice and tea extracts. Ti’ON is not a national brand yet. It is also important to note that PepsiCo’s partnership with Hindustan Unilever*
for distributing Lipton iced tea in India did not take off in the way both companies expected to. Tata Tea and PepsiCo have said, “The proposed joint venture, is not intended to conflict with any existing arrangements of either party.” Though, Rs. 7,000 crore aerated soft drink market has been growing at a healthy 20% plus in India, PepsiCo has been expanding its portfolio in the health and wellness space aggressively globally as well as in the domestic market, in line with its ambition of being a global leader in the ‘good for you’ beverages segment.

PepsiCo’s existing health and wellness brands include packaged water Acquafina, Tropicana juices, Nimbooz nimbu pani and sports drink Gatorade.

Questions —

(i) Is joint venture the only way to enter into strategic alliance?

(ii) Alliances are not new, but in the competitive landscape, distinguishing features are emerging. Identify these features.

(iii) Is strategic alliance different from merger and when does an alliance become a merger?

(iv) What reasons can you anticipate that Tatas had to sell Glaceau to Coca-Cola within such a short time? (5 marks each)

Answer 4(i)

No, joint venture is not only a way to enter into a strategic alliance. Apart from joint venture, Strategic alliances may be in the form of –

— Management contract.
— Franchising
— Supply or purchase agreement
— Marketing and distribution agreement
— Agreement to provide technical services
— Licensing of know-how, technology, design, patent, etc.

Answer 4(ii)

All alliances involve some measure of inter-corporate integration. In the new emerging competitive environment the companies are finding innovative ways of alliances with features meeting their requirements. Trading alliances are only a bit more complicated than traditional buy-sell relationship. Normally the objectives of such trading alliances include the need to secure supplies of product, buy or exchange skills/technology and exploit market networks. The main features of such alliance are management at arm’s length, implementation at a fast pace, exclusivity, limited time frames with options to renew based on certain well-defined milestones.

On the other hand, partnerships involving an integration of business resources can take the form of functional alliances. Functional alliances are usually joint ventures or equity-based partnerships. They are characterised by management integration, open-ended collaboration, separate joint-venture entity and long-term commitment.
Any arrangement or agreement under which two or more firms cooperate in order to achieve certain commercial objectives is referred to as strategic alliance. A true strategic alliance is a written arrangement between two companies that complement each other in a particular identified area. It is not a partnership, and neither company has legal power to control or obligate the other. Instead, it is a commitment by the two companies to provide capabilities or cross servicing in certain identified areas.

In merger, one of the two existing companies merges its identity into another existing company or one of more existing companies may form a new company and merge their identities into the new company by transferring their business and undertakings including all other assets and liabilities to the new company.

Alliances between companies have become a crucial weapon in the battle for competitive advantage. Mergers/acquisitions/strategic alliance can be termed as coalescing and are becoming more and more popular. A “strategic alliance” is an excellent vehicle for two companies to work together profitably. As the alliance is developing, there is every chances that both the party will finally merge all their operations.

The reasons for Tata to sell Glaceau to Coca-Cola within short time might have been as under:

— Tata were to make some other acquisition abroad and they needed funds for the same.
— Tatas wanted to make quick money
— There might have been cross cultural differences
— Failure to eradicate competitive rivalry
— Complex structure and process
— Size of the organization
— Organizational age
— Dissimilarities scope of management

(a) Discuss the procedure for foreign direct investment in India. (8 marks)
(b) Discuss the problems associated with technology transfer agreements. (8 marks)
(c) State the categories for which government approval through Foreign Investment Promotion Board (FIPB) route is necessary. (4 marks)

Procedure for Foreign Direct Investment are as under

— Foreign Direct Investment in India is governed by FDI Policy issued by the Government of India and Foreign Exchange Management Act, 1999 and Rules and Regulation made thereunder.
— Foreign Direct Investments (FDI) can be made under two routes—Automatic Route and Government Route.

— RBI has given permission to Indian Companies to accept investment under automatic route without obtaining prior approval from Reserve Bank of India. However, investors will have to file the required document with the concerned Regional Office of the RBI within 30 days after issue of shares to foreign investors.

— Under the Government Route,

(i) The Minister of Finance who is in-charge of FIPB would consider the recommendations of FIPB on proposals with total foreign equity inflow of and below Rs.1200 crore.

(ii) The recommendations of FIPB on proposals with total foreign equity inflow of more than Rs. 1200 crore would be placed for consideration of Cabinet Committee on Economic Affairs (CCEA). The FIPB Secretariat in DEA will process the recommendations of FIPB to obtain the approval of Minister of Finance and CCEA.

(iii) The CCEA would also consider the proposals which may be referred to it by the FIPB/ the Minister of Finance (in-charge of FIPB).

— Companies may not require fresh prior approval of the Government i.e. Minister in-charge of FIPB/CCEA for bringing in additional foreign investment into the same entity, in the following cases:

(i) Cases of entities whose activities had earlier required prior approval of FIPB/ Cabinet Committee on Foreign Investment (CCFI)/CCEA and who had, accordingly, earlier obtained prior approval of FIPB/CCFI/CCEA for their initial foreign investment but subsequently such activities/sectors have been placed under automatic route;

(ii) Cases of entities whose activities had sectoral caps earlier and who had, accordingly, earlier obtained prior approval of FIPB/CCFI/CCEA for their initial foreign investment but subsequently such caps were removed/increased and the activities placed under the automatic route; provided that such additional investment alongwith the initial/original investment does not exceed the sectoral caps; and

(iii) The cases of additional foreign investment into the same entity where prior approval of FIPB/CCFI/CCEA had been obtained earlier for the initial/original foreign investment due to requirements of Press Note 18/1998 or Press Note 1 of 2005 and prior approval of the Government under the FDI policy is not required for any other reason/purpose.

Answer 5(b)

The problems associated with technology transfer agreements are as under:

— Identification of the required level of technology. For this purpose, the recipient may have to depend on the information, product bulletin supplied by the technology supplier company.

— No technology supplier will transfer the technology being used by him. Rather,
he may prefer to provide the second level of technology which has already been exploited by him.

— After identification, defining technology transfer in the agreement poses certain practical difficulties. Technology cannot be transferred in one lot through transfer of documents. This may have to be done through transfer of designs and drawings, supply of additions and improvements made by the technology supplier, providing the services of its experts and for training of Indian staff at the works of the technology supplier etc.

— The most difficult task in an imported technology is its indigenisation. While the technology supplier desires the recipient company to achieve the same level of quality to be able to compete in the National and Inter-national markets, the achievement of this goal bristles with practical difficulties.

— The nature of technology transferred for the purposes of manufacture and sale poses another problem.

— Technological support of an umbrella type is the emerging scenario in these days of inter-nationalisation of business and this provides technology transfer on a continuous basis.

— Long term business relationship can be built up provided that the technology supplier has a stake in the technology recipient company.

**Answer 5(c)**

Major Categories for which government approval through Foreign Investment Promotion Board (FIPB) is necessary, are as under:

— Defence Industries
— Terrestrial Broadcasting FM (FM Radio)
— Cable network
— Direct to Home Broadcasting
— Print Media
— Security Agency in Private Sector
— Banking- Public Sector
— Commodity Exchange
— Credit Information Companies
— Infrastructure Companies in Securities market.

**PART C**

_(Answer ANY TWO questions from this part)_

**Question 6**

*The South Asian Association for Regional Co-operation (SAARC) comprises Bangladesh, Bhutan, India, The Maldives, Nepal, Pakistan and Sri Lanka. The main goal of the association is to accelerate the process of economic and social development in member States, through joint action in the agreed areas of co-operation.*
The idea of regional co-operation in South Asia was first mooted in November, 1980. After consultations, the Foreign Secretaries met in Colombo in April, 1981, which was followed by the meeting of the Committee of the Whole, which identified five broad areas for regional co-operation. The Foreign Ministers at their first meeting in New Delhi in August, 1983 formally launched the Integrated Programme of Action through the adoption of the Declaration of South Asian Regional Co-operation. At the first Summit in Dhaka on 7-8 December, 1985, the charter establishing the SAARC was adopted.

Answer the following questions:
(i) What are the objectives of SAARC?
(ii) Discuss the institutional structure of SAARC.
(iii) Explain the role of SAARC Chamber of Commerce and Industry.
(iv) “SAARC has miserably failed to perform and fulfill its objectives, but it must succeed.” Comment. (5 marks each)

Answer 6(i)

The objectives of the SAARC are as follows:
— To promote the welfare of the peoples of South Asia and to improve their quality of life;
— To accelerate economic growth, social progress and cultural development in the region and to provide all individuals the opportunity to live in dignity and to realise their full potentials;
— To promote and strengthen collective self-reliance among the countries of South Asia;
— To contribute to mutual trust, understanding and appreciation of one another’s problems;
— To promote active collaboration and mutual assistance in the economic, social, cultural, technical and scientific fields;
— To strengthen cooperation with other developing countries;
— To strengthen cooperation among themselves in international forums on matters of common interests; and
— To cooperate with international and regional organizations with similar aims and purposes.

Answer 6(ii)

Institutional structure of SAARC

Summits
The highest authority of the Association rests with the Heads of State or Government.

Council of Ministers
Comprising of the Foreign Ministers of member states is responsible for the formulation of policies; reviewing progress; deciding on new areas of cooperation; establishing additional mechanisms as deemed necessary.
Standing Committee

Comprising of the Foreign Secretaries of member states is entrusted with the overall monitoring and coordination of programmes and the modalities of financing; determining inter-sectoral priorities; mobilising regional and external resources; and identifying new areas of cooperation based on appropriate studies.

Programming Committee

Comprising of the senior officials meets prior to the Standing Committee sessions to scrutinize Secretariat Budget, finalise the Calendar of Activities and take up any other matter assigned to it by the Standing Committee.

Technical Committees

Comprising of representatives of member states, formulates programmes and prepare projects in their respective fields. They are responsible for monitoring the implementation of such activities and report to the Standing Committee.

Action Committees

According to the SAARC Charter, there is a provision for Action Committees comprising member states concerned with implementation of projects involving more than two, but not all member states.

SAARC Secretariat

SAARC Secretariat is in Kathmandu and is responsible for coordinating and monitoring the implementation of SAARC activities, servicing the meetings of the Association and serving as the channel of communication between SAARC and other international organizations. The Secretariat comprises of the Secretary-General, a Director from each member state and the General Services Staff.

Answer 6(iii)

Role of SAARC Chamber of Commerce and Industry (SCCI) are as under:

— To act as a dynamic instrument of promoting regional cooperation in the areas of trade and economic relations.

— Instrumental in disseminating the information about the content, scope, and potential of the Framework Agreement on SAARC Preferential Trading Arrangement (SAPTA) among the business community in the region.

— To organise various National Seminars on SAPTA in the Member Countries.

— To visit various countries for expanding the exports from the SAARC region.

— To expand activities in the field of promoting trade both within and outside the SAARC region.

Answer 6(iv)

SAARC have achieved a number of important milestones during twenty five years of its existence. The scope and substance of cooperation have expanded to diverse fields, providing a firm basis for genuine partnership. However, number initiatives could not be
translated into meaningful and tangible benefits to the people. SAARC therefore, highlights the need for more efficient, focused, time-bound and people-centric activities and calls for appropriate reflection of all the SAARC decisions into the national policies and programmes of Member States. There is need to make SAARC a truly action oriented by fulfilling commitments, implementing declarations and decisions and operationalizing instruments and living up to the hopes and aspirations of one fifth of humanity.

Greater focus is needed to pursue people-centric development with due emphasis on socio-cultural progress, upholding traditions, values preservation of environment and better governance. At the 16th SAARC Summit held in April 2010, the leaders emphasized the need to strengthen the role of private sector in regional initiatives, concrete measure to improve trade facilitation and cooperation in the field of education. The need for promotion of tourism to enhance people to people contract by creating tourism friendly environment has also been emphasized. With these proposed initiative the SAARC is bound to succeed.

Question 7

(a) State, with reasons in brief, whether the following statements are true or false:

(i) The Harmonised Code for custom classification, custom valuation and rules of origin are the three basic custom laws.

(ii) Safeguard measures and anti-dumping actions and countervailing duties are one and the same.

(iii) Regional trade agreements are entered into only between neighbouring countries.

(iv) Trade policy mechanism has no utility. (2 marks each)

(b) Write notes on the following: (i) Limitations of dispute settlement procedure mechanism under the WTO. (ii) Role of Director General of the WTO. (6 marks each)

Answer 7(a)(i)

True

Three basic custom laws are:

— Harmonised Code of custom classification.
— Custom valuation.
— Rules of origin.

Answer 7(a)(ii)

False

Safeguard measures are applied to all imports of the product in question irrespective of the countries in which it originates or from which it is exported. This aspect distinguishes Safeguards from anti dumping and anti subsidy measures which are always country specific and exporter specific. Safeguards are applied in the form of either safeguard duty or in the form of safeguard Quantities Restrictions (import licenses). These measures
are administered in India by an Authority called Director General (Safeguards) who functions under the jurisdiction of the Department of Revenue, Ministry of Finance.

Anti dumping and anti subsidies & countervailing measures in India are administered by the Directorate General of Anti dumping and Allied Duties (DGAD) functioning under the Dept. of Commerce in the Ministry of Commerce and Industry.

Answer 7(a)(iii)
False

In the WTO context, regional trade agreements (RTAs) have both a more general and a more specific meaning: more general, because RTAs may be agreements concluded between countries not necessarily belonging to the same geographical region; more specific, because the WTO provisions relates specifically to conditions of preferential trade liberalization with RTAs.

Answer 7(a)(iv)
False

Individuals and companies involved in trade have to know as much as possible about the conditions of trade. It is therefore fundamentally important that regulations and policies are transparent. In the WTO, this is achieved in two ways: governments have to inform the WTO and fellow- members of specific measures, policies or laws through regular “notifications”; and the WTO conducts regular reviews of individual countries’ trade policies — the trade policy reviews. Therefore, trade policy mechanism has utility as it provide trading partners a predictable environment.

Answer 7(b)(i)
Limitations of dispute settlement procedure mechanism under the WTO may be summarized as under —

— The panel process is required to be more transparent to build confidence.
— Confusion apparently still exists as to the panel's function while performing a mediating function.
— Under current WTO procedures, a panel’s Interim Report is not made available to countries which have intervened in the case as interested third parties.
— Questions of procedure, interpretations of agreements, burdens of proof, evidentiary standards, establishment of doctrines, requires an independent and standing judiciary composed of individuals who are free from undue bias.
— Requires reduction in time line for resolving dispute.

Answer 7(b)(ii)
Role of the Director-General of the WTO

The WTO Secretariat in Geneva is headed by a Director-General. The role of the Director General may be summarized as under —

— To supply technical and professional support for the various councils and committees.
The Director-General of the WTO acting in an ex officio capacity, offer good offices, conciliation or mediation with a view to assisting Members to settle a dispute. The Director-General may also be requested, in certain circumstances, to appoint panel members. The Director-General is to determine the composition of the panel in consultation with the Chairman of the DSB and the Chairman of the relevant Councils or Committees, after consulting the parties to the dispute. The Director-General may appoint an arbitrator in cases where it is necessary to determine the reasonable period of time for implementation or where a suspension of concessions or other obligations has been authorized by the DSB.

Question 8

(a) What are the different kinds of intellectual property rights protected by Trade Related Aspects of Intellectual Property Rights (TRIPS) agreement? (4 marks)

(b) What are the remedies against prohibited subsidies? (4 marks)

(c) “Injury analysis can be broadly classified into two categories.” Elucidate. (4 marks)

(d) Briefly discuss the duration and review of countervailing duties. (4 marks)

(e) What are anti-dumping actions? (4 marks)

Answer 8(a)

TRIPS agreement looks at different kinds of intellectual property rights and how to protect them. The purpose is to ensure that adequate standards of protection exist in all member countries. The different kinds of intellectual property rights protected by TRIPS agreement are as under:

Copyright

The TRIPS agreement ensures protection to literary works including computer programmes. It also expands international copyright rules to cover rental rights.

Trademarks

The agreement defines what types of signs must be eligible for protection as trademarks, and what the minimum rights conferred on their owners must be. It says that service marks must be protected in the same way as trademarks used for goods. Marks that have become well known in a particular country enjoy additional protection.

Geographical indications

Place names are sometimes used to identify a product and the TRIPS agreement contains special provisions for these products.
Industrial designs

Under the TRIPS agreement, industrial designs must be protected. Owners of protected designs must be able to prevent the manufacture, sale or importation of articles bearing or embodying a design, which is a copy of the protected design.

Patents

Under TRIPS agreement patents protection available for inventions.

Answer 8(b)

Prohibited subsidies can be challenged under the WTO dispute settlement procedure where they are handled under an accelerated timetable. If the dispute settlement procedure confirms that the subsidy is prohibited, it must be withdrawn immediately. Otherwise, the complaining country can take counter measures. If domestic producers are hurt by imports of subsidized products, countervailing duty can be imposed.

Answer 8(c)

Injury analysis can broadly be divided in two major categories as under:

The Volume Effect

The Authority examines the volume of the dumped imports, including the extent to which there has been or is likely to be a significant increase in the volume of dumped imports, either in absolute terms or in relation to production or consumption in India, and its effect on the domestic industry.

The Price Effect

The effect of the dumped imports on prices in the Indian market for like articles, including the existence of price undercutting, or the extent to which the dumped imports are causing price depression or preventing price increases for the goods which otherwise would have occurred. The consequent economic and financial impact of the dumped imports on the concerned Indian industry can be demonstrated, *inter alia*, by decline in output, loss of sales, loss of market share, reduced profits, decline in productivity, decline in capacity utilization, reduced return on investments, price effects, adverse effects on cash flow, inventories, employment, wages, growth, investments, ability to raise capital, etc.

Answer 8(d)

Duration and review of countervailing duties

A countervailing duty remains in force only as long as and to the extent necessary to counteract subsidization, which is causing injury. The authorities review the need for the continued imposition of the duty, where warranted, on their own initiative or, provided that a reasonable period of time has elapsed since the imposition of the definitive countervailing duty, upon request by any interested party, which submits positive information substantiating the need for a review.

Interested parties have the right to request the authorities to examine whether the continued imposition of the duty is necessary to offset subsidization, whether the injury
would be likely to continue or recur if the duty are removed or varied, or both. If, as a result of the review, the authorities determine that the countervailing duty is no longer warranted, it is terminated immediately.

**Answer 8(e)**

Anti dumping, in common parlance, is understood as a measure of protection for domestic industry. However, anti dumping measures do not provide protection per se to the domestic industry. It only serves the purpose of providing remedy to the domestic industry against the injury caused by the unfair trade practice of dumping. In fact, anti dumping is a trade remedial measure to counteract the trade distortion caused by dumping and the consequential injury to the domestic industry. Only in this sense, it can be seen as a protective measure. It can never be regarded as a protectionist measure.

Anti-dumping action can be taken only when there is an Indian industry which produces “like articles” when compared to the allegedly dumped imported goods. The article produced in India must either be identical to the dumped goods in all respects or in the absence of such an article, another article that has characteristics closely resembling those goods.

Anti-dumping actions include imposition of anti-dumping duty and countervailing duty.
ADVANCED TAX LAWS AND PRACTICE

Time allowed : 3 hours    Maximum marks : 100

NOTE : All references to sections mentioned in Part-A of the Question Paper relate to the Income-tax Act, 1961 and relevant Assessment Year 2010-11, unless stated otherwise.

PART A

(Answer ANY TWO questions from this part)

Question 1

(a) Choose the most appropriate answer from the given options in respect of the following :

(i) There is no obligation on the part of the assessee to pay advance tax during financial year 2009-10 if the advance tax payable as computed under section 209 is less than —
   (a) Rs. 7,500
   (b) Rs. 5,000
   (c) Rs. 10,000
   (d) None of the above.

(ii) The levy of minimum alternate tax (MAT) under section 115JB in case of a corporate assessee at the specified percentage of book profit is @ —
   (a) 5%
   (b) 15%
   (c) 10%
   (d) None of the above.

(iii) Any expenditure on scientific research on in-house research and development facility incurred by a company engaged in the production or manufacture of any article not covered by Schedule XI of the Income-tax Act, 1961 is eligible for weighted deduction of —
   (a) 125%
   (b) 150%
   (c) 110%
   (d) None of the above.

(iv) Failure to keep, maintain or retain books of accounts, etc., as required under section 44AA will attract minimum and maximum penalty of —
   (a) Rs. 25,000 and Rs. 25,000 respectively
   (b) Rs. 25,000 and Rs. 1,00,000 respectively
   (c) Rs. 25,000 and Rs. 50,000 respectively
   (d) None of the above.
(v) Fee for filing an appeal under section 249(1) to the Commissioner (Appeals) when the assessed income is more than Rs.2 lakh is —
   
   (a) Rs.250
   (b) Rs.500
   (c) Rs.1,000
   (d) None of the above.  

(b) Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s):

   (i) While making an appeal to the Tribunal against order of the Commissioner of Income-tax (Appeals), the requisite documents shall be sent in ______. 

   (ii) An application of fitness for appeal to the Supreme Court has to be made within ______ days from the date of High Court’s judgment. 

   (iii) Where the appeal to the Commissioner (Appeals) under section 246A relates to any assessment or penalty order, the appeals have to be presented within ______ days of the date of service of the notice of the demand relating to that assessment or penalty order.

   (iv) A minimum penalty of Rs.__________ per day for the days of default shall be levied upon failure to furnish annual information return.

   (v) The newly introduced section 144C envisages an alternate dispute resolution mechanism by empowering the CBDT to constitute a ____________ for this purpose. 

(c) Discuss briefly the provisions under section 4(l)(a)(ii) of the Wealth-tax Act, 1957 regarding assets held by a minor child. 

Answer 1(a)

   (i) (c) Rs.10,000
   (ii) (b) 15%
   (iii) (b) 150%
   (iv) (a) Rs.25,000 and Rs.25,000 respectively.
   (v) (c) Rs.1,000

Answer 1(b)

   (i) While making an appeal to the Tribunal against order of the Commissioner of Income-tax (Appeals), the requisite documents shall be sent in **Triplicate**.

   (ii) An application of fitness for appeal to the Supreme Court has to be made within **60** days from the date of High Court’s judgment.

   (iii) Where the appeal to the Commissioner (Appeals) under section 246A relates to any assessment or penalty order, the appeals have to be presented within **30** days of the date of service of the notice of the demand relating to that assessment or penalty order.
(iv) A minimum penalty of **Rs. 100** per day for the days of default shall be levied upon failure to furnish annual information return.

(v) The newly introduced section 144C envisages an alternate dispute resolution mechanism by empowering the CBDT to constitute a **Dispute Resolution Panel** for this purpose.

**Answer 1(c)**

As per Section 4(1)(a) of the Wealth Tax Act, 1957, assets held by the minor child shall be included in the net wealth of that parent, whose net wealth (excluding the assets of the minor child) is greater. However, the following assets shall not be included in the net wealth of the parent and would be taxable in the hands of the minor only.


(ii) Assets held by a minor married daughter.

(iii) Assets acquired by a minor child out of the following income:

(a) Income from manual work done by him.

(b) Income from any activity involving application of his skill, talent or specialized knowledge or experience.

Further, where the marriage of the parents does not subsist then the assets of minor child will be clubbed in the net wealth of the parent who maintained the minor child in the previous year as defined in the Income Tax Act, 1961.

**Question 2**

(a) State, with reasons in brief, whether the following statements are true or false, having regard to the provisions of the relevant direct tax laws:

(i) A foreign company may be treated as domestic company under the Income-tax Act, 1961.

(ii) A belated return of income can be filed after due date but within six months from the end of the relevant assessment year.

(iii) Any citizen of India who holds any wealth outside India is liable to pay wealth-tax on his foreign wealth.

(iv) It is mandatory for a person to whom the provisions of section 44AB are applicable to pay tax electronically, and it may be paid from the account of any other person.

(v) Where an appellate authority accepts the contention of the tax payer and allows the appeal, there lies no further appeal by the assessee against that order.

(2 marks each)

(b) “With the abolition of fringe benefit tax effective from assessment year 2010-11, the actual tax burden on fringe benefits is completely eliminated.” Do you agree?

(2 marks)

(c) Discuss the allowability of depreciation under section 32 read with section 43,
where a non-operating plant and machinery is a part of block of assets and the said block of assets is used for the purpose of business.  

**Answer 2(a)**

(i) **True**: A foreign company shall become a domestic company if it has made arrangements for the declaration and payment of dividends in India which is payable out of domestic income.

(ii) **False**: A belated return of income can be filed even after due date but maximum within one year from the end of the relevant assessment year or before the completion of assessment whichever is earlier.

(iii) **False**: Any citizen of India who is also resident and ordinary resident in India has to pay wealth tax on his foreign wealth.

(iv) **True**: The CBDT has vide circular No.5/2008 dated 14.07.2008 has clarified that an assessee can make electronic payment of taxes also from the account of any other person. However, the challan for making such payment must clearly indicate the Permanent Account Number (PAN) of the assessee on whose behalf the payment is made. It is not necessary for the assessee to make payment of taxes from his own account in an authorized bank.

(v) **True**: When the contention of the tax payer is accepted and the appellate authority allows the appeal, no scope for further appeal by the assessee against that order is available to the assessee, except in case of partial allowance of appeal.

**Answer 2(b)**

No, The tax burden has been shifted from the employer to the employee. The employer instead of paying FBT would now have to deduct tax at source from the employees in respect of certain Fringe Benefits including ESOPS and contribution to superannuation fund in excess of the prescribed limit. These would now be taxed as perquisite in the hands of the employees, as the scope of the term ‘perquisites’ under Section 17(2) has been expanded to cover such benefits.

**Answer 2(c)**

**Facts**: The facts of this case are similar to that of **CIT v. Bharat Aluminium Co. Ltd.** [2009-TIOL-619-HC-DEL]. In this case the High Court held that

(i) The rational and purpose for which the concept of block of asset was introduced by the amendment in the provisions of the Act, as reflected in the circular dated 23.09.1988 of CBDT plays a vital part.

(ii) The intention behind this provision is apparent. Once various assets are clubbed together and they become block and assets within the meaning of Section 2(11), and for the purpose of depreciation, it is one asset. Individual assets lose their identity from that very moment and become inseparable part of block of assets in so far as calculation of depreciation is concerned.

(iii) Once this scheme contained in the aforesaid provisions is understood and appreciated, it is not possible to accept the contention that unless a particular
asset is used for the purpose of business or profession, deprecation is not allowed. However, the expression “used for the purpose of business” when applied to block asset would mean use of block of assets and not any specific building, machinery, plant or furniture in the block of asset as individual assets have lost their identity after becoming inseparable part of the block asset.

**Question 3**

(a) The book profits of a company in the previous year 2009-10 computed in accordance with section 115JB is Rs.15 lakh. If the total income computed for the same period as per the provisions of the Income-tax Act, 1961 is Rs.3 lakh, calculate the tax payable by the company in the assessment year 2010-11 and also indicate whether the company is eligible for any tax credit. (5 marks)

(b) What penalties can be imposed under the -Income-tax Act, 1961 in the case of following defaults:

(i) Failure to furnish return of income under section 139; and

(ii) Failure to get accounts audited under section 44AB. (5 marks)

(c) Distinguish between ‘tax planning’ and ‘tax management’. (5 marks)

**Answer 3(a)**

**Computation of Tax Payable by the Company for the Assessment Year 2010-11**

(i) Tax on total income as computed under Income Tax Act:

30% of Rs. 3,00,000

Rs. 90,000

(ii) Income Tax at the rate of 15% of the book profits

15% of Rs.15,00,000

Rs. 2,25,000

In the above case tax payable on total income is Rs.90,000 while 15% tax on book profit is Rs. 2,25,000. Since tax payable on total income is less than 15% on book profit, therefore the company is liable to pay MAT.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax Payable 15% of Rs.15 lac</td>
<td>Rs. 2,25,000</td>
</tr>
<tr>
<td>Add Surcharge</td>
<td>Nil</td>
</tr>
<tr>
<td>Add Education Cess 2%</td>
<td>4,500</td>
</tr>
<tr>
<td>Add SHEC @ 1%</td>
<td>2,250</td>
</tr>
<tr>
<td><strong>Total Tax Payable</strong></td>
<td><strong>Rs. 2,31,750</strong></td>
</tr>
</tbody>
</table>

Thus, the company is liable to pay MAT Rs. 2,31,750. However, the excess tax paid i.e. (Rs. 2,25,000 – 90,000) Rs.1,35,000 will be eligible for tax credit and can be carry forward for ten succeeding assessment years for set-off against the tax payable on the total income during such period. If the credit is not so set-off it shall lapse.
Answer 3(b)(i)

Failure to furnish return of income under Section 139

Explanation 3 to Section 271 provides that if return is not filed voluntarily under Section 139(1) but the assessee had taxable income, he will be liable to penalty. The concealment of income will be applicable if the following conditions are satisfied:

(a) The assessee, whether or not assessed earlier, fails without reasonable cause, to furnish the return of his income which he was required to furnish under section 139 within the period specified in Section 153(1).

(b) No notice has been issued to him either under Section 142(1) or 148.

(c) The Assessing Officer/Commissioner (Appeal) is satisfied that the person has taxable income in the relevant assessment year;

(d) The taxable income of such assessment year shall be deemed to be the concealed income even if such person furnishes a return at any time after the expiry of the period in the pursuance of a notice under Section 148.

Penalty: Minimum penalty is 100% of the tax sought to be evaded and maximum 300% of such amount.

Answer 3(b)(ii)

Failure to get accounts audited under Section 44AB (Section 271B)

If an assessee fails to get accounts audited or to furnish a report of such audit as required by Section 44AB, a penalty will be imposed by the assessing officer. The minimum penalty shall be 0.5% of the total sales, turnover or gross receipts as the case may be or Rs.1,00,000, whichever is less. However, no penalty under Section 44AB will be imposed, if the assessee has already paid penalty under Section 44AA for non-maintenance of books of account. [Ram Parkash C. Puri v. CIT (2001) 117 Taxman 154 (Pune)].

Answer 3(c)

Tax planning and Tax Management seem to be similar in approach but these two activities can be differentiated on following grounds:

(i) Tax planning is a wider term which includes tax management while tax management is a narrower term;

(ii) The aim of the tax planning is to minimize tax incidence while management refers to the compliance with statutory provisions of the law.

(iii) Tax planning is not required for every person while tax management is essential for every person.

(iv) Tax planning helps in decision making process while tax management-helps in complying with the conditions for effective decision making and compliance with law.

(v) Tax planning involves comparison of various alternatives before selecting the
best one while tax management involves maintenance of accounts in prescribed formats, filing of returns, payment of tax, deduction of tax at source etc. as per the legal requirements.

PART B

(Answer Question No.4 which is compulsory and ANY TWO of the rest from this part.)

Question 4

(a) Choose the most appropriate answer from the given options in respect of the following:

(i) For charging excise duty, 'goods' must fulfill following conditions —  
   (a) It must be moveable  
   (b) It must be marketable  
   (c) It must be specified in the central excise tariff  
   (d) All of the above.

(ii) In the case of products covered by maximum retail price (MRP) specifications, the assessable value will be calculated on the basis of —  
   (a) Transaction value  
   (b) MRP Zess abatement  
   (c) MRP  
   (d) Percentage of tariff value.

(iii) The CENVAT credit can be carried forward and utilised up to —  
   (a) One year  
   (b) Five years  
   (c) Ten years  
   (d) No time limit.

(iv) Warehousing facility is not availed of for the following reasons —  
   (a) The importer may not require the goods immediately  
   (b) The importer wants to avoid heavy demurrage charges imposed by the port  
   (c) The importer may not have enough funds to make payment of duty immediately  
   (d) None of the above.

(v) Under Section 25(1) of the Customs Act, 1962, an ad hoc exemption cannot be granted to the following items —  
   (a) Life saving drugs  
   (b) Article imported for handicapped persons  
   (c) Import of software  
   (d) Import by Indian Navy.
(b) Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s):

(i) Service tax is levied on services provided within the territory of India including territorial waters of India extending up to __________ (under International Sea Act).

(ii) ‘Labelling or re-labelling’ of containers and re-packing from bulk packs to retail packs of natural or artificial mineral- waters shall amount to __________.

(iii) When the goods manufactured are not sold but are re-used in the factory for the manufacture of other articles, the value for the purpose of excise shall be __________ of the cost of production.

(iv) As per Section 13 of the Customs Act, 1962, duty is payable at the rate of __________ if any goods are pilfered after the unloading and before order of clearance.

(v) If the goods are re-imported within one year from the date of exportation, an application for refund of duty shall be made within __________ from the date on which proper officer makes an order of clearance. (1 mark each)

(c) Bharat Export Corporation gets its product manufactured on job work basis from Softex Ltd., an independent processor. The details of the transactions are as follows:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount (Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of materials sent to job worker for processing</td>
<td>25,000</td>
</tr>
<tr>
<td>Processor’s charges (including Rs.7,000 as processing charges and Rs.5,000 as its profit)</td>
<td>12,000</td>
</tr>
<tr>
<td>Transport charges for receiving goods at the premises of the processor</td>
<td>1,000</td>
</tr>
</tbody>
</table>

After processing, the goods, are sold by Bharat Export Corporation at Rs.58,000 from the premises of Softex Ltd. Determine the assessable value of the goods under Section 4 of the Central Excise Act, 1944.

(d) Explain the provisions for claiming drawback of duty paid on imported goods when they are re-exported.

Answer 4(a)

(i) (d) All the above

(ii) (b) MRP less abatement

(iii) (d) No time limit

(iv) (d) None of the above

(v) (c) Import of software.
Answer 4(b)

(i) Service tax is levied on services provided within the territory of India including territorial waters of India extending up to 12 nautical miles (under International Sea Act).

(ii) ‘Labelling or re-labelling’ of containers and re-packing from bulk packs to retail packs of natural or artificial mineral-waters shall amount to Manufacture.

(iii) When the goods manufactured are not sold but are re-used in the factory for the manufacture of other articles, the value for the purpose of excise shall be 110% of the cost of production.

(iv) As per Section 13 of the Customs Act, 1962, duty is payable at the rate of Zero/Nil if any goods are pilfered after the unloading and before order of clearance.

(v) If the goods are re-imported within one year from the date of exportation, an application for refund of duty shall be made within Six months from the date on which proper officer makes an order of clearance.

Answer 4(c)

As per Rule 10A of the Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000, where the excisable goods are produced or manufactured by a job worker, on behalf of a ‘Principal Manufacturer’ and the goods are sold by the principal manufacturer for delivery at the time of removal of goods from the factory of job worker, where the principal manufacturer and the buyer of the goods are not related and the price is the sole consideration for the sale, the value of the excisable goods shall be the transaction value of the said goods sold by the principal manufacturer. Hence, in the given case, the assessable value of the goods shall be Rs.58,000.

Answer 4(d)

Drawback of Customs duty allowed on re-export of duty paid on imported goods [Section 74(1)]

When any goods capable of easy identification as imported goods into India on which duty has been paid on importation are entered for export and the proper officer makes an order of clearance.

(i) Under Section 51 for cargo permitting clearance and loading of the goods for exportation; or

(ii) Are to be exported as baggage and the owner of such baggage makes a declaration under Section 77 for the purpose of clearing it and the proper officer makes an order permitting clearance of the goods for exportation; or

(iii) Under Section 82, the goods are entered for export by post, then, 98% of such duty will be refunded as draw back provided the goods are entered for export within 2 years from the date of payment of duty on the importation thereof or any extended period granted.

Question 5

(a) Examine briefly, whether the process of commercial duplication by which a blank CD is transformed into software loaded marketable CD constitutes
manufacturing or processing of goods? Support your answer with recent judicial pronouncement.

(b) Define the term ‘classification’ and indicate briefly its salient features in the context of excise law. (5 marks)

(c) What are the conditions for claiming refund of import duty under the newly inserted Section 26A of the Customs Act, 1962? (5 marks)

Answer 5(a)

**Facts:** Assessee imported Master Media of the software from Oracle Corporation, U.S.A. which was duplicated on blank discs, packed and sold in the market. The Question arose whether process by which blank Compact Disc (CD) is transformed into software loaded marketable disc constitutes “manufacture or processing of goods”.

The Hon’ble Supreme Court in the case of CIT v. Oracle Software India Ltd. held the term “manufacture” implies a change, but, every change is not a manufacture, despite the fact that every change in an article is the result of a treatment of labour and manipulation. However, this test of manufacture needs to be seen in the context of the process adopted by the assessee for duplication of software. If an operation/process renders a commodity or article fit for use for which it is otherwise not fit, the operation/process falls within the meaning of the word “manufacture”. Applying this test, as the assessee has undertaken an operation which renders a blank CD fit for use for which it was otherwise not fit, the duplicating process constitutes ‘manufacture’ u/s 80IA(12)(b) of the Income Tax Act, 1961.

Hence it can be said that it constitutes ‘manufacture’ under the Excise Law also.

Answer 5(b)

Classification is the process by which identification of excisable goods can be made. Under the Central Excise, the goods are indentified by their code numbers called as classification numbers. Ascertaining the classification number is necessary to:

- Determine excisability of the goods manufactured;
- Finding out rate of duty applicable to such excisability;
- Establish dutibility by checking up whether any exemption is available under Section 5A of Central Excise Act, 1944, or any new levy or increase of duty is there under Section 3 of Central Tariff Act, 1985;
- Proper classification of goods ensures smooth functioning of Excise duty administration and avoids disputes.

**Salient Features of Classification**

- Classification is based on eight digits system known as “Harmonised System of Nomenclature”. First two digits represent chapter number, next two digits- Heading Number and the last two digits show the Sub-heading numbers of the goods in question. If two more digits are added for sub-classification, it is termed as Tariff item.
- Chapter No. and Heading No. may be common but the sub-heading is unique.
— Schedule 1 of the Central Excise Tariff Act, 1985 as amended with effect from 28th March, 2005 has four columns viz: (i) Tariff Item (ii) Description of goods (iii) Unit (iv) Rate of duty;
— The goods are so grouped that they are classified beginning with raw material and ending with finished goods under the same Chapter.
— There are 20 Sections in the Schedule, each section is divided into a number of Chapters and each chapter is further divided into Headings and Sub-headings.
— There are Section notes, Chapter notes to enable better understanding and proper application which have binding effect.
— There are also rules provided for interpretation in case of need. If the rules cannot be applied successfully, then the principles evolved by the Courts may be resorted to.
— In case of dispute over correctness of classification number, the burden of proof is on the department (Hindustan Ferodo Ltd., S.C.).

**Answer 5(c)**

Under Section 26A, effective from 19.08.2009, where on the importation of any goods capable of being easily identified as such imported goods, any duty has been paid on clearance of such goods for home consumption, such duty shall be refunded to the person by whom or on whose behalf it was paid subject to the fulfillment of the following conditions:

(i) Goods are defective/not as per specifications agreed upon between the importer and the supplier of goods. However, such goods should not have been worked, repaired or used after importation except where such use was indispensable to discover such defects or non-conformity;

(ii) No drawback is claimed;

(iii) Goods are identified as imported goods;

(iv) The importer exports the goods or relinquishes title to the goods and abandons them or destroys or renders them commercially valueless within 30 days of approval by Assistant or Deputy Commissioner.

(v) Application for refund of duty is made before the expiry of six months from the relevant date in the prescribed form and in the prescribed manner.

No refund is allowed in respect of perishable goods and goods which have exceeded their shelf life or their recommended storage-before-use period.

**Question 6**

(a) Pawan, a manufacturer, purchased certain inputs from his supplier Binod. The assessable value was Rs. 2,00,000 and the central excise duty was calculated at Rs. 32,960. Thus, the total purchase invoice was for Rs. 2,32,960. However, Pawan settled the total invoice by paying Rs. 2,08,000 only to Binod in full settlement. How much CENVAT credit can be availed by Pawan? (5 marks)

(b) Whether confiscation of improperly imported goods by the customs authority under section 111 read with section 112 of the Customs Act, 1962, is justifiable
where respondent imported goods free from customs duty availing benefit of Notification No.48/99-CUS dated 29th April, 1999 providing exemption exclusively to manufacturer-exporter only, even though they had no manufacturing unit at all? Critically examine the matter and offer your comments. (5 marks)

(c) Describe the cases where goods being exported are liable to confiscation under section 113 of the Customs Act, 1962. (5 marks)

Answer 6(a)

Pawan can avail CENVAT Credit to the extent of Rs.32960. CENVAT Credit cannot be reversed just because the supplier Binod has given some discount after removal of the goods or Pawan paid a reduced amount than the invoice price in full settlement (CCE v. Trinetra texturisers 2004).

Circular No. 877/15/2008-CX dated 17-11-2008 has also clarified that in such cases, the entire amount of duty paid by the manufacturer, as shown in the invoice would be available as credit irrespective of the fact that subsequent to clearance of goods, the price is reduced by way of discount or otherwise. However, if the duty paid is also reduced, along with reduction in price, the reduced excise duty would only be available as credit. It may however be confirmed in such cases that the supplier who has paid duty has not filed or claimed refund on account of reduction in price.

Answer 6(b)

The Notification No.48/99-CUS dated 29.04.1999 pertains to a exemption in respect of import against Annual Advance License with Actual User Condition i.e., exemption can be availed by a manufacturer-exporter only. The company did not have a manufacturing unit for manufacture of resultant product out of the duty free imported raw material.

The declaration given by the company for availing the Annual Advance License with Actual User that they were manufacturer-exporter was a false declaration. Even assuming that the company had sent the goods to job workers, they would still not be entitled to avail the benefit of exemption notification since they ought to be manufacturer-exporter to be eligible for the exemption.

Clause (O) of Section 111 contemplates confiscation of goods which are exempted from duty subject to a condition, and that condition is not observed by the importer. As the condition of Manufacturer Exporter has not been observed by the respondent, the confiscation under Section 111 read with 112 of the Act is justifiable.

The company is not an actual user and would not be entitled to utilize the license. The licence having been secured by adopting fraudulent method would not confer any right on the importer and as such company cannot be allowed to plead any equity.

Answer 6(c)

Confiscation of goods under Section 113

The following export goods shall be liable to confiscation under Section 113:

(i) Any goods attempted to be exported by sea or air from any place other than a custom port or a custom airport;
(ii) Any goods attempted to be exported by land or inland water through any route other than a specified route;

(iii) Any goods attempted to be exported or brought within the limit of any custom area for the purpose of being exported contrary to any prohibition imposed under this Act;

(iv) Any goods found concealed in a package;

(v) Any goods which are not included or are in excess of those included in the entry made under this Act;

(vi) Any goods loaded or attempted to be loaded on any conveyance, the eventual destination of which is a place outside India;

(vii) Any goods on which import duty has not been paid and which are entered for exportation under Section 74;

(viii) Any goods entered for exportation under claim for drawback which do not correspond in any material particular with any information furnished by the exporter or manufacturer under this Act in relation to the fixation of rate of drawback under Section 75.

Question 7

(a) (i) Briefly enumerate the persons not eligible for compounding of offences under Section 9A(2) of the Central Excise Act, 1944. (3 marks)

(ii) Explain the amendments made by the Finance (No. 2) Act, 2009 in the provisions relating to valuation audit under section 14A and CENVAT audit under Section 14AA of the Central Excise Act, 1944. (3 marks)

(b) Discuss briefly the salient features of the system of ‘advance rulings’ under the Customs Act, 1962. (5 marks)

(c) The Central Excise Act, 1944 as well as the Customs Act, 1962 were amended recently to relax the time limits for filing reference application to the High Court and for filing memorandum of cross objections. Indicate briefly the normal time limits for this purpose and the effect of the changes. (4 marks)

Answer 7(a)(i)

The Finance (No.2) Act, 2009 provides that the following persons are not eligible for compounding under Section 9A(2):

(a) a person who has been allowed to compound once in respect of any of the offences under the provisions of clause (a), (b), (bb), (bbb), (bbbb) or (c) of Sub-section (1) of Section 9;

(b) a person who has been accused of committing an offence under this Act which is also an offence under the Narcotic Drugs and Psychotropic Substances Act, 1985;

(c) a person who has been allowed to compound once in respect of any offence under this Chapter for goods of value exceeding rupees one crore;

(d) a person who has been convicted by the court under the Central Excise Act on or after the 30th day of December, 2005.
Answer 7(a)(ii)

As a result of the amendments made by the Finance (No.2) Act, 2009, now, the Chartered Accountants may also be nominated for the purposes of carrying out valuation audit under Section 14A or CENVAT Audit under Section 14AA of the Central Excise Act, 1944. Earlier the provision enabled the nomination of only a Cost Accountant for the purpose.

Answer 7(b)

Advance Ruling for Customs Duty

Chapter VB of Customs Act, 1962 provides for appointment of ‘Authority for Advance Ruling’ which would pronounce ruling regarding rate and quantum of duty payable in advance for the benefit of Non-resident setting up joint venture in India in collaboration with a Non-Resident or Resident and for the benefit of Resident setting up joint venture in India in collaboration with a Non-Resident. Following are some salient features of the scheme.

(i) Authority for Advance Ruling is to be constituted under Section 28F of the Customs Act, 1962. As per the new Sub-section (2A) in section 28F, inserted by the Finance (No.2) Act, 2009, the Central Government can authorize the AAR under the Income-tax Act, 1961, to act as an authority under the Customs Act also by issuing a notification in the Official Gazette in this regard.

(ii) This authority can determine a question of law or fact specified in the application;

(iii) The Advance Ruling can only relate to the liability to pay custom duty on an activity proposed to be undertaken in future.

(iv) The Authority may, after examining the application and the records called for, by order, either allow or reject the application. However, the Authority shall not allow the application where the question raised in the application is pending before any officer of Customs, the Appellate Tribunal or any Court or the matter has already been decided by the Appellate Tribunal or any Court

(v) The Ruling issued under the scheme would be binding on the applicant and the concerned Commissioner of Customs including their subordinates.

(vi) The application for Advance Ruling can be made by the applicant along with a fee of Rs. 2500.

(vii) The Authority for Ruling is required to pronounce its decision in writing within 90 days from the date of application.

(viii) If the Advance Ruling is obtained by fraud or suppression of facts, it should be declared void ab-initio.

Answer 7(c)

The normal time limits for filing appeal to the High Court under Section 35H(1) of the Excise Act, 1944/Section 130A(1) of the Customs Act, 1962 is 180 days from the date on which the order appealed against is received by the Commissioner or the other party. The time limit for filing memorandum of cross objections under Central Excise Act and
Customs Act against any part of the order in relation to which an application for reference has been made is 45 days from the date of the receipt of the notice.

The newly inserted Sub-sections (2A) and (3A) of Section 35G and 35H of the Central Excise Act, 1944 and the newly inserted Sub-sections (2A) and (3A) respectively of Sections 130 and 130A of the Customs Act, seek to empower the High Court to condone the delay in appropriate cases and admit the application for reference even after 180 days and memorandum of cross objections after the period of 45 days.

PART C

Question 8

Attempt any five of the following:

(i) What are the entry options available to foreign companies? Describe briefly. (4 marks)

(ii) Can a resident assessee claim that the advance ruling obtained by his brother in respect of a similar issue faced by him is applicable to him also? Will such a ruling be binding on him also? (4 marks)

(iii) Whether tax is required to be deducted from commission paid to an agent outside India, if no services are performed in India or there is no fixed place of business in India? Explain and comment in the light of recent judgement of Authority for Advance Rulings (AAR). (4 marks)

(iv) Explain, with the help of a simple example, the determination of arm’s length price where more than one such price is arrived at by the Transfer Pricing Officer by following the most appropriate method. (4 marks)

(v) Paresh, aged 66 years and ordinarily resident in India, is a professional. He has earned Rs. 1,00,000 from services provided outside India. His foreign income was taxed at 20% in that country where services were rendered. India does not have any tax treaty with that country. Assuming that Indian income of Paresh is Rs. 3,00,000, what relief of tax under section 91 of the Income-tax Act, 1961 will be allowed to him for the assessment year 2010-11? Paresh has contributed Rs. 32,000 towards public provident fund during the previous year 2009-10. (4 marks)

(vi) State, with reasons in brief, whether the following statements’ are true or false:

(a) A foreign company is resident in India if it is operating its activities in India.

(b) Arm’s length price means price which is applied in a transaction between unassociated persons.

(c) A resident having transactions with another resident can also seek advance ruling under section 245N of the Income-tax Act, 1961.

(d) A foreign corporation is considered as a passive foreign investment company under the asset test, if 75% or more of the foreign corporation’s assets produce or are held to produce passive income. (1 mark each)
Answer 8(i)

A foreign company planning to set up business operations in India has the following entry options:

- As an incorporated entity by getting incorporated under the Companies Act, 1956 or through Joint Ventures or as wholly owned subsidiaries;
- As an office of a foreign entity like a Liaison Office/Representative Office/Project Office/Branch Office.

Entry routes can be through technical collaboration or through financial collaboration. Such investments are made either under automatic route or approval route. Investment under automatic route involves post facto approval of RBI for the investments made and the investments under approval route require prior approval of FIPB.

Foreign Direct investment in India is allowed on automatic route in almost all sectors except:

- Proposals that require an industrial license and cases where foreign investment is more than 24% in the equity capital of units manufacturing items reserved for the small scale industries.
- Proposals in which the foreign collaborator has a previous venture/tie-up in India.
- Proposals relating to acquisition of shares in an existing Indian Company in favour of a Foreign/Non-Resident Indian (NRI)/Overseas Corporate Body (OCB) investor; and
- Proposals falling outside notified sectoral policy/caps or under sectors in which FDI is not permitted etc.

Answer 8(ii)

No, a resident assessee can not claim that the advance ruling obtained by his brother in respect of a similar issue faced by him. According to section 245S the advance ruling shall be binding:

(a) on the applicant who had sought it and
(b) in respect of the specific transaction in relation to which advance ruling was sought.

Further it shall also be binding on the Commissioner and the Income Tax Authorities subordinate to the Commissioner.

Therefore, the advance ruling obtained by his brother cannot be binding on him.

Answer 8(iii)

No tax is required to be deducted from commission paid to an agent outside India, if no services are performed in India or there is no fixed place of business in India. The facts of the question are similar to the recent judgment of Advance Ruling authority in AAR No.802 of 2009.
**Facts of the ruling**: The appellant was an Indian Company engaged in the business of manufacture and sale of industrial pesticides. The applicant appointed a South African Company to promote and market its products in South Africa. In consideration of its services, South African Co was to receive commission from the applicant in respect of completed transactions.

**Decision**

(i) As no business operations are carried out in India by South African Co. therefore no income can be deemed to accrue or arise in India.

(ii) South African Co has no fixed place of business in India. Therefore the business profits of South African Co. for services rendered as commission agent in South Africa could not be brought to tax in India.

(iii) As commission paid by the applicant to SA Co. is not chargeable to tax in India by virtue of Article 7 of DTAA and Section 9(1)(i) read with the Explanation thereto, the applicant is not obliged to deduct tax under section 195 of the Act.

(Note: Due credit may be given to the students if they have broadly and logically argued and arrived at the correct conclusion)

**Answer 8(iv)**

As per the amendment made by the Finance (No.2) Act, 2009, in Section 92C(2) w.e.f 01/10/2009 where more than one price is determined by the Transfer Pricing Officer by following the most appropriate method, the arm’s length price shall be taken to be the arithmetical mean of such price. However, if the arithmetical mean so determined is within five percentage of the Transfer Price, then the transfer price shall be deemed to be the arm’s length price and no adjustment is required to be made. This provision is effective from 1st October, 2009.

**Example:**

<table>
<thead>
<tr>
<th>Transfer Price</th>
<th>ALP determined by applying arithmetical mean</th>
<th>ALP for Transfer Price adjustment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. 100</td>
<td>105.2</td>
<td>105.2</td>
</tr>
<tr>
<td>2. 100</td>
<td>104.9</td>
<td>100</td>
</tr>
</tbody>
</table>

**Answer 8(v)**

The assessee is a senior citizen in the previous year 2009-10. His tax liability will be calculated as under:

<table>
<thead>
<tr>
<th></th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indian Income</td>
<td>3,00,000</td>
</tr>
<tr>
<td>Income from abroad</td>
<td>1,00,000</td>
</tr>
<tr>
<td>Gross Total Income</td>
<td>4,00,000</td>
</tr>
<tr>
<td><strong>Less</strong>: Deduction under section 80-C</td>
<td></td>
</tr>
<tr>
<td>- Public Provident Fund</td>
<td>32,000</td>
</tr>
<tr>
<td>Total Taxable Income</td>
<td>3,68,000</td>
</tr>
</tbody>
</table>
Tax on Rs. 3,68,000

<table>
<thead>
<tr>
<th>On Rs.</th>
<th>Rate</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>2,40,000 to Rs. 3,00,000</td>
<td>@10%</td>
<td>Rs. 6000</td>
</tr>
<tr>
<td>3,00,000 to Rs. 3,68,000</td>
<td>@20%</td>
<td>Rs 13600</td>
</tr>
<tr>
<td>Add (EC @2%+ SHEC @1%)</td>
<td></td>
<td>588</td>
</tr>
</tbody>
</table>

Less: Relief u/s 91 (See W.N 1) | 5,500 |

Total Tax | 14,688 |
Rounded off | 14,690 |

**Working Note:**

Calculation of Relief u/s 91

1. Average Rate tax in India
   
   \[
   \left( \frac{20,190}{3,68,000} \right) \times 100 = 5.5\% 
   \]

2. Average Rate of tax in foreign country
   
   20% 

Income subject to double Taxation | 1,00,000 |

Hence, relief available under Section 91 shall be 5.5% or 20% of foreign income, whichever is less

Rs.1,00,000 @ 5.5% = Rs. 5,500

**Answer 8(vi)**

(a) **False**: A foreign company will be treated as Resident in India only if during the relevant previous year, the control and management of its affairs is situated wholly in India [Section 6(3)(ii)]

(b) **True**: Under Section 92F(ii), arm's length price is defined to mean the price which is applied or proposed to be applied in a transaction between persons other than associated enterprises in uncontrolled conditions.

(c) **False**: As per Section 245N(b) advance ruling can be sought by a resident having transactions with a non-resident.

(d) **False**: Even if 50% of the foreign corporations assets produce passive income, it could be treated as PFIC.
PROFESSIONAL PROGRAMME EXAMINATION
DECEMBER 2010
DUE DILIGENCE AND CORPORATE COMPLIANCE MANAGEMENT

Time allowed: 3 hours Maximum marks: 100

NOTE: Answer SIX questions including Question No. 1 which is COMPULSORY.

Question 1

(a) State, with reasons in brief, whether the following statements are true or false:

(i) A Practising Company Secretary will be attracting the penal provisions of the Companies Act, 1956 for any false statement in the compliance certificate.

(ii) Normally, the register of members or of debentureholders of an unlisted company is closed before the annual general meeting.

(iii) Each due diligence review is unique but the overall aim is to provide an investor with sufficient, relevant and timely information in order to assist in the investment decision.

(iv) Foreign investment can be taken in the form of technical collaboration but not in the form of financial collaboration.

(v) Under the takeover regulations, once the public announcement has been made, the Board of directors of the target company can appoint an additional director or fill in any casual vacancy. (2 marks each)

(b) Critically examine and comment on the following:

(i) The proportionate allotment of securities in an issue that is oversubscribed shall be subject to reservation for retail individual investors.

(ii) Payment of royalty by Indian companies is allowed under automatic route under the FEMA regulations. (5 marks each)

Answer 1(a)(i)

True

Section 628 deals with penalty for false statements. According to said Section, if in any return, report, certificate, balance sheet, prospectus, statement or other document, required by or for the purpose of any of the provisions of the Act, any person makes a statement

(a) which is false in any material particular, knowing it to be false, or

(b) which omits any material fact, knowing it to be material;

he shall, except as otherwise expressly provided in the Act, be punishable with imprisonment for a term which may extend to two years and shall also be liable to fine. Accordingly, a Practising Company Secretary will be attracting the penal provisions of Section 628, for any false statement in any material particular or omission of any material fact in the Compliance Certificate.
Answer 1(a)(ii)
False

Normally, the Register is closed before the Annual General Meeting and for other purposes record dates may be fixed by listed companies. This requirement will not normally apply to a private limited company/unlisted company.

Answer 1(a)(iii)
True

Due diligence exercise is transaction based and not simply a number crunching exercise. It involves collation of strategic non financial information which is likely to be crucial in the overall investment decision.

Answer 1(a)(iv)
False

Foreign investment can be taken in the form of technical collaboration as well as financial collaboration. Technical collaboration involves payment of royalty, technical know-how fee etc. and in financial collaboration it involves foreign direct investments in the form of equity, FCCB’s etc.

Answer 1(a)(v)
False

Once the public announcement has been made, the Board of Directors of the target company cannot appoint any additional director or fill in any casual vacancy on the Board of Directors, by any person(s) representing or having interest in the acquirer, till the date of certification by the merchant banker on fulfillment of obligations by acquirer.

However, upon closure of the offer and the full amount of consideration payable to the shareholders being deposited in the special account, changes as would give the acquirer representation on the board on control over the company can be made by the target company;

Answer 1(b)(i)
The proportionate allotment of shares to retail individual investors would be equivalent to the number of shares applied for divided by the oversubscription rate of retail individual investor category, subject to minimum application size. For example the retail individual investors’ category is over subscribed 8.25 times and the minimum application size is 9. A has applied for 81 specified Securities, B has applied for 72 specified securities and C has applied for 45 specified securities. As per allotment procedure, the allotment to retail individual investors shall be on proportionate basis i.e., at 1/8.25th of the total number of specified securities applied for. The actual entitlement shall be as follows:

1. For A- \( \frac{81}{8.25} = 9.82 \) specified securities rounded off to 10 specified securities.
2. For B- \( \frac{72}{8.25} = 8.73 \) specified securities rounded off to 9 specified securities (i.e. minimum application size).
3. For C-45/8.25=5.45 specified securities. Application liable to be rejected. (as the entitlement is less than the minimum application size).

It may be noted that as per SEBI (ICDR) Regulations 2009 not less than 35% of net offer in case of issue through book building process and not less than 50% of net offer in case of issue other than book building process, shall be allocated to retail individual investors.

Answer 1(b)(ii)

Earlier, the payment of royalties under Foreign Technology Collaboration was provided for automatic approval for foreign technology transfers involving payment of lumpsum fee not exceeding US$ 2 million and payment of royalty limited to 5% on domestic sales and 8% on exports. The said limits have been removed and payments for royalty, lumpsum fee for transfer of technology and payments for use of trademark/brand name is permitted under the automatic route i.e. without any approval of the Government of India. However, all such payments are subject to Foreign Exchange Management (Current Account Transactions) Rules, 2000 as amended from time to time.

Question 2

(a) Choose the most appropriate answer from the given options in respect of the following:

(i) The merger of subsidiary company into its parent company is called —
   (a) De facto merger
   (b) Up stream merger
   (c) Down stream merger
   (d) Reverse merger.

(ii) Which of the following committees is a non-mandatory under the listing agreement —
   (a) Remuneration committee
   (b) Share transfer committee
   (c) Shareholders/investors grievance committee
   (d) Audit committee.

(iii) The circular of National Securities Depository Limited (NSDL) providing for the process of demat account opening, control and verification of Delivery Instruction Slips (DIS) is subject to —
   (a) Statutory audit
   (b) Concurrent audit
   (c) Internal audit
   (d) Continuous audit.

(iv) Which of the following sources is not allowed to Indian companies to raise resources from the international market —
   (a) Global depository receipts
   (b) American depository receipts
(c) Indian depository receipts
(d) Foreign currency convertible bonds.

(v) Which of the following is not involved in the issue of Indian depository receipts —
(a) Foreign company
(b) Overseas custodian bank
(c) Domestic depository
(d) Foreign investors.

(vi) Under the approval route, the foreign investor or the Indian company requires prior approval from —
(a) Securities and Exchange Board of India
(b) Reserve Bank of India
(c) Company Law Board
(d) Foreign Investment Promotion Board.

(b) Distinguish between the following:
(i) Amalgamation’ and ‘takeover’,
(ii) ‘Liaison office’ and ‘project office’.

(c) Mention the sectors which are prohibited for foreign investment in India.

Answer 2(a)(i)
(b) Up stream merger

Answer 2(a)(ii)
(a) Remuneration Committee

Answer 2(a)(iii)
(b) Concurrent audit

Answer 2(a)(iv)
(c) Indian depository receipts

Answer 2(a)(v)
(d) Foreign investors

Answer 2(a)(vi)
(d) Foreign Investment Promotion Board

Answer 2(b)(i)
Amalgamation is a legal process by which two or more companies are joined together to form a new entity or one or more companies are absorbed or blended with another and as a consequence the amalgamating company loses its existence and
its shareholders become the shareholders of new company or the amalgamated company. In case of amalgamation, a new company may come into existence or an old company may survive while amalgamating company may lose its existence.

Takeover means acquisition by one company of control over another, usually by buying all or a majority of its shares. A transaction or a series of transactions by which a person acquires control over the assets of a company is generally known as takeover of the company. Takeover may be ‘friendly take over’ or ‘hostile take over’

Answer 2(b)(ii)

Liaison Office acts as a channel of communication between the principal place of business or head office and Indian activities. Liaison office cannot undertake any commercial activity directly or indirectly and cannot, therefore, earn any income in India. The role of Liaison Office is limited to collecting information about possible market opportunities and providing information about the company and its products to prospective Indian customers.

Reserve Bank has granted general permission to foreign companies to establish Project Offices in India, provided they have secured a contract from an Indian company to execute a project in India, and

(i) the project is funded directly by inward remittance from abroad; or

(ii) the project is funded by a bilateral or multilateral International Financing Agency; or

(iii) the project has been cleared by an appropriate authority; or

(iv) a company or entity in India awarding the contract has been granted Term Loan by a Public Financial Institution or a bank in India for the project.

Answer 2(c)

Prohibition on Investment in India

FDI is prohibited in the following activities/sectors:

(a) Retail Trading (except single brand product retailing)

(b) Lottery Business including Government/private lottery, online lotteries, etc.

(c) Gambling and Betting including casinos etc.

(d) Business of chit fund

(e) Nidhi company

(f) Trading in Transferable Development Rights (TDRs)

(g) Real Estate Business or Construction of Farm Houses

(h) Manufacturing of Cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes
(i) Activities / sectors not opened to private sector investment including Atomic Energy and Railway Transport (other than Mass Rapid Transport Systems). Besides foreign investment in any form, foreign technology collaboration in any form including licensing for franchise, trademark, brand name, management contract is also completely prohibited for Lottery Business and Gambling and Betting activities.

Question 3

(a) Rosy Trading Ltd. borrowed a sum of Rs.20 lakh from a bank on the mortgage of entire assets of the company and on execution of personal guarantee by all its directors, who stood as sureties for the loan. After one year, the company went into liquidation. For paying off the bank loan, on passing a Board resolution, the directors advanced money to the company to discharge the liability towards the bank loan. However, no action for satisfaction of charge against the property of the company with the Registrar of Companies was taken. Directors claimed that they were subrogated to the position of mortgagee bank on paying off the debt and thus wanted to claim the money in priority to others. You have been engaged to decide their claim. Decide giving reasons and citing case law. (6 marks)

(b) Ankur, a shareholder of Radha Financial Services Ltd., requested for copies of the register under section 301 of the Companies Act, 1956. His request was turned down stating that the register contains details about interest of directors and contracts in which they are interested, it is therefore confidential and copies thereof cannot be given. As a Practising Company Secretary, advise Ankur whether the refusal is valid. (5 marks)

(c) Sonia Enterprises Ltd. is having a good track record for payment of dividend in past five years. The company has paid dividend in the last five years as follows:

<table>
<thead>
<tr>
<th>Year Ended</th>
<th>Rate of Dividend Paid</th>
</tr>
</thead>
<tbody>
<tr>
<td>31st March, 2005</td>
<td>12.0%</td>
</tr>
<tr>
<td>31st March, 2006</td>
<td>12.5%</td>
</tr>
<tr>
<td>31st March, 2007</td>
<td>12.5%</td>
</tr>
<tr>
<td>31st March, 2008</td>
<td>15.0%</td>
</tr>
<tr>
<td>31st March, 2009</td>
<td>18.0%</td>
</tr>
</tbody>
</table>

It is apparent from the annual accounts for the year ended 31st March, 2010 that the profits are inadequate to declare dividend for the year ended 31st March, 2010 but the Board of directors of the company wants to declare a dividend @ 14% on the equity shares so as to maintain the image of the company. The company has some accumulated profits earned in the previous years which were not transferred to reserves.

The company seeks your advice as to how it can pay dividend at the rate of 14% on the equity shares. (5 marks)

Answer 3(a)

The directors of Rosy Limited are not entitled to claim money in priority to others. Although, the directors advanced money on passing the board resolution, yet the particulars of charge under Section 125 of the Company Act, 1956 not got registered in their favour.
in the records of the Registrar of Companies. Accordingly, their position was of an ordinary unsecured creditor. Hence, the directors are not entitled to get payment in priority over the secured creditor.

In case of, Prabhu v. Official Liquidator (2008) 146, Com cases 157(ker), the Appellant was one of the directors of M/s. Mittal Steel Re-rolling and Allied Industries Ltd., which was under liquidation. The company, earlier applied for and availed of financial facilities from Canara Bank, to a limit of Rs.75 lakhs out of which an amount of Rs.22 lakhs and odd was outstanding as payable in June, 1981. The entire assets of the company including the land and machinery were mortgaged to the Canara Bank and directors of the company including the appellant had executed personal guarantee bonds and stood as sureties for the said loan. On account of the failure of the company to pay back the dues in proper time by 1981 the Canara Bank had expressed its inability to make further advances for the functioning of the company. In view of the above, the director advanced some money to the company and the company cleared the liabilities of the Canara Bank. The company filed winding up petition in 1987. It was observed in the judgement that there was no registered deed crediting mortgage in favour of appellant. But, the appellant advanced money to the company. The company paid the amount due to the bank using the money advanced by the appellant’s group. At the time when winding up application was filed in 1987, he has no case that there is a charge for the property. So, he was not subrogated to the position of the Canara Bank.

Answer 3(b)

No, the stand taken by Radha Financial Services Limited is untenable.

The refusal is not valid and binding on the company. As per Section 301 of the Companies Act, 1956, every company shall keep one or more registers in which shall be entered separately particulars of all contracts entered into by the company in which any of the directors is interested. Such register shall be kept at the registered office of the company and shall also be open to the inspection of any member of the company and extracts may be taken therefrom and copies thereof may be required by any member of the company, to the same extent, in the same manner and on the payment of the same fee, as in case of the register of members of the company.

In view of this provision, Mr. Ankur a shareholder of the Radha Financial Services Limited had a right to take the copies of the register u/s 301 of the Companies Act, 1956. Here, the company can be directed to give the copies of the register as per his request.

Answer 3(c)

In the event of inadequacy or absence of profits in any year, divided may be declared by a company for that year out of the accumulated profits earned by it in previous years and transferred it to the reserves. As per Companies (Declaration of Divided out of Reserves) Rules, 1975, dividends out of past profits/reserves shall not exceed average of dividends declared during the last 5 years or 10% of its paid up capital whichever is less. Since, in the given problem, it is proposed to declare divided @ 14% it shall not be possible without previous approval of the Central Government as per section 205 A (3) if the accumulated profits earned in the previous years which were not transferred to reserves is inadequate.
Here, in such situation the company is advised to make an application to the Central Government seeking approval for payment of dividend at 14%.

**Question 4**

(a) Mention any six cases where approval from shareholders is mandatory by way of special resolution.  

(b) Prepare a check-list of takeover process in India when there is no competitive bid.  

(c) Ash Ltd. and Cash Ltd. are contemplating setting-up a project in joint venture. To guide them, you are required to state the advantages and disadvantages of joint ventures.

**Answer 4(a)**

Instances where the approval of shareholders is mandatory by way of special resolution

1. Change of name of the Company under Section 21
2. Alteration of Articles of association of the company under Section 31
3. Buy-back of shares under Section 77A
4. Issue of sweat equity shares under Section 79A
5. Appointment of Auditor under Section 224A
6. Appointment of sole selling agents under Section 294AA(3)
7. Appointment of director/relative etc to hold office or place of profit under Section 314.  
8. Winding up of company by Tribunal under Section 433(a)
9. For Keeping of register or index of members etc at a place other than registered office, but within the city in which the registered office is situated. (Section 163)

**Answer 4(b)**

**Takeover Process in India**

The following chart gives an overview of takeover process in India, when there is no competitive bid.

- Check whether the company has conducted Board meeting for considering public offer.
- Check whether the company has appointed Merchant Banker.
- Check whether the company has Opened Escrow Account.
- Check whether the company has made Public Announcement (PA).
- It may be noted that PA has to be made within 4 days of agreement with Merchant Banker. PA has to contain specified details and not contain misleading
information. Copy of PA has to be filed with SEBI, Target Company and Stock Exchanges where the shares are listed.

— Check whether the company has filed Letter of Offer (LOO) with SEBI.

It may be noted that LOO has to be filed with SEBI within 14 days of PA. Draft LOO has to be sent to the target company also within 14 days of PA.

— Check whether the company has carried out the modifications recommended by SEBI.

— Check whether the company has dispatched LOO to Shareholders, which has to be dispatched not earlier than 21 days from the date of filing LOO with SEBI.

— Opening of Offer has to be made not later than 55th day of PA and to be opened for atleast 20 days.

— Ensure the payment of consideration as required.

Answer 4(c)

**Benefit of Joint Venture**

— Sharing of risks;

— Access to technology/R&D/markets;

— Access to foreign capital;

— Reduction of manufacturing costs and other overheads including expenditure on R&D;

— Complimentary skills/resources;

— New technology or products or capital;

**Disadvantages of a Joint Venture**

— Potentially high capital cost plus ongoing financial support are required;

— Profitable returns may take some time to achieve;

— High level of commitment of staff and management takes time;

— Time consuming (especially where a new venture is involved);

— Potential for conflict between joint venture partners;

— Cultural differences and communications difficulties;

— A minority equity position may work against partner;

— Difficult to get out of it quickly, if desired;

— Working in a different legal and commercial system;

— Political risks in the country where the joint venture is based.
Question 5

(a) Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s):

(i) ____________ covers those findings in a diligence which may not impact the financials but there exist certain non-compliances which though rectifiable require the investor to tread a cautious path.

(ii) ____________ is a mechanism for subscribing to an issue containing an authorisation to block the application money in a bank account.

(iii) ____________ instruments help in reducing the risk of investing in fixed income instruments.

(iv) A ____________ is a technique which is adopted by a company for taking over control of the management and affairs of another company by acquiring its controlling shares.

(v) The aggregate of foreign investment made either directly or indirectly (through depository receipts mechanism) shall not exceed ____________ of the issued and subscribed capital of the issuing company.

(vi) Under section 113 of the Companies Act, 1956, a company is required to deliver the certificate within ____________ after the allotment of any of its securities. (1 mark each)

(b) Nalini, a Practising Company Secretary, was engaged to perform secretarial audit of Hindustan Fibres Ltd. Draft the audit report to be submitted by her, assuming at least three qualifications. (10 marks)

Answer 5(a)

(i) **Deal Cautioners** covers those findings in a diligence which may not impact the financials but there exist certain non-compliances which though rectifiable require the investor to tread a cautious path.

(ii) **Applications supported by blocked account (ASBA)** is a mechanism for subscribing to an issue containing an authorisation to block the application money in a bank account.

(iii) **Hedging** instruments help in reducing the risk of investing in fixed income instruments.

(iv) A **Takeover bid** is a technique which is adopted by a company for taking over control of the management and affairs of another company by acquiring its controlling shares.

(v) The aggregate of foreign investment made either directly or indirectly (through depository receipts mechanism) shall not exceed **51%** of the issued and subscribed capital of the issuing company.

(vi) Under section 113 of the Companies Act, 1956, a company is required to deliver the certificate within **three months** after the allotment of any of its securities.
Answer 5(b)

To
The Board of Directors
Hindustan Fibres Ltd.

I have examined the registers, records and documents of Hindustan Fibres Ltd (“the Company”) for the financial year ended on March 31, 2010 according to the provisions of-

1. The Companies Act, 1956 and the Rules made under that Act;
2. The Depositories Act, 1996 and the Regulations and Bye-laws framed under that Act;
3. The following Regulations and Guidelines prescribed under the Securities and Exchange Board of India Act, 1992 (‘SEBI Act’);
   (a) The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997;
   (b) The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992;
   (c) The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;
   (d) The Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999 and
4. The Securities Contracts (Regulation) Act, 1956 (‘SCRA’) and the Rules made under that Act; and
5. The Equity Listing Agreements with Bombay Stock Exchange Limited and National Stock Exchange of India Limited.

A. Based on my examination and verification of the registers, records and documents produced to me and according to the information and explanations given to me by the Company, I report that the Company has, in my opinion, complied with the provisions of the Companies Act, 1956 (“the Act”) and the Rules made under the Act and the Memorandum and Articles of Association of the Company, with regard to:

(a) maintenance of various statutory registers and documents and making necessary entries therein;
(b) closure of the Register of Members;
(c) forms, returns, documents and resolutions required to be filed with the Registrar of Companies and Central Government;
(d) service of documents by the Company on its Members, and the Registrar of companies;
(e) notice of Board meetings and Committee meetings of Directors;
(f) the meetings of Directors and Committees of Directors including passing of resolutions by circulation;
(g) the 17th Annual General Meeting held on June 20, 2009;
(h) requirements under section 391-394 of the Act read with Companies (Court) Rules, and the Order of the Hon’ble High Court of Delhi with regard to amalgamation of XYZ Private Limited with the Company.
(i) minutes of proceedings of General Meetings and of Board and other meetings;
(j) approvals of the Members, the Board of Directors, the Committees of Directors and government authorities, wherever required;
(k) constitution of the Board of Directors / Committee(s) of directors and appointment, retirement and re-appointment of Directors including the Managing Director and Wholetime Directors;
(l) payment of remuneration to the Directors including the Managing Director and Wholetime Directors;
(m) appointment and remuneration of Auditors and Cost Auditors;
(n) transfers and transmissions of the Company’s shares, issue and allotment of shares and issue and delivery of original and duplicate certificates of shares;
(o) declaration and payment of dividends;
(p) transfer of certain amounts as required under the Act to the Investor Education and Protection Fund;
(q) borrowings and registration, modification and satisfaction of charges;
(r) investment of the Company’s funds including inter corporate loans and investments and loans to others;
(s) giving guarantees in connection with loans taken by subsidiaries and associate companies;
(t) form of balance sheet as prescribed under Part I of Schedule VI to the Act and requirements as to Profit & Loss Account as per Part II of the said Schedule;
(u) contracts, common seal, registered office and publication of name of the Company; and
(v) generally, all other applicable provisions of the Act and the Rules made under that Act.

B. I further report that:

(a) the Directors have not complied with the requirements as to disclosure of interests and concerns in contracts and arrangements, shareholdings / debenture holdings and directorships in other companies and interests in other entities;

(b) the Directors have not complied with the disclosure requirements in respect of their eligibility of appointment, their being independent and compliance with the Company’s Code of Business Conduct & Ethics (COBE) for Directors and Management Personnel;

(c) the Company has obtained all necessary approvals under the various provisions of the Act;

(d) there was no prosecution initiated against or show cause notice received by the
Company and no fines or penalties were imposed on the Company during the year under review under the Companies Act, SEBI Act, SCRA, Depositories Act, Listing Agreement and Rules, Regulations and Guidelines framed under these Acts against the Company, its Directors and Officers.

C. **I further report that the Company has not complied with the certain provisions of the Depositories Act, 1996 and the Bye-laws framed under that Act by the Depositories with regard to dematerialisation / rematerialisation of securities and reconciliation of records of dematerialised securities with all securities issued by the Company.**

D. I further report that:

   (a) the Company has complied with the requirements under the Equity Listing Agreements entered into with the Bombay Stock Exchange Limited and the National Stock Exchange of India Limited;

   (b) the Company has complied with the provisions of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009;

   (c) the Company has complied with the provisions of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 including the provisions with regard to disclosures and maintenance of records required under the Regulations;

   (d) the Company has complied with the provisions of the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992 including the provisions with regard to disclosures and maintenance of records required under the Regulations; and

   (e) the Company has not complied with the provisions of the Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999 with regard to implementation of Employee Stock Option Scheme, grant of Options and other aspects.

Signature of Company Secretary

C.P. No.

DECLARATION

I ____________________ a member of the Institute of Company Secretaries of India, do declare that I am a Secretary in whole-time practice as defined in Section 2(2) of the Company Secretaries Act, 1980 and hence am I qualified to undertake Secretarial Audit of your company.

I do further declare that I do not suffer from any of the disqualifications set out in the Guidance Note issued by the Institute of Company Secretaries of India.

Signature

Certificate of Practice No.

Membership No.

Place :

Date :
Question 6

(a) Bharat Foods Ltd., has decided to invite the public to subscribe its equity capital. List out the services which a Practising Company Secretary can render in respect of the initial public offering (IPO). (6 marks)

(b) Tej Speed Ltd., an unlisted public company, has issued bonus shares in the ratio 2:1. You are required to prepare a check-list to confirm that every requirement has been fulfilled. Further, if the company is a listed company, what are the additional requirements which are required to be met? (6 marks)

(c) Mention the provisions regarding obtaining of compliance certificate by a company from a Secretary in Whole-time Practice. Also, state the action to be taken on such certificate by the company. (4 marks)

Answer 6(a)

The plethora of services, which a Practising Company Secretary can render in IPOs include the following:

1. Planning Stage
   (a) Deciding the time line
   (b) Compliance related issues
   (c) Importance of Corporate Governance
   (d) Structure of Board
   (e) Promoters consent
   (f) Method of issuance of shares (Demat/Physical/Both) - Compliance

2. Due diligence
   (a) Company Contract and Leases
   (b) Legal and Tax Issues
   (c) Corporate issues
   (d) Financial Assets
   (e) Financial Statement
   (f) Creditors & Debtors
   (g) Legal Cases against the company

3. Appointing Advisors and other intermediaries such as:
   (a) Investment Bankers
   (b) Book Running Lead Managers
   (c) Issues with Depository
(d) Legal Advisor
(e) Bankers

4. Offer Document
(a) Drafting the offer document
(b) Filing with SEBI
(c) In-principle approval of Stock Exchange
(d) Filing with Designated Stock Exchanges
(e) Complying with Comments received from SEBI
(f) Filing with ROC

5. Issue Period
(a) Adhering to Issue Opening/Closing Date
(b) Compiling Field Reports on subscription status
(c) Coordinating with Registrar/Bankers to the issue

6. Allotment of shares
(a) Basis of allotment
(b) Board meeting for allotment
(c) Crediting shares in beneficiary account/dispatch of share certificates
(d) Despatch of refund orders
(e) Payment of stamp duty

7. Listing
(a) Filing for Listing with Designated Stock Exchange
(b) Finalisation of Listing Process

8. Post issue compliances
(a) To ensure proper compliance with Listing Agreement
(b) Redressal of shareholder complaints
(c) Timely filing of required reports with ROC/SEBI/Stock Exchange

As can be seen from the above, a Company Secretary is a key member in an IPO team. Apart from checking the applicability and eligibility norms or exemption from eligibility norms and the pre-listing requirements of Stock Exchange, he is responsible for ensuring that the company has complied with the pre-issue, issue and post-issue obligations of the company and corporate governance requirements including disclosures with respect to, inter alia, material contracts, statutory approvals, subsidiaries and promoter holding and litigations.
Compliance of SEBI (ICDR) Regulations 2009 and other applicable Acts and guidelines is a primary responsibility of the Company Secretary in case the company proposes to list its securities abroad, he is also required to comply with conditions for listing abroad.

**Answer 6(b)**

**Checklist for issue of Bonus shares**

**Checklist for unlisted company**

Check whether:

(i) Articles of Association of the company provide for capitalisation of profits;

(ii) Requisite resolution was passed by the Board and shareholders in their meeting for capitalization of profits and issuing bonus shares;

(iii) Return of allotment in e-Form No. 2 was filed within 30 days of passing resolution.

**Checklist for listed company**

With respect to listed companies, SEBI (ICDR) Regulations additionally prescribes the following criteria for issue of bonus shares.

— Ensure that issuer has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;

— Ensure that the issuer has sufficient reason to believe that it has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity and bonus;

— Ensure that partly paid shares, if any outstanding on the date of allotment, are made fully paid up

— It may be noted that no issuer shall make a bonus issue of equity shares if it has outstanding fully or partly convertible debt instruments at the time of making the bonus issue, unless it has made reservation of equity shares of the same class in favour of the holders of such outstanding convertible debt instruments in proportion to the convertible part thereof.

— The equity shares reserved for the holders of fully or partly convertible debt instruments shall be issued at the time of conversion of such convertible debt instruments on the same terms or same proportion on which the bonus shares were issued.

— The Bonus issue shall be made out of free reserves and not out of revaluation reserves.

— The bonus share shall not be issued in lieu of dividend.

— An issuer, announcing a bonus issue after the approval of its board of directors and not requiring shareholders’ approval for capitalisation of profits or reserves
for making the bonus issue, shall implement the bonus issue within fifteen days from the date of approval of the issue by its board of directors: However, where the issuer is required to seek shareholders’ approval for capitalisation of profits or reserves for making the bonus issue, the bonus issue shall be implemented within two months from the date of the meeting of its board of directors wherein the decision to announce the bonus issue was taken subject to shareholders’ approval.

— Once the decision to make a bonus issue is announced, the issue can not be withdrawn.

Answer 6(c)

Under Section 383 A(1) of the Companies Act, 1956, every Company having a paid-up share capital of not less than five crore rupees shall have a whole-time Company Secretary. Every Company not required to employ a whole-time secretary under Section 383 A(1) of the Companies Act, 1956 and having a paid up capital of ten lakhs rupees or more shall obtain a certificate from a secretary in whole-time practice. It is necessary for the company to attach a copy of the Compliance Certificate with the Board’s report while forwarding the same to members and others. The Compliance Certificate is required to be laid by the company in its annual general meeting. The compliance certificate is also required to be filed with the ROC the Compliance Certificate within thirty days from the date on which its annual general meeting is held.

Question 7

(a) Distinguish between any two of the following:

(i) ‘Initial public offering’ and ‘further public offering’.
(ii) ‘Physical data room’ and ‘virtual data room’.
(iii) ‘Joint venture’ and ‘wholly owned subsidiary’.  (4 marks each)

(b) Write notes on any two of the following:

(i) Transfer of unpaid amount to the Investor Education and Protection Fund
(ii) Whistle blower policy
(iii) Depository participants.  (4 marks each)

Answer 7(a)(i)

Initial Public Offering (IPO) is when an unlisted company makes either a fresh issue of securities or an offer for sale of its existing securities or both for the first time to the public. This paves way for listing and trading of the issuer’s securities.

A further public offering (FPO) is when an already listed company makes either a fresh issue of securities to the public or an offer for sale to the public, through an offer document. An offer for sale in such scenario is allowed only if it is made to satisfy listing or continuous listing obligations.
Virtual and Physical Data Room – A comparison

Some of the major points of distinction between the two include the following:

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Particulars</th>
<th>Physical Data Room</th>
<th>Virtual Data Room</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Form of documents</td>
<td>Papers, files, boxes or any tangible thing</td>
<td>Electronic / Digital/soft copies of documents including video/audio documents</td>
</tr>
<tr>
<td>2</td>
<td>Security of documents</td>
<td>Lies with the integrity of person who is in charge of the data room</td>
<td>More secured through specific log-in id and password. In addition facilities like internet firewalls are there.</td>
</tr>
<tr>
<td>3</td>
<td>Time required for creation of data room</td>
<td>Longer time required.</td>
<td>Can be created within 48 hours also once demands of prospective bidders are identified.</td>
</tr>
<tr>
<td>4</td>
<td>Cost</td>
<td>High because of reasons like—Requirement of one person to take care of data room. Requires bidders to travel from their place to the place of location of data room etc</td>
<td>Low as the documents can be viewed from any location with internet security.</td>
</tr>
<tr>
<td>5</td>
<td>Convenience</td>
<td>Low Level because of reasons like—Only one prospective bidder can review the documents at a time Difficult to search the documents that is required</td>
<td>More convenient as it enables multiple bidders to review documents with search facility also.</td>
</tr>
<tr>
<td>6</td>
<td>Accessibility to data room</td>
<td>Restricted time</td>
<td>Any time.</td>
</tr>
<tr>
<td>7</td>
<td>Facility to restrict access of document access</td>
<td>Not there</td>
<td>Access can be restricted.</td>
</tr>
<tr>
<td>8</td>
<td>Facility to check who has reviewed what documents and how many times</td>
<td>Not available</td>
<td>Available</td>
</tr>
<tr>
<td>9</td>
<td>Facility to highlight new information</td>
<td>To be conveyed manually to all bidders</td>
<td>A highlight can be made in the site created as data room</td>
</tr>
<tr>
<td>10</td>
<td>Ability to copy documents</td>
<td>Possible</td>
<td>Not possible always</td>
</tr>
<tr>
<td>11</td>
<td>One to one communication in person with the seller or his representatives</td>
<td>Available</td>
<td>Not available</td>
</tr>
</tbody>
</table>
Answer 7(a)(iii)

Joint Ventures and Foreign Collaborations are important business models which become more popular with the opening up of the economies in the context of liberalization, competition and globalization.

A joint venture is a partnership through which two or more firms create a separate entity to carry out a particular economic activity in which each partner takes an active role in decision making. The essential features of joint ventures may be classified as:

(a) an agreement between the parties on common long term objectives such as production, sales, financing etc.

(b) pooling of assets, IPRs and other facilities for achievement of agreed objectives

(c) sharing of profits.

Joint ventures are considered appropriate when complementary needs exist between companies and there is compatibility with the strategies.

Wholly owned subsidiary with respect to Indian holding company means a foreign entity formed, registered or incorporated in accordance with the laws and regulation of the host country whose entire capital is hold by Indian party. Similarly foreign entities may incorporate wholly owned subsidiaries in India subject to conditions and approvals as prescribed.

Answer 7(b)(i)

Transfer of unpaid amount to the Investor Education and Protection Fund

As per Section 205C of the Companies Act, 1956, the Central Government shall establish a fund to be called the Investor Education and Protection Fund which shall be credited with the following amounts, namely:

(a) amounts in the unpaid dividend accounts of companies;

(b) the application moneys received by companies for allotment of any securities and due for refund;

(c) matured deposits with companies;

(d) matured debentures with companies;

(e) the interest accrued on the account referred to in clauses (a) to (d);

(f) grants and donations given to the Fund by the Central Government, State Government, companies or any other institutions for the purposes of the Fund; and

(g) the interest or other income received out of the investments made from the Fund.

It may be noted that no such amounts referred to in clauses (a) to (d) above shall form part of the fund unless such amounts have remained unclaimed and unpaid for a period of seven years from the date they became due for payment.
The Fund shall be utilised for promotion of investor awareness and protection of the interests of investors in accordance with such rules as may be prescribed.

Answer 7(b)(ii)

Whistle Blower Policy

The company may establish a mechanism for employees to report to the management concerns about unethical behaviour actual or suspected fraud or violation of the company’s code of conduct or ethics policy. This mechanism could also provide for adequate safeguards against victimization of employees who avail of the mechanism and also provide for direct access to the Chairman of the Audit Committee in exceptional cases. Once established, the existence of the mechanism may be appropriately communicated within the organization.

Answer 7(b)(iii)

Depository Participants

Just as a broker act an agent of the investor at the stock exchange, a depository participant (DP) is the representative (agent) of the investor in the depository system providing the link between the company and investor through the depository. The depository participant maintains securities account balance and intimate the status of holding to the account holder from time to time. According to SEBI guidelines, financial institutions like banks, custodians, stock brokers etc. can become participants in the depository. A DP is one with whom an investor needs to open an account to deal in shares in electronic form. While the depository can be compared to a bank, DP is like a branch of that bank with which an account can be opened.

Question 8

Critically examine and comment on any four of the following :

(i) The objective of due diligence is to allow the investigator to consider the various options, considering the facts found in the course of due diligence.

(ii) Whenever a corporate action is announced, the issuer or its Registrar and Transfer Agent (RTA) should inform its depository just after the day of communication of the same to the relevant stock exchange(s).

(iii) A limited two-way fungibility scheme has been put in place by the Government of India for ADRs/GDRs.

(iv) Overseas investments by established proprietorship or unregistered partnership exporter firms will be subject to certain conditions.

(v) Corporate laws are core competence areas of a Company Secretary and corporate compliance management broadly requires complete compliance of these laws. (4 marks each)

Answer 8(i)

The goal of due diligence is to provide the party proposing the transaction with sufficient information to make a reasoned decision as to whether or not to complete the transaction as proposed. It should provide a basis for determining or validating the
appropriate terms and price for the transaction incorporating consideration of the risks inherent in the proposed transaction.

*Withdrawal of deal* - if the due diligence uncovers information that disclosed the investments, loan or participation, a risky or undesirable one and which cannot be adequately resolve then the investigator may withdrawal from the deal.

*Adjusting the valuation of the investment* – the investigator may revise his valuation of the company or reassess the price at which it will provide services. More often, the information will be adverse and therefore the valuation will go down or the price will go up.

*Solving of problems uncovered* - it may be possible for a problem uncovered by the due diligence to be solved before the deal goes ahead. For example, unpaid stamp duty could be paid, company filing could be put in order or, if negative information is uncovered on a principal of the target company, the investor may put pressure on the target is put into a state that the investigator is happier with before it deals with it.

**Answer 8(ii)**

Whenever a corporate action is announced, the issuer or its register and transfer agent, should inform its depository just after the day of communication of the same to the relevant stock exchange(s). The depository should then inform the participants through a circular about the relevant action, the no-delivery period, the cut-off date and the procedure to be followed by the participants.

On the basis of the particulars of the holding a beneficial owners received from the depository as of the cut-off date, the issuer or its register and transfer agent would distribute dividend, interest and other monetary benefits directly to the beneficial owners.

**Answer 8(iii)**

A limited two-way fungibility scheme has been put in place by the Government of India for ADRs/GDRs. Under this scheme, a stock broker in India registered with SEBI, can purchase shares of an Indian company from the market for conversion into ADRs/GDRs based in instructions received from overseas investors. Re-issuance of ADRs/GDRs would be permitted to the extent of ADRs/GDRs which have been redeemed into underlying shares and sold in the Indian market.

**Answer 8(iv)**

Overseas investments by established proprietorship or unregistered partnership exporter firms will be subject to the following conditions:

(i) The Partnership/Proprietorship firm is a (Director General of Foreign Trade) DGFT recognized Star Export House.

(ii) The Authorised Dealer category-I blank is satisfied that the exporter is KYC (know your customer) compliant-B engaged in the proposed business and meets the requirement.

(iii) Exporter has proven track record i.e. export outstanding does not exceed 10 per cent of the average export realization of preceding three financial years.
(iv) The exporter has not come under adverse notice of any government agency like Enforcement Directorate, CBI and does not appear in the exporters’ caution list of the Reserve Bank or in the list of defaulters to the banking system in India.

(v) The amount of investment outside India does not exceed 10 per cent of the average of three financial years export realization or 200 per cent of the net owned funds of the firm, whichever is lower.

**Answer 8(v)**

Corporate Compliance Management can add substantial business value only if compliance is done with due diligence. A Company Secretary is the ‘Compliance Manager’ of the company. It is he who ensures that the company is in total compliance with all regulatory provisions. Corporate disclosures, which play a vital role in enhancing corporate valuation, is the forte of a Company Secretary.

Corporate laws are core competence areas of a company secretary and corporate compliance management broadly requires compliance of laws by corporates which includes:

(i) Companies Act, 1956 and the various Rules and Regulations framed there under, MCA-21 requirements and procedures.

(ii) Secretarial standards/Accounting Standards/Cost Accounting Standards issued by ICSI/ICAI/ICWAI respectively.

(iii) Foreign Contribution Regulation Act, 1976.


(v) Foreign Exchange Management Act, 1999.


(ix) Intellectual Property Laws, etc.
GOVERNANCE, BUSINESS ETHICS AND SUSTAINABILITY

Time allowed : 3 hours    Maximum marks : 100

PART A

(Answer Question No. 1 which is compulsory
and any two of the rest from this part)

Question 1

(a) “Independent directors are known to bring objective view in Board deliberations. They also ensure that there is no dominance of one individual or special interest group or the stifling of healthy debate. They act as the guardians of the interest of all shareholders and stakeholders, especially in the areas of potential conflict.” Discuss the above statement in the light of Clause 49 of the listing agreement. (10 marks)

(b) State, with reasons in brief, whether the following statements are true or false:

(i) Kautilya’s Arthashastra maintains that for good governance all administrators including the king were considered the masters of the people.

(ii) Clause 49 of the listing agreement obligates a company to make disclosure about the remuneration of directors.

(iii) Any person, who has access to the price sensitive information, need not be an ‘insider’.

(iv) Board meetings should be held at least four times in a year with a maximum gap of six months.

(v) Shareholders activism does not refer to the active involvement of stakeholders in their company. (2 marks each)

Answer 1(a)

Independent directors are known to bring an objective view in board deliberations. They also ensure that there is no dominance of one individual or special interest group or the stifling of healthy debate. They act as the guardians of the interest of all shareholders and stakeholders, especially in the areas of potential conflict.

Independent Directors bring a valuable outside perspective to the deliberations. They contribute significantly to the decision-making process of the Board. They can bring on objective view to the evaluation of the performance of Board and management. In addition, they can play an important role in areas where the interest of management, the company and stakeholders may diverge such as executive remuneration, succession planning, changes in corporate control, audit function etc.

Independent directors are required because they perform the following important role:

(i) Balance the often conflicting interests of the stakeholders.

(ii) Facilitate withstanding and countering pressures from owners.
(iii) Fulfill a useful role in succession planning.
(iv) Act as a coach, mentor and sounding Board for their full time colleagues.
(v) Provide independent judgment and wider perspectives.

In this context, the Clause 49 requires that the Board of directors of the company shall have an optimum combination of executive and non-executive directors with not less than fifty percent of the board of directors comprising of non-executive directors. In terms of Clause 49 of the Listing Agreement, at least one-third of the Board should comprise of independent directors where the Chairman of the Board is a non-executive director, and in case the Chairman is an executive director, at least half of the Board should comprise of independent directors.

Further, where the non-executive Chairman is a promoter of the company or is related to any promoter or person occupying management positions at the Board level or at one level below the Board, at least one-half of the Board of the company shall consist of independent directors."

As per Clause 49, an independent director shall mean a non-executive director of the company who:

(a) apart from receiving director's remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its directors, its senior management or its holding company, its subsidiaries and associates which may affect independence of the director;
(b) is not related to promoters or persons occupying management positions at the board level or at one level below the board;
(c) has not been an executive of the company in the immediately preceding three financial years;
(d) is not a partner or an executive or was not partner or an executive during the preceding three years, of any of the following:
   (i) the statutory audit firm or the internal audit firm that is associated with the company, and
   (ii) the legal firm(s) and consulting firm(s) that have a material association with the company.
(e) is not a material supplier, service provider or customer or a lessor or lessee of the company, which may affect independence of the director; and
(f) is not a substantial shareholder of the company i.e. owning two percent or more of the block of voting shares;
(g) is not less than 21 years of age.

**Answer 1(b)(i)**

False. Kautilya’s Arthashastra maintains that for good governance, all administrators including the King were considered the servants of the people.

**Answer 1(b)(ii)**

True. Clause 49 of the listing agreement obligates a company to make disclosure about the remuneration of directors.
Answer 1(b)(iii)

**False.** In terms clause 2 (e) (ii) of SEBI (Prohibition of Insider Trading) Regulations, 1992, Insider is any person who has received or has had access to unpublished price sensitive information in respect of securities of the company.

Answer 1(b)(iv)

**False.** Board meetings should be held at least four times in a year with a maximum gap of four months.

Answer 1(b)(v)

**False.** Shareholder activism refers to the active involvement of stockholders in their organization.

Question 2

(a) Write short notes on any three of the following:

(i) The Turnbull Report
(ii) CII’s Desirable Corporate Governance Code
(iii) Role of institutional investors in Corporate Governance
(iv) Shareholders’ rights. (3 marks each)

(b) Juris Global Ltd., an LPO company, aims for listing at New York Stock Exchange (NYSE). The companies listed on the NYSE are required to comply with certain standards regarding Corporate Governance as prescribed in the NYSE’s listing rules. Your company will be required, inter alia, to comply with these rules. As a Company Secretary, you are required to prepare a Board note highlighting the provisions of the NYSE’s listing rules with respect to the Board structure and constitution of various committees of the Board. (6 marks)

Answer 2(a)(i)

**The Turnbull Report**

The original Combined Code required companies to include a narrative statement in their Annual Report of how in internal control provisions had been applied. However, the combined code did not have guidelines of how the provisions should be applied by the companies. This led to the establishment of a Working Group under the Chairmanship of Nigel Turnbull. Turnbull Committee published “Internal Control Guidance for Directors on Combined Code”.

In 2004, the Financial Reporting Council established the Turnbull Review Group to consider the impact of the guidance and the related disclosures and to determine whether the guidance needed to be updated. In October 2005, the revised guidance was issued.

Answer 2(a)(ii)

**CII’S Desirable Corporate Governance Code**

Confederation of Indian Industry (CII) took a special initiative on Corporate Governance, the first institution initiative in Indian Industry. The objective was to develop
and promote a code for Corporate Governance to be adopted and followed by Indian companies, whether in the Private Sector, the Public Sector, Banks or Financial Institutions, all of which are corporate entities. The final draft of the said Code was widely circulated in 1997. In April 1998, the Code was released. It was called Desirable Corporate Governance Code.

Answer 2(a)(iii)

Institutional shareholders should reflect the following characteristics:

- Take active interest in the composition of board of Directors
- Be vigilant
- Maintain regular and systematic contact at senior level for exchange of views on management, strategy, performance and quality of management
- Ensure that voting intentions are translated into practice
- Evaluate Corporate Governance performance of the company

The Combined Code (2008) stated the following principles of good governance for the Institutional Shareholders

(a) Dialogue with companies

Institutional shareholders should enter into a dialogue with companies based on the mutual understanding of objectives.

(b) Evaluation of governance disclosures

When evaluating companies’ governance arrangements, particularly those relating to board structure and composition, institutional Investors should give due weight to all relevant factors drawn to their attention.

(c) Shareholder voting

Institutional shareholders have a responsibility to make considered use of their votes.

Answer 2(a)(iv)

Shareholders’ Rights

The provisions of Companies Act 1956 guarantee shareholders with several rights some of which have been discussed hereunder:

- Right to receive copies of the abridged balance-sheet and profit & loss account, report of cost auditor, contracts for appointment of the managing director/manager & notices of the general meetings of the company
- Right to inspect statutory registers/ returns and get copies thereof on payment of prescribed fee.
- Right to attend meetings of the shareholders and exercise voting rights at these meetings either personally or through proxy.
Apart from these shareholders have right to receive share certificates, transfer shareholdings, right to receive dividend when declared, to appoint directors, right to share the surplus assets on winding up, right to collectively make application to the Central Government for the investigation of the affairs of the company.

Under section 106 the rights attached to the shares of any class can be varied with the consent in writing of the holders of not less than three-fourths of the issued shares of that class or sanction in a separate meeting.

Right to make application collectively to Company Law Board/ tribunal for oppression and mismanagement.

Right of Dissentient shareholders to apply to the court.

**Answer 2(b)**

**Board of Directors**

Juris Global Limited

*Sub*: A note on the listing Requirements of NYSE in respect of Board structure and its committees.

Companies listed on the New York Stock Exchange are required to comply with certain standards regarding corporate governance NYSE Listing Rules. The relevant provisions of the New York Stock Exchange’s Listing Rules are summarized below:

**Board Structure**

*Listed companies must have a majority of independent directors*

This condition is however not applicable to the following companies:

- A company of which more than 50% of the voting power is held by an individual, a group or another company.
- Limited partnerships and companies in bankruptcy proceedings need not comply with the requirements.
- Listed companies that are foreign private issuers are permitted to follow home country practice in lieu of this provision.

*Criteria for determining Independence of Director*

(i) A director who is an employee or whose immediate family member is an executive officer, of the company is not independent until three years after the end of such employment relationship.

(ii) A director who receives, or whose immediate family member receives, more than $100,000 per year in direct compensation from the listed company, other than director and committee fees and pension or other forms of deferred compensation for prior service, is not independent until three years after he or she ceases to receive more than $100,000 per year in such compensation.

(iii) A director who is affiliated with or employed by, or whose immediate family
member is affiliated with or employed in a professional capacity by, a present or former internal or external auditor of the company is not “independent” until three years after the end of the affiliation or the employment or auditing relationship.

(iv) A director who is employed, or whose immediate family member is employed, as an executive officer of another company where any of the listed company’s present executives serve on that company’s compensation committee is not “independent” until three years after the end of such service or the employment relationship.

(v) A director who is an executive officer or an employee, or whose immediate family member is an executive officer, of a company that makes payments to, or receives payments from, the listed company for property or services in an amount which, in any single fiscal year, exceeds the greater of $1 million, or 2% of such other company’s consolidated gross revenues, is not “independent” until three years after falling below such threshold.

Audit Committee

Listed companies must have an audit committee

Composition of Audit Committee

— The audit committee must have a minimum of three members.

— All the members of the Audit Committee must be independent

— Each member of the audit committee must be financially literate, as such qualification is interpreted by the company’s board in its business judgment, or must become financially literate within a reasonable period of time after his or her appointment to the audit committee.

— In addition, at least one member of the audit committee must have accounting or related financial management expertise, as the company’s board interprets such qualification in its business judgment.

Remuneration/Compensation Committee

Listed companies must have a compensation committee composed entirely of independent directors.

Nominating/Corporate Governance Committee

Listed companies must have a nominating/corporate governance committee composed entirely of independent directors.

Sd/-

Company Secretary

Question 3

(a) “The rapidly growing global economy has created an expanding array of risks to be managed to ensure the viability and success of an enterprise.” Discuss this statement enumerating various classes of risks and the ways of risk handling. (5 marks)
(b) “Corporate social responsibility is an evolving concept.” Describe and distinguish 'corporate social responsibility' with 'corporate philanthropy'. (5 marks)

(c) “Corporate communication is all about managing perceptions and ensuring effective and timely dissemination of information, positive corporate image, and smooth and affirmative relationship with all stakeholders.” Explain and outline the scope of corporate communication. (5 marks)

**Answer 3(a)**

Risk may be broadly classified under the following heads:

(a) Industry & Services Risks
(b) Management and Operations Risks
(c) Market Risks
(d) Political Risks
(e) Credit Risks
(f) Liquidity Risks
(g) Disaster Risks
(h) Systems Risks
(i) Legal Risks
(j) Non-compliance and related risk

**Risk Handling**

Firms are not entirely free to decide on how they shall handle their risks. In every country there are governmental and official regulations governing health and safety at work like fire precautions, hygiene, environmental pollution, food, handling of dangerous substances and many other matters relating to properties, personal injuries and other risks. The Central Government and State Governments have enacted compulsory insurance regulations (for vehicles and individuals). And in addition a firm may be obliged to insure certain risks under provisions of leases, construction and other contracts. Failure to comply with both safety and compulsory insurance regulations may constitute a criminal offence and may lead to the closure of a plant or other establishments. Thus, if a firm wishes to carry on certain activities it must comply with the relevant official risk handling regulations. There will remain, however, broad areas where it can exercise its own discretion to control physical or financial loss.

Risks can be handled broadly in four ways:

**Risk Avoidance**

It is a rare possibility to avoid a risk completely. A riskless situation is rare. Generally risk avoidance is only feasible at the planning stage of an operation.

**Risk Reduction**

In many ways physical risk reduction (or loss prevention, as it is often called) is the best way of dealing with any risk situation and usually, it is possible to take steps to reduce the probability of loss. Again, the ideal time to think of risk reduction measures is at the planning stage of any new project when considerable improvement can be
achieved at little or no extra cost. The only cautionary note regarding risk reduction is that, as far as possible expenditure should be related to potential future saving in losses and other risk costs; in other words, risk prevention generally should be evaluated in the same way as other investment projects.

**Risk Retention**

It is also known as risk assumption or risk absorption. It is the most common risk management technique. This technique is used to take care of losses ranging from minor to major break-down of operation. There are two types of retention methods for containing losses as under:

(i) Risk retained as part of deliberate management strategy after conscious evaluation of possible losses and causes. This is known as active form of risk retention.

(ii) Risk retention occurred through negligence. This is known as passive form of risk retention.

**Risk Transfer**

This refers to legal assignment of cost of certain potential losses to another. The insurance of ‘risks’ is to occupy an important place, as it deals with those risks that could be transferred to an organization that specialises in accepting them, at a price. Usually, there are 3 major means of loss transfer viz., (i) By Tort (ii) By contract other than insurance (iii) By contract of insurance. The main method of risk transfer is insurance. The value of the insurance lies in the financial security that a firm can obtain by transferring to an insurer, in return for a premium for the risk of losses arising from the occurrence of a specified peril. Thus, insurance substitutes certainty for uncertainty. Insurance does not protect a firm against all perils but it offers restoration, atleast in part of any resultant economic loss.

**Answer 3(b)**

Philanthropy means the act of donating money, goods, time or effort to support a charitable cause with regard to a defined objective. Philanthropy can be equated with benevolence and charity for the poor and needy. Philanthropy can be any selfless giving towards any kind of social need that is not served, underserved, or perceived as unserved or underserved. Philanthropy can be by an individual or by a corporate.

The Etymological origin of the word is from Late Latin philanthropia, from Greek philanthropia, from philanthropos loving people that is phil- + anthropos human being. It is the active effort to promote human welfare.

Corporate Social Responsibility on the other hand is about how a company align their values to social causes by including and collaborating with their investors, suppliers, employees, regulators and the society as a whole. The investment in CSR may be on people centric issues and/or planet issues. CSR initiatives of a corporate is not a selfless act of giving; companies derive long-term benefits from the CSR initiatives and it is this enlightened self interest which is driving the CSR initiatives in companies.

**Answer 3(c)**

Corporate communication means the corporation’s voice and the images it projects of itself to the various stakeholders. This includes various areas such as corporate
reputation, corporate advertising, and employee communications, government relations and media management. These days most of the bigger organizations have departments of corporate communication which appears on the organizational chart along with traditional functions like marketing or accounting.

The corporate communication can also be defined as the processes a company uses to communicate all its messages to key constituencies —

— a combination of meetings,
— interviews,
— speeches,
— reports,
— images
— advertising, and
— on-line communication.

Ideally, corporate communication is an attitude or a set of mental habits that employees internalize. The result is good communication practices that permeate an organisation and are present in all its communications with constituencies.

Corporate communications also includes all the products of communication, such as memos, letters, reports, websites, e-mails, speeches or new releases. In the aggregate of these messages is what a company sends to its constituencies, whether internal or external. The communications can be written communication verbal or spoken communications or non-verbal communications. Electronic channels like email, voice mail, telephone calls video conferencing and chat sessions are gaining more importance as communication channels.

**Question 4**

(a) **Describe briefly any three of the following:**

(i) ICSI initiatives towards Corporate Governance
(ii) Prohibition on insider trading
(iii) Mandatory committees under the listing agreement
(iv) COSO’s internal control framework.

(3 marks each)

(b) **Enumerate any six Corporate Governance Forums worldwide, which are instrumental in promoting the culture of creativity and compliance among corporates.**

(6 marks)

**Answer 4(a)(i)**

**ICSI’s Philosophy on Corporate Governance**

The ICSI, after extensive research, has taken a lead step in defining Corporate Governance as “the application of best management practices, compliance of law in letter and spirit and adherence to ethical standards for effective management and
distribution of wealth and discharge of social responsibility for sustainable development of all stakeholders.”

**The ICSI National Awards for Excellence in Corporate Governance**

In pursuit for excellence and to identify, foster and reward the culture of evolving globally acceptable standards of corporate governance among Indian companies, the Institute instituted the “ICSI National Award for Excellence in Corporate Governance” in the year 2001. The underlying guideline for the Corporate Governance Award is to identify the corporates, which best establish and follow, corporate governance norms in letter and spirit.

**Institute’s Post Membership Qualification Course in Corporate Governance**

In order to update members of ICSI about best practices in Corporate Governance, the ICSI has introduced Post Membership Qualification Course in Corporate Governance.

**Some of ICSI’s other major initiatives in Corporate Governance include**

— ICSI Recommendations to Strengthen Corporate Governance Framework.

— ICSI- Centre for Corporate Governance Research and Training

— Founder Trustee of National Foundation For Corporate Governance

— Secretarial Standards Board

— Segmentwise Role of Company Secretaries

— Directors’ Training and Orientation Investor Education Programmes

— MOU with Chambers on CSR

**Answer 4(a)(ii)**

**Prohibition on insider trading**

Regulation 2(e) of Securities and Exchange Board of India (Prohibition of Insider trading) Regulations, 1992 defines “insider” as any person who,

(i) is or was connected with the company or is deemed to have been connected with the company and is reasonably expected to have access to unpublished price sensitive information in respect of securities of a company, or

(ii) has received or has had access to such unpublished price sensitive information;

Regulation 3 of aforesaid regulations provide for restriction on trading of securities by providing that no insider shall—

(i) either on his own behalf or on behalf of any other person, deal in securities of a company listed on any stock exchange when in possession of any unpublished price sensitive information; or

(ii) communicate or counsel or procure directly or indirectly any unpublished price sensitive information to any person who while in possession of such unpublished price sensitive information shall not deal in securities.
It further provides that nothing contained above shall be applicable to any communication required in the ordinary course of business or profession or employment or under any law.

**Answer 4(a)(iii)**

**Mandatory Committees**

Audit Committee and Shareholder Grievance Committees are mandatory committees which has to be constituted by a listed entity to whom clause 49 of the Listing Agreement is applicable

A qualified and independent audit committee shall be set up, having minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors.

In terms of Clause 49-IV(G)(iii) of the Listing Agreement, a board committee under the chairmanship of a non-executive director shall be formed to specifically look into the redressal of shareholder and investors complaints like transfer of shares, non-receipt of balance sheet, non-receipt of declared dividends etc. This Committee shall be designated as ‘Shareholders/Investors Grievance Committee’.

**Answer 4(a)(iv)**

COSO is the acronym for Committee of Sponsoring Organizations of the Treadway Commission. COSO is a U.S. private-sector initiative. Its major objective is to identify the factors that cause fraudulent financial reporting and to make recommendations to reduce its incidence. COSO has established a common definition of internal controls, standards, and criteria against which companies and organizations can assess their control systems.

Internal control is a process, effected by an entity’s board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

— Effectiveness and efficiency of operations
— Reliability of financial reporting
— Compliance with applicable laws and regulations.

**Answer 4(b)**

(i) **National Foundation for Corporate Governance (NFCG)**

With the goal of promoting better corporate governance practices in India, the Ministry of Corporate Affairs, Government of India, has set up National Foundation for Corporate Governance (NFCG) in partnership with Confederation of Indian Industry (CII), Institute of Company Secretaries of India (ICSI) and Institute of Chartered Accountants of India (ICAI).

NFCG endeavours to build capabilities in the area of research in corporate governance and to disseminate quality and timely information to concerned
stakeholders. It works to foster partnerships with national as well as international organisations.

(ii) **Organisation for Economic Co-operation & Development (OECD)**

The Organisation for Economic Co-operation and Development (OECD) was established in 1961. The OECD was one of the first non-government organizations to spell out the principles that should govern corporates.

The OECD Principles of Corporate Governance set out a framework for good practice which was agreed by the governments of all 30 countries that are members of the OECD. They were designed to assist governments and regulatory bodies in both OECD countries and elsewhere in drawing up and enforcing effective rules, regulations and codes of corporate governance. They also provide guidance for stock-exchanges, investors, companies and others that have a role in the process of developing good corporate governance.

(iii) **Global Corporate Governance forum (GCGF)**

The Global Corporate Governance Forum (the Forum) was founded in 2001 by the World Bank and the Organisation for Economic Co-operation and Development (OECD) following the financial crises in Asia and Russia in the latter part of the 1990’s. It was established to promote initiatives to raise corporate governance standards and practices in developing countries and emerging markets, using the OECD Principles of Corporate Governance as the basis for its work.

(iv) **Common Wealth Association of Corporate Governance (CACG)**

The Commonwealth Association of Corporate Governance (CACG) was established in 1998 with the objective of promoting the best international standards on corporate governance throughout the Commonwealth as a means to achieve global standards of business efficiency, commercial probity and effective economic and social development.

(v) **International Corporate Governance Network (ICGN)**

The International Corporate Governance Network (“ICGN”) is a not-for-profit company limited by guarantee under the laws of England and Wales. The Network’s mission is to develop and encourage adherence to corporate governance standards and guidelines, and to promote good corporate governance worldwide.

(vi) **European Corporate Governance Institute (ECGI)**

The European Corporate Governance Institute (ECGI) was founded in 2002. It has been established to improve corporate governance through fostering independent scientific research and related activities.

(vii) **Conference Board**

The Conference Board was established in 1916 in the United States of America. The Conference Board governance programs helps companies improve their
processes, inspire public confidence, and ensure they are complying with regulations.

(viii) **Asian Corporate Governance Association (ACGA)**

The Asian Corporate Governance Association (ACGA) is an independent, non-profit membership organisation dedicated to working with investors, companies and regulators in the implementation of effective corporate governance practices throughout Asia.

(Note: Candidates may elaborate on any six forums.)

**PART B**

*Answer ANY TWO questions from this part*

**Question 5**

(a) “The code of conduct of each company summarises its philosophy of doing business.

The exact details of this code are a matter of discretion, but there are some common principles in drafting of the code in most of the companies.” What are these principles? (6 marks)

(b) Write short notes on any three of the following:

(i) Activity analysis
(ii) Code of ethics
(iii) Deontological ethics
(iv) Ethics in marketing. (3 marks each)

**Answer 5(a)**

Although the exact details of this code are a matter of discretion, the following principles have been found to occur in most of the companies:

— Use of company’s assets;
— Avoidance of actions involving conflict of interest;
— Avoidance of compromising on commercial relationship;
— Avoidance of unlawful agreements;
— Avoidance of offering or receiving monetary or other inducements;
— Maintenance of confidentiality;
— Collection of information from legitimate sources only.
— Safety at workplace
— Maintaining and Managing Records
— Free and Fair competition
— Disciplinary actions
Answer 5(b)(i)

Activity Analysis

The ethical dimension of an activity can be determined with the help of the following grid which is self-explanatory:

<table>
<thead>
<tr>
<th>Parasite</th>
<th>Win-win Situation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Helping self</td>
<td>Helping self</td>
</tr>
<tr>
<td>Injuring Others</td>
<td>Helping Others</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Martyr</th>
<th>Total Loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>Helping Others</td>
<td>Injuring self</td>
</tr>
<tr>
<td>Injuring self</td>
<td>Injuring Others</td>
</tr>
</tbody>
</table>

The first block in the grid – help self and injuring others is obviously unethical. The second block that is helping others and injuring self may appear to be ethical, however it is not ethical. The third grid wherein one helps self and also helps others is the most ideal and ethical situation. The win-win situation. The last grid is a situation that should be avoided at all costs and is highly unethical.

Answer 5(b)(ii)

A code of ethics consists of general statements, sometimes altruistic or inspirational, that serve as principles and the basis for rules of conduct. A code of ethics generally specifies methods for reporting violations, disciplinary action for violations, and a structure of due process.

A code of ethics should reflect upper managers’ desire for compliance with the values, rules, and policies that support an ethical climate. The development of a code of ethics should involve the president, board of directors, and chief executive officers who will be implementing the code. Legal staff should also be called on to ensure that the code has correctly assessed key areas of risk and that it provides buffers for potential legal problems.

Corporate codes of ethics often contain about six core values or principles in addition to more detailed descriptions and examples of appropriate conduct. The six values that are desirable for codes of ethics include: (1) trustworthiness, (2) respect, (3) responsibility, (4) fairness, (5) caring, and (6) citizenship.

Answer 5(b)(iii)

Deontological ethics or deontology (Greek: (deon) meaning ‘obligation’ or ‘duty’) is an approach to ethics that focuses on the rightness or wrongness of actions themselves, as opposed to the rightness or wrongness of the consequences of those actions. Thus, the term ‘deontological’ picked out the set of ethical theories that are
based on the idea that an action’s being right or wrong is basic and the determining
factor, and whether a situation is good or bad depends on whether the action that brought
it about was right or wrong. This can be clarified with an example – if a manager decides
that it is his duty to always be on time to meetings is running late for reasons not in his
control, how is he supposed to drive to reach the meeting on time? Is he supposed to
speed, breaking his duty to uphold the law, or is he supposed to arrive at his meeting
late, breaking his duty to be on time?

Answer 5(b)(iv)

Ethics in Marketing

Marketing ethics is the area of applied ethics which deals with the moral principles
behind the operation and regulation of marketing. The ethical issues confronted in this
area include:

— Pricing: price fixing, price discrimination, price skimming.
— Anti-competitive practices like manipulation of supply, exclusive dealing
  arrangements, tying arrangements etc.
— Misleading advertisements
— Content of advertisements.
— Children and marketing.
— Black markets, grey markets.

Question 6

(a) “A major step in developing an effective ethics programme is implementing a
training programme and communication system to communicate and educate
employees about the company’s ethical standards.” Elucidate. (5 marks)

(b) What is ‘ethics committee’? Describe the functions of an ethics committee.
    (5 marks)

(c) “There are four theses viewing stakeholders’ theory.” Describe and discuss.
    (5 marks)

Answer 6(a)

Ethics Training and Communication

A major step in developing an effective ethics program is implementing a training
program and communication system to communicate and educate employees about the
firm’s ethical standards.

Training can educate employees about the firm’s policies and expectations, as well
as relevant laws and regulations and general social standards. Training programs can
make employees aware of available resources, support systems, and designated
personnel who can assist them with ethical and legal advice. They can also empower
employees to ask tough questions and make ethical decisions. Many companies are
now incorporating ethics training into their employee and management development
training efforts.
If ethics training is to be effective, it must start with a foundation, a code of ethics, a procedure for airing ethical concerns, line and staff involvements, and executive priorities on ethics that are communicated to employees. Managers from every department must be involved in the development of an ethics training program. Training and communication initiatives should reflect the unique characteristics of an organization: its size, culture, values, management style, and employee base. It is important for the ethics program to differentiate between personal and organizational ethics.

To be successful, business ethics programs should educate employees about formal ethical frameworks and more for analyzing business ethics issue. Then employees can base ethical decisions on their knowledge of choices rather than on emotions.

**Answer 6(b)**

**Ethics Committee**

Companies should have a committee of independent non-executive directors who are responsible for ensuring that systems are in place in the company to assure employee compliance with the Code of Ethics.

**Functions of Ethics Committee**

The oversight process of the Ethics Committee of an organization involves the following areas to be addressed by it:

**Review of the definitions of standards and procedures**

The Committee should review the organization’s areas of operation, the activities that require a formal set of ethical standards and procedures.

Once the review is complete and any shortcomings have come to light the ethics committee should assign the creation of revised guidelines to the appropriate personnel including the design of a formal method for communicating standards and procedures to employees. This method should ensure that employees both understand and accept the ethics program.

The ethics committee can suggest behaviors to upper management that reinforce the organization’s guidelines.

**Facilitate Compliance**

The ethics Committee has the responsibility for overall compliance. It is the responsible authority for ethics compliance within its area of jurisdiction It should serve as the court of last resort concerning interpretations of the organization’s standards and procedures. When and if inconsistencies come to light in this manner, the committee should make recommendations on improving the existing compliance mechanisms. And, as always, there should be follow-up to ensure that compliance recommendations have been understood and accepted.

**Due diligence of prospective employees**

The ethics committee should define how the organization will balance the rights of individual applicants and employees against the organization’s need to avoid risks that come from placing known violators in positions of discretionary responsibility. This includes
the oversight of background investigations on employees/applicants who are being considered for such positions.

**Oversight of communication and training of ethics programme**

The ethics committee should define methods and mechanisms for communicating ethical standards and procedures. This includes the distribution of documents (codes of conduct, for example) to ensure that every employee understands and accepts the organization’s ethical guidelines. To make certain that published standards are understood, the ethics committee should provide regular training sessions as well.

Since communication is two-way, the ethics committee should solicit stakeholder input regarding how standards and procedures are defined and enforced. In this connection, it is useful to create ways of providing proof that each employee has received the appropriate documents and understands the standards and procedures described.

**Monitor and audit compliance**

Compliance is an ongoing necessity and the ethics committee should design controls which monitor, audit and demonstrate employees’ adherence to published standards and procedures. There should also be mechanisms which check the effectiveness and reliability of such internal controls.

To warrant that the organization’s goals, objectives and plans do not conflict with its ethical standards and procedures, the ethics committee should develop methods for regular review and assessment.

**Enforcement of disciplinary mechanism**

Disciplinary provisions should be in place to ensure consistent responses to similar violations of standards and procedures (as against applying different standards to different employees based on their position, performance, function, and the like). There should be provisions for those who ignore as well as those who violate standards and procedures.

**Analysis and follow-up**

When violations occur, the ethics committee should have ways to identify why they occurred. It is also important that lessons learned from prior violations are systematically applied to reduce the chance that similar violations takes place in future.

**Answer 6(c)**

There are four theses viewing stakeholder theory:

1. *Descriptive*: The Corporation is viewed as an assemblage of co-operative and competitive interests possessing intrinsic value. The theory is used to describe specific corporate characteristics such as nature of the firm, the way managers think about managing, how corporations are managed, or how the board members think about the interests of constituencies.

   Descriptive stakeholders are defined as to whether they are affected by the firm and/or can potentially affect the firm.

2. *Instrumental*: This approach establishes a framework of examining ceteris paribus
connections, between the practice of stakeholder management and achievement of corporate performance goals. If you want to achieve (avoid) results________, then adopt (don’t adopt) principles & practices…..

Instrumental stakeholders are defined by the need of the management to take them into account when trying to achieve their goals.

3. **Normative**: The identification of moral or physical guidelines for the management of corporations. This approach is categorical in effect it says—’Do (don’t do) this because it is the right (wrong) thing to do’.

   Normative stakeholders have a valid normative claim on the firm.

4. **Broadly managerial**: It recommends attitudes, structures and practices that taken together constitute stakeholder management. Stakeholder management requires, as its key attribute, simultaneous attention to legitimate interests of all appropriate stakeholders, both in the establishment of organization structures and general policies.

**Question 7**

(a) Explain the Clarkson Principles of Stakeholders’ Management. (5 marks)

(b) “The ethical tendency or climate of an organisation is set at the top.” In the light of this statement, critically examine the role of Board of directors in the ethical climate of a company. (5 marks)

(c) “Social and ethical accounting is a process that helps a company to address issues of accountability to stakeholders and to improve performance of all aspects, viz., social, environmental and economic.” Explain and discuss briefly the principles of social and ethical accounting. (5 marks)

**Answer 7(a)**

The Clarkson Principles emerged from a project undertaken by the Centre for Corporate Social Performance and Ethics:

- **Principle 1**: Managers should acknowledge and actively monitor the concerns of all legitimate stakeholders, and should take their interests appropriately into account in decision-making and operations.

- **Principle 2**: Managers should listen to and openly communicate with stakeholders about their respective concerns and contributions, and about the risks that they assume because of their involvement with the corporation.

- **Principle 3**: Managers should adopt processes and modes of behavior that are sensitive to the concerns and capabilities of each stakeholder constituency.

- **Principle 4**: Managers should recognize the interdependence of efforts and rewards among stakeholders, and should attempt to achieve a fair distribution of the benefits and burdens of corporate activity among them, taking into account their respective risks and vulnerabilities.

- **Principle 5**: Managers should work cooperatively with other entities, both public and private, to insure that risks and harms arising from corporate activities are minimized and, where they cannot be avoided, appropriately compensated.
Principle 6: Managers should avoid altogether activities that might jeopardize inalienable human rights (e.g., the right to life) or give rise to risks which, if clearly understood, would be patently unacceptable to relevant stakeholders.

Principle 7: Managers should acknowledge the potential conflicts between (a) their own role as corporate stakeholders, and (b) their legal and moral responsibilities for the interests of all stakeholders, and should address such conflicts through open communication, appropriate reporting and incentive systems and, where necessary, third party review.

Answer 7(b)

The board of directors hold the ultimate responsibility for their firm’s success or failure, as well as for ethics of their actions. As has been stated earlier the ethical tone of an organization is set at the top, the actions and attitudes of the board greatly influence the ethical climate of an organization. The directors on a company’s board assume legal responsibility for the firm’s resources and decisions. Board members have a fiduciary duty, i.e. a position of trust and confidence. Due to globalization, the role of the media, technology revolutionizing the nature and speed of communication, directors are feeling greater demands for accountability and transparency. This calls for ethical decision making and providing an ethical decision making framework.

The perspective and independent judgement of independent directors can be helpful in determining a company’s approach towards ethical issues and stakeholder interests. Independent directors are in a position to challenge current practices and also contribute knowledge and experience of good practices.

A Report by the Conference Board Commission on Public Trust and Private Enterprise suggested the following areas of oversight by a Board:

- Designation of a Board committee to oversee ethics issues;
- Designation of an officer to oversee ethics and compliance with the code of ethics;
- Inclusion of ethics-related criteria in employees’ annual performance reviews and in the evaluation and compensation of management;
- Representation by senior management that all known ethics breaches have been reported, investigated, and resolved; and
- Disclosure of practices and processes the company has adopted to promote ethical behavior.

Answer 7(c)

Social and ethical accounting is a process that helps a company to address issues of accountability to stakeholders, and to improve performance of all aspects i.e. social, environmental and economic. The process normally links a company’s values to the development of policies and performance targets and to the assessment and communication of performance.

The dominant principle of social and ethical accounting is inclusivity. This principle
requires that the aspirations and needs of all stakeholder groups are taken into account at all stages of the social and ethical accounting process.

— **Planning**: The company commits to the process of social and ethical accounting, auditing and reporting, and defines and reviews its values and social and ethical objectives and targets.

— **Accounting**: The scope of the process is defined, information is collated and analysed, and performance targets and improvement plans are developed.

— **Reporting**: A report on the company’s systems and performance is prepared.

— **Auditing**: The process of preparing the report and the report itself are externally audited, and the report is made accessible to stakeholders in order to obtain feedback from them.

— **Embedding**: To support each of the stages, structures and systems are developed to strengthen the process and to integrate it into the company’s activities.

— **Stakeholder engagement**: The concerns of stakeholders are addressed at each stage of the process through regular involvement.

**PART C**

**Question 8**

Attempt any four of the following:

(i) Write a note on ‘sustainability reporting in emerging economies’.

(ii) Discuss the fundamental principles of sustainable development. How are these principles related to United Nations Conference on Environment and Development (UNCED), 1992 held at Rio de Janeiro?

(iii) What is the ‘global compact’? What are the objectives of this initiative?

(iv) What is difference between ‘convention’ and ‘protocol’? Discuss briefly the major features of Kyoto Protocol. How was the implementation of Kyoto Protocol accorded?

(v) The Supreme Court of India has shown its concern about the discharge of untreated effluents into the rivers in many cases. Discuss the problem of water pollution in India and court’s initiatives for its protection in the light of decided case law. (5 marks each)

**Answer 8(i)**

Investors increasingly recognize the value of robust sustainability reporting and expectations for such reporting have spread to companies in emerging markets. While it may be difficult for emerging market companies to devote the resources to such reporting and companies should begin by taking the first step, committing to the process of reporting, and demonstrating that they are managing the sustainability issues most material to their sector. Such companies will develop a competitive advantage in the marketplace and reach a greater range of investors and customers.
Increasingly global companies understand that a commitment to sustainability reporting can contribute to financial success. Such transparency allows companies to reach a broader range of investors and customers, enhance operational efficiency, improve brand positioning, and develop leadership in the marketplace.

**Answer 8(ii)**

Four fundamental Principles of Sustainable Development agreed by the world community are:

1. **Principle of Intergenerational equity**: need to preserve natural resources for future generation.
2. **Principle of sustainable use**: use of natural resources in a prudent manner without or with minimum tolerable impact on nature.
3. **Principle of equitable use or intergenerational equity**: Use of natural resources by any state/country must take into account its impact on other states.
4. **Principle of integration**: Environmental aspects and impacts of socio-economic activities should be integrated so that prudent use of natural resources is ensured.

This was reinforced at the United Nations Conference on Environment and Development (UNCED) held in Rio de Janeiro in 1992. It is now universally acknowledged that the present generation has to ensure that the people coming ahead, the generations still unborn, have a world no worse than ours and hopefully better.

**Answer 8(iii)**

The UN Global Compact presents a unique and powerful platform for participants to advance their commitments to sustainability and corporate citizenship. More than 5200 company are participants and has stakeholders from more than 120 countries, over 60 networks in developed and emerging economies.

The Global Compact is a voluntary corporate citizenship initiative with two objectives:

“Making the Global Compact and its principles part of business strategy and operations.”

“Facilitating cooperation among key stakeholders and promoting partnerships in support of U.N. goals.”

**Answer 8(iv)**

The Kyoto Protocol, adopted at the third Conference of the Parties to the UNFCCC (COP 3) in Kyoto, Japan, in 1997 came into force in 2005, is an international agreement linked to the United Nations Framework Convention on Climate Change. The major feature of the Kyoto Protocol is that it sets binding targets for 37 industrialized countries and the European community for reducing greenhouse gas (GHG) emissions. These amount to an average of five per cent against 1990 levels over the five-year period 2008-2012.

The major distinction between the Protocol and the Convention is that while the Convention encouraged industrialised countries to stabilize GHG emissions, the Protocol commits them to do so.
The Protocol requires developed countries to reduce their GHG emissions below levels specified for each of them in the Treaty. These targets must be met within a five-year time frame between 2008 and 2012, and add up to a total cut in GHG emissions of at least 5% against the baseline of 1990.

The Kyoto Protocol is generally seen as an important first step towards a truly global emission reduction regime that will stabilize GHG concentrations at a level which will avoid dangerous climate change. As a result of the Protocol, governments have already put, and are continuing to put legislation and policies in place to meet their commitments; a carbon market has been created; and more and more businesses are making the investment decisions needed for a climate-friendly future. The Protocol provides the essential architecture for any new international agreement or set of agreements on climate change. The first commitment period of the Kyoto Protocol expires in 2012.

The detailed rules for the implementation of the Protocol were adopted at COP 7 in Marrakesh in 2001, and are called the “Marrakesh Accords.”

Answer 8(v)

Water Pollution

Leather industry is one of the three major industries besides paper and textiles, consuming large quantities of water for processing of hides and skins into leather. Naturally most of the water used is discharged as waste water containing putrescible organic and toxic inorganic materials which when discharged as such will deplete dissolved oxygen content of the receiving water courses resulting in the death of all acquatic life and emanating foul odour. The M.C. Mehta v. Union of India [AIR 1988 SC 1037] also known as the Kanpur Tanneries or Ganga Pollution case is among the most significant water pollution case. Detailed scientific investigations and the reports were produced before the Court as evidence.

“Where in public interest litigation owners of some of the tanneries discharging effluents from their factories in Ganga and not setting up a primary treatment plant in spite of being asked to do so for several years did not care, in spite of notice to them, even to enter appearances in the Supreme Court to express their willingness to take appropriate steps to establish the pre-treatment plants it was held that so far as they were concerned on order directing them to stop working their tanneries should be passed. It was observed that the effluent discharged from a tannery is ten times noxious when compared with the domestic sewage water which flows into the river from any urban area on its bank. It was further observed that the financial capacity of the tanneries should be considered as irrelevant while requiring them to establish primary treatment plants. Just like an industry which cannot pay minimum wages to it worker cannot be allowed to exist, a tannery which cannot set up a primary treatment plant cannot be permitted to continue to be in existence for the adverse effect on the public at large which is likely to ensure by the discharging of the trade effluents from the tannery to the river Ganga would be immense and it will outweigh any inconvenience that may be caused to the management and the labour employed by it on account of its closure”.

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