

GUIDELINE ANSWERS

PROFESSIONAL PROGRAMME (NEW SYLLABUS)

JUNE 2014

**MODULE III
Elective Paper(s)**



**THE INSTITUTE OF
Company Secretaries of India**

IN PURSUIT OF PROFESSIONAL EXCELLENCE
Statutory body under an Act of Parliament

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

The Guideline answers to June 2014 session examination are based on Companies Act, 1956. Students may please note that December 2014 examinations will carry questions from those sections of the Companies Act, 2013 and the rules made there under which have been notified by the Government of India and came into force w.e.f. April 01, 2014 (including Amendments/clarifications/circulars issued there under upto June, 2014). In respect of sections of The Companies Act, 2013 which have not been notified, applicable sections of Companies Act, 1956 shall apply.

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PROFESSIONAL PROGRAMME EXAMINATION

JUNE 2014

BANKING LAW AND PRACTICE
(Elective Paper 9.1)

Time allowed : 3 hours

Maximum marks : 100

NOTE : Answer **ALL** Questions.

Question 1

Read the following details of ABC Ltd. carefully :

ABC Ltd. has applied for enhancement of both fund based and non-fund based credit limit to its bankers. This is a public limited company listed on both BSE and NSE. The management and affairs of the company are being looked after by a Board of directors. The Board comprises three whole-time directors and seven part-time directors. X (Chairman and Managing Director) has a long association with the electrical industry and he is also Chairman of the leading chamber of Original Equipment Manufacturers (OEM) in electrical industry. He has won national awards for his contribution in the industry. He is a graduate. Y, a whole-time director, is brother of X. He looks after the technical and manufacturing activities of the company. He is an engineer. Z is also a whole-time director and looks after marketing, business development and finance areas of the company. He is son of X.

Products

The company is one of the leading equipment manufacturers for electrical industry of the country and engaged in manufacturing LOW AND MEDIUM VOLTAGE equipments for distribution of electricity.

Marketing network

The company has a robust marketing and distribution network in the low and medium voltage electrical distribution industry. It comprises 20 branches and 30 representative offices covering length and breadth of the country with its headquarters in New Delhi. The branches are spread over in all major State capitals and big cities.

Distribution and service network

The company has more than 3,000 authorised dealers and 2,500 retail outlets across the country. The service set-ups are having well trained service engineers located at headquarters and all branches to provide efficient after-sales service.

Capital Structure (as on 31.3.2014)

The total paid-up capital of the company is ₹400 crore. The reserves and surplus

of the company are ₹1,178 crore. The shareholding pattern of the company is as under :

Sl. No.	Name of Shareholders	Size of Holding (₹ in crore)	% of Holding
1	X	160	40
2	Y	40	10
3	Z	80	20
4	N. Pvt. Ltd.	40	10
5	Others	80	20
Total		400	100

N. Pvt. Ltd. belongs to the promoters of ABC Ltd., whose shareholding pattern is as follows :

Sl. No.	Name of Shareholders	Size of Holding (₹ in crore)	% of Holding
1	X	40	40
2	Y	20	20
3	Z	40	40
Total		100	100

X and Z are featuring as defaulters in the RBI list of defaulters. The company has clarified that X and Z are not related to the defaulting companies and it is only similarity in names. They did not put any affidavit from the directors at the time of documentation. The company has also confirmed that they do not have any court cases relating to financing initiated by any bank or other financial institution.

Corporate Governance

The company holds its Board meetings generally in Delhi. In the last year (2013), the Board met 4 times i.e. on 1st January, 2013, 30th June, 2013, 30th August, 2013 and 29th December, 2013. The proposal for further loan was approved by the Board in its meeting held on 4th April, 2014 where 7 directors out of 10 were present. All the whole-time directors were present at the meeting.

D has been appointed as the Chairman of the Audit Committee of the Board. The Chairman of the Audit Committee was not present at the last Annual General Meeting of the company held on 30th September, 2013.

The company assigned a major contract to N. Pvt. Ltd. on 30th August, 2013 where 6 members of the Board were present, including all three whole-time directors. Minutes of the meeting reveal that none of the directors abstained from the deliberation while assigning contract to N. Pvt. Ltd.

The company is facing stress in its business operation due to slow down of the economy and particularly in electrical industry.

The Board decided to boost up its operations and it requires infusing more working capital to gear up the operations. In order to finance enhanced operation, the Board proposed to have its cash credit limit increased from `200 crore to `300 crore with a sub-limit of ₹50 crore for packing credit/packing credit in foreign

currency/foreign demand bill of exchange/bill re-discounting. Sub-limit is required due to expected foreign orders from EU countries. The existing sanctioned limit is ₹200 crore. It was reported that the bank offers margin of 25% on cash credit/overdraft against book debts/packing credit/packing credit in foreign currency.

Bank interest for domestic credit is Base Rate + 2.50 (floating) totalling 13% rate of interest. For packing credit/foreign demand bill/foreign bill of exchange, the bank charges 11.25% as interest. Packing credit in foreign currency/bill re-discounting rate is 6-months LIBOR + 350 bps. In addition, there are 0.50% commitment and usance charges on letter of credit. The bank also charges normal commission on bank guarantee.

Details of Securities Proposed

Particulars	Description	Value (₹ in crore)	Source and date of report	Nature of charge
<i>(a) Primary</i>				
Working capital	Stock and book debts	300	Stock statement and ledger	1st Charge
Term loan	Fully automated plant with CNC equipment at Delhi	250	Valuation report dated 06.04.2014 of XYS Valuers	1st Charge
<i>(b) Collateral</i>				
Land and building	Property at New Delhi	500	Valuation Report dated 6.4.2014 of XYS Valuers	1st Charge
Plant and machinery	Fully automated plant with CNC equipments on which 1st charge is held with term lenders	250	Valuation Report dated 6.4.2014 of XYS Valuers	2nd Charge

The company is not willing to give any personal guarantee by its whole-time promoter directors.

The select financial indicators of the company for last 2 years, estimates for current year and projection for next year are as under :

Financial Indicators

Particulars	(₹ in crores)			
	31.03.2012 (Audited)	31.03.2013 (Audited)	31.03.2014 (Estimated)	31.03.2015 (Projected)
<i>Shareholders' funds :</i>				
Share capital	400	400	400	400
Reserve and surplus	1,020	1,149	1,178	1,256
<i>Non-current liabilities :</i>				
Long-term loans from banks/FIs	400	360	320	280

Particulars	(₹ in crores)			
	31.03.2012 (Audited)	31.03.2013 (Audited)	31.03.2014 (Estimated)	31.03.2015 (Projected)
Current liabilities and provisions :				
Current liabilities	450	510	610	800
Total	2,270	2,419	2,508	2,736
Non-current assets :				
Land	200	200	200	200
Furniture and fittings	81	83	75	77
Building	270	243	219	197
Plant and machinery	340	289	246	294
Investments	400	400	400	400
Current assets :				
Current assets	979	1,204	1,368	1,568
Total	2,270	2,419	2,508	2,736
Sales	1,800	1,700	1,810	1,860
Other income	200	190	210	250
Total income	2,000	1,890	2,020	2,110
Total expenditure before depreciation, interest and tax	1,700	1,750	1,800	1,850
Profit before depreciation, interest and tax (PBDIT)	300	140	220	260
Depreciation	99	87	76	82
Interest (tentative)	41	36	33	30
Net profit before tax/loss	160	17	111	148
Net profit after tax/loss	106	11	73	98
Capital employed 1,820	1,909	1,898	1,936	
Fund based credit from bank	200	200	200	300
Net profit as a % of capital employed	5.82%	0.58%	3.85%	5.06%
Ratios				
Current ratio	2.18	2.36	2.24	1.96
Debt-equity ratio	0.28	0.23	0.20	0.17
Profit before depreciation, interest and tax (PBDIT) as a % of sales	16.67	8.24	12.15	13.98
Net profit as a % of sales	5.89%	0.65%	4.03%	5.27%
Term debt/ PBDIT 1.33	2.57	1.45	1.08	
Inventory turnover (days)	45	45	45	45
Debtors velocity (days)	30	30	30	30
Creditors velocity (days)	60	45	45	45
Cost of sales to net sales	0.94	1.03	0.99	0.99

Note : The company has a policy of charging depreciation on WDV basis. Any purchase after the middle of year is charged with depreciation at half rate.

Keeping the above details in view, prepare a Proposal Assessment Report covering the following for Credit Approval Committee of the bank :

- (i) Major factors deciding the credit enhancement. (10 marks)*
- (ii) Shareholding structure of the company and perceived risk from bank's point of view. (10 marks)*
- (iii) Governance practices of the company vis-a-vis requirement of the Companies Act, 1956. (10 marks)*
- (iv) Financial position of the company indicating the company capacity to pay the enhanced working capital loan, if approved. (10 marks)*
- (v) A report consolidating the (i) to (iv) above and final recommendation to approve or disapprove the credit limit enhancement proposal. (10 marks)*

Answer 1(i)

Major factors deciding credit enhancement

There are many factors affecting the credit decision. The few factors are mentioned below:

- The promoters track record/back ground & experience in line of activity.
- Outlook of the industry.
- Financial position of the company & resourcefulness of the promoters.
- Company's arrangement for networking/marketing.
- Availability of the infrastructure.

In instant case, the company is the leading equipment manufactures for electrical industry of the country and the promoters have long association with the line of activity and chairman of the company is also chairman of the leading chamber of Original Equipment Manufacturers (OEM) in electrical industry. The affairs of the company are being managed by the promoters themselves with multiple responsibilities which may result in losing the focus on the core area of the business. Hence Management risk is considered to be Moderate.

The company has well established marketing and distribution network and spread over the country. Apart from this the company has service set ups which having well trained service engineers. However it is reported at present there is stress on account of slow down in the economy. Considering the experience of the promoter in the line of the activity, outlook of industry can be considered as normal.

In present case, the company has net worth of ₹1549.00 crores as on 31.03.2013 with low gearing ratio. Though the profitability of the company is low, the overall financials can be considered as satisfactory.

Keeping in view of the size of the investment in fixed assets of ₹815.00 crores and level of sales of ₹1700.00 crores, we presume that company has adequate infrastructure to increase the level of operation.

Answer 1(ii)**Share holding structure of the company and perceived risk from bank's point of view.**

Ideally the shareholding structure of the company should be broad based with different entities in order to have better say in the management & control. In the instant case, the majority stakes are held by the 3 promoters along with the company which is also owned by the promoters.

Though the shares are offered to the public, the stake of the promoter in the company is more than 2/3 of the total voting rights. Hence they may pass major resolutions with their present voting rights without considering minority stakeholders views. In view of the above there is possibility that promoters may borrow in excess of the company's genuine requirement, declare higher dividends, remunerations to the directors etc.

Answer 1(iii)**Governance practices of the company vis-à-vis requirement of the Companies Act, 1956.**

The company being a listed company has to comply with the Corporate Governance as required under the Listing Agreement with stock exchanges. However it is observed that the company's corporate governance is far from satisfactory in view of the following:

- The Chairman of the Audit Committee was not present in the last Annual General Meeting where stakeholders interact with the promoters regarding financials, future plans etc.
- It is stated that Mr. X and Mr. Z are appearing in RBI Defaulter list and it is clarified that is only similarity of names. However the promoters have not provided suitable affidavit in this regard at the time of documentation which lead to suspect the intention of the promoters.
- Company assigning major contracts with the group company which is against the normal practice of keeping the group company's at arm's length. There is scope for accommodation of contracts to boost parent company sales & present rosy pictures to lenders.

Answer 1(iv)**Financial position of the company indicating the company capacity to avail enhance working capital loan, if approved.**

- The company has incurred operating loss during the year 2013 while marginal estimated operating profit have been shown for the year 2014 and 2015.
- Profit after Tax of ₹11.00 crores as on 31.03.2013 is positive only on account of other income of ₹190.00 crores the details of which are not known.
- In projected figures 2015, the interest cost has been estimated at present level inspite of increase in bank borrowing to the extent of ₹100.00 crores.
- For increase in sales of ₹60.00 crores for the year 2014-15, additional bank borrowing envisaged of ₹100.00 crores which is not convincing one.

- Net profit ratio have been estimated at very high level (i.e. 5.27%) compared to the last year i.e. 2013 (i.e. 0.65%) which appears very optimistic particularly in stressed economy wherein there always be strain in margins.
- Major contracts are given to the group company which may affect the diversion of the funds by way of intergroup transactions.
- The net-worth of the company as on 31.03.2013 is ₹1549.00 crores. The company has investment portfolio of ₹400.00 crores. It is not clear that whether this investment are yielding or not.
- It is observed from the working capital cycle that realization of debtors takes place within period of 30 days whereas creditors are being paid at 45 days which indicates that there is no need for additional working capital borrowing to the extent credit limits requested.
- Though the current assets is estimated to increase substantially whereas there is no corresponding increase in the working capital cycle, which indicates that the additional borrowing sought is likely to go for non business purpose leading to diversion of funds.
- For the proposed additional cash credit limit of ₹100.0 crores there is no sufficient DP available against stock and book debts & no additional collateral security offered including personal guarantee of promoters. In terms of RBI guidelines, personal guarantee of promoter Directors are required.
- In proportion to additional working capital of ₹100.00 crores requested, promoter's stake is not increasing. The company is raising additional working capital funds with the existing stake only.

Answer 1(v)

A report consolidating the (1) to (4) above and final recommendations to approve or disapprove the credit limit enhancement proposal.

We may not recommend the proposal in view of the following:

- Though the promoters are highly experience, the corporate governance practiced by the company is to be strengthened.
- Though apparently financials looks good, on analyzing the financials in depth it observed that the company has built up the current assets in excess of the requirement resulting in blockage of funds. Instead of resorting to additional borrowings, company should liquidate the excess current assets built up including investments which is staggering around ₹400.00 crores to improve the liquidity.
- There is a need to reduce working capital cycle to improve the profitability which is surviving only on the strength of other income.
- From long term viability perspective, company should survive from its own operational profits rather than on other income.
- Sale contracts among group companies to be avoided & to go beyond group companies.
- The long term source for funding to be examined by way of fresh capital in proportion to Working Capital sought.

- Broad based product development & connected activity where profit margin is higher may be thought off/examined.
- Cost control exercise is to be carried out to improve the profitability.

Question 2

- (a) *The increasing non-performing assets (NPAs) and the time consuming legal process of loan recovery prompted enactment of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002. Describe the important provisions of this Act having a bearing on NPAs. Is it justified to use the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 as a tool in management of NPAs ? Has this Act helped in quicker recovery of loan and reducing NPAs?* (15 marks)
- (b) *Return on capital employed (ROCE) is one of the important financial analysis tools which provides information about the earning power of a firm. In this context, discuss the 'DU PONT MODEL' of financial analysis. Support your answer with two examples one with poor ROCE and other with positive ROCE.* (15 marks)

Answer 2(a)

The Securitization and Reconstruction of Financial Assets and Enforcement of Securities Act, 2002 [SARFAESI] Act, 2002 was enacted to regulate securitization and reconstruction of financial assets and enforcement of security interest and for matters connected therewith or incidental thereto.

Provisions of SARFAESI related to NPA

The right of the banks/financial institutions to resort to the provisions of the SARFAESI arises only in the event where any borrower, who is under liability to a secured creditor under a security agreement, makes any default in payment of a secured debt or any installment thereof and his account in respect of such debt is classified by the secured creditor as non-performing asset. Therefore, classification of account as an NPA is a sine qua non and, the following eventualities can be called out for recovery under the provisions of SARFAESI, that is,

- there must be a debt by a borrower from a secured creditor under a security agreement;
- there must be a default in repayment of secured debt or any installment thereof by the borrower;
- the borrower's account in respect of such debt is classified by the secured creditor as 'nonperforming asset';
- a notice in writing should be issued by the secured creditor to the borrower to discharge in full his liabilities within sixty days from the date of the notice;
- in terms of sub-section (3) of Section 13, the notice shall also give details of the amount payable by the borrower and the secured assets intended to be enforced by the secured creditor.

It is mandatory by the Banks to follow the RBI guidelines on asset classification before any account can be classified as an NPA and any irregularity in this regard can be fatal and can nullify the proceedings initiated under the SARFAESI Act. Normally Bankers are giving enough opportunity & sufficient time like

- i) Following up for 90 days
- ii) Examining restructuring option for viable unit

Bank voluntarily taking the action to save the account from NPA. The process runs nearly 6 to 9 months from date of surface of overdue. And only after exhausting all options to help the borrower & to save the economic value of assets, lenders resort to go for SARFAESI Action as last resort for recovery action. Hence we are of view that borrower are given enough opportunity voluntarily to take out account from NPA before SARFAESI Action.

Under this act, the secured creditor may take recourse to one or more of the following measures to recover his secured debt, namely:--

- (a) take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realizing the secured asset;
- (b) substitution of management of the business of the borrower including the right to transfer by way of lease, assignment or sale for realizing the secured asset;
- (c) appoint any person (hereafter referred to as the manager), to manage the secured assets the possession of which has been taken over by the secured creditor;
- (d) require at any time by notice in writing, any person who has acquired any of the secured assets from the borrower and from whom any money is due or may become due to the borrower, to pay the secured creditor, so much of the money as is sufficient to pay the secured debt.

Further the provisions of this Act shall have effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law.

In view of the above, we may say that SARFAESI can be used as tool in management of NPAs.

The promulgation of the SARFAESI Act has been a benchmark reform in the Indian banking sector. The progress under this Act had been significant, as evidenced by the fact that during 2002-03 when the Act came into effect, there was an overall reduction of non-performing loans to 9.4 per cent of gross advances from 14.0 per cent in 1999-2001.

Currently, three legal options are available to banks for resolution of NPAs- the SARFAESI Act, Debt Recovery Tribunals and Lok Adalats. The SARFAESI Act has been the most important means for recovery of NPAs.

For example: Banks have referred as many as 78,366 loan default cases for the year 2010 under the SARFAESI Act involving a loan amount of ₹14,249 crores. Against this, banks managed to recover ₹ 4,269 crores representing 30% of the loans.

The 'Report of the Working Group on the Issues and Concerns in the NBFC Sector' laid out recommendations to extend the coverage of SARFAESI to NBFCs as well. This move will benefit NBFCs, ensuring quicker recovery of their non-performing assets.

Answer 2(b)

Return on capital employed (ROCE) is a measure of how well a company's management creates value for its shareholders. The computation of ROE requires only net income and shareholders' equity. $ROE = \text{net income} / \text{shareholder's equity}$

If this number goes up, it is generally a great sign for the company as it is showing that the rate of return on the shareholders' equity is rising. The problem is that this number can also rise simply when the company takes on more debt, thereby decreasing shareholder equity. This would increase the company's leverage, which will make the stock more risky. Therefore for more detailed analysis DU PONT Model is used.

DuPont Model: The Du Pont Company of the United States introduced a system of financial analysis considered as one of the important tool for financial analysis. DuPont model is an extended analysis of a company's return on equity. It concludes that a company can earn a high return on equity if:

- It earns a high net profit margin;
- It uses its assets effectively to generate more sales; and/or
- It has a high financial leverage

According to DuPont analysis:

Return on Equity = Net Profit Margin × Asset Turnover × Financial Leverage

$$\text{Return on Equity} = \frac{\text{Net Income}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Total Assets}} \times \frac{\text{Total Assets}}{\text{Total Equity}}$$

DuPont equation provides a broader picture of the return the company is earning on its equity. It tells where a company's strength lies and where there is a room for improvement.

Example: Company A and B operate in the same market and are of the same size. The following table shows their respective net profit margin, asset turnover and financial leverage.

	Company A	Company B
Profit Margin	30%	30%
Total Asset Turnover	.50	6.0
Financial Leverage	3.0	.50
ROE	45%	90%

In the above example, both companies have the same overall profit margin, but the companies' ROE are completely different.

Question 3

As per the Basel Norms, bank's risks are broadly classified into credit risk, market risk and operational risk. Write a short overview of the risk management structure of a bank and its important features. (5 marks)

Answer 3

Risk Management is a methodology that helps managers makes best use of their available resources. The process consists of important steps like:

- Identification of risks
- Analyzing the risks
- Evaluating the risks
- Monitor and review
- Mitigation of risks

Important Features of Risk Management

- Risk management policies should be approved by the board. It should cover all the required guidelines and directives of the regulators and applicable legal frame work.
- There should be a good support from the Information Technology wing for creating an integrated system whereby an effective and efficient MIS would be an integral part of the risk management.
- There should be clear demarcation of functions and authority levels to ensure better internal control systems (ex: front office, mid office and back office of an intygrated treasury).
- An effective communication system coupled with the training programs.
- One of the risk mitigation measures is to setup appropriate limits for various aspects like counter party limit, country limit, currency limit, over night and intraday limits, stop loss limit, individual and group exposure limits etc.
- Inbuilt checking and balancing systems, such as input and output controls, access control to the computer systems, and sensitive areas of the banks.
- Apart from review by the ALCO members, a periodical review and evaluation system should be in place.

Risk Management Structure

Banking companies should create an effective risk management structure to handle the risks associated with the bank's business models and operations. The risk management structure should cover the Credit, Market, Operational and other risks. The structure should be ably supported by the technology in identification and monitoring process of risks.

- The Risk Management Committee should be formed at the Board level with the overall responsibility to monitor and manage the overall risks of the bank.

- Asset-Liability Management Committee (ALCO) is a strategic decision making body, formulating and overseeing the function of asset liability management (ALM) of a bank.
- ALCO is headed by the Managing Director or the Chief Executive Officer.
- The indentified Risk, analysis and evaluation etc. are to be first discussed, analyzed at Credit Risk Management Committee (CRMC), Operating Risk Management Committee (ORMC) and Marketing Risk Management Committee (MRMC).
- Thereafter the proposals emerging from this is to be placed before Audit Committee of the Board. With the orders of Audit Committee of the Board the proposal should place before Risk Management Committee of the Board.
- The concerned Risk Management Department to monitor the implementation and compliance of the same.

Functions

- The Risk Management Committee should also monitor compliance of various risk parameters by operating departments.
- The function of Risk Management Committee should essentially be to identify and monitor to measure the risk profile of the Bank. The committee should design stress scenario to measure the impact of unusal market conditions and monitor the variance between actual volatility of portfolio value so that predicted by the risk measures.

Basel I

The Basel Committee on Banking Supervision (BCBS) is a committee which was set up by the Central Bank Governors of a group of ten countries, to address international issues relating to the banking supervision. The Basel Committee on Banking Supervision in 1988 came out with a Capital Accord for banks, covering the areas of risks in respect of banks' assets and liabilities in the balance sheet and off balance sheet exposures. Under the Basel I Accord, only the credit risk factor was considered and the minimum requirement of capital funds was fixed at 8 per cent of the total risk weighted assets. In India, banks are required to maintain a minimum of 9 percent (Capital to Risk Weighted Asset Ratio – CRAR) on an ongoing basis.

Basel II

The Second Accord brought in significant changes in risk management in banks. The Basel II accord introduced a new approach based on the three pillars:

- *Pillar I: Minimum Capital Requirements* : The minimum capital requirement should be calculated based on three risks viz., (a) Credit Risk – (i) Standardized Approach (ii) Internal Ratings Based Approach (b) Operational Risk and (c) Market Risk.
- *Pillar II: Supervisory Review Process* : This pillar addresses the issues like the key aspects of supervisory review, risk management guidance and transparency and accountability. It also covers the treatment of interest rate

risk in the banking book, credit risk (stress testing, credit concentration risk etc) operational risk, enhanced cross border risks.

- *Pillar III – Market Discipline* : As part of an effective risk management, banks are expected to disclose important information. Such market discipline can contribute to a safe and sound banking environment. These disclosures would assist various stakeholders to review and understand the status of the banks' operations and strategies in a competitive business environment. These disclosures would assist the investors to make their investment decisions

Question 4

'Banking Ombudsman' was created for quick and honest redressal of grievances of customers. How effective it has been over the years in redressing the grievances? Does it create a healthier and ethical customer relationship ? (5 marks)

Answer 4

Banking Ombudsman Service is a grievance redressal system. This service is available for complaints against a bank's deficiency of service. A bank's customer can submit complaint against the deficiency in the service of the bank's branch and bank as applicable, and if he does not receive a satisfactory response from the bank, he can approach Banking Ombudsman for further action. Banking Ombudsman is appointed by RBI under Banking Ombudsman Scheme, 2006. RBI as per Sec 35 A of the Banking Regulation Act, 1949 introduced the Banking Ombudsman Scheme with effect from 1995.

The Banking Ombudsman is a senior official appointed by the Reserve Bank of India to redress customer complaints against deficiency in certain banking services. All Scheduled Commercial Banks, Regional Rural Banks and Scheduled Primary Co-operative Banks are covered under the Scheme.

Banking Ombudsman has helped to create a healthier and ethical customer relationship by covering deficiencies in following banking services:

- deficiency in customer service like non-acceptance, without sufficient cause, of small denomination notes tendered for any purpose, and for charging of commission in respect thereof;
- delayed or non- payment of inward remittance, delay in issuance of drafts,
- non-adherence to prescribed working hours;
- refusal to open deposit accounts without any valid reason for refusal;
- levying of charges without adequate prior notice to the customer;
- forced closure of deposit accounts without due notice or without sufficient reason;
- refusal to close or delay in closing the accounts; etc.,
- non-adherence to the fair practices code as adopted by the bank or non-adherence to the provisions of the Code of Bank's Commitments to Customers issued by Banking Codes and Standards Board of India and as adopted by the bank ;

- non-observance of Reserve Bank guidelines on engagement of recovery agents by banks; and any other matter relating to the violation of the directives issued by the Reserve Bank in relation to banking or other services.

According to the RBI data, during the year 2012-13, OBOs handled 75183 complaints. This, comprised of 4642 complaints brought forward from the previous year and 70541 fresh complaints received during the year under review. Of these, 69704 complaints (93%) were disposed of during the year 2012-13. Moreover, over last three years, percentage of maintainable complaints has increased gradually from 49% in 2010-11 to 56% in 2012-13. This indicates increasing awareness about the applicability of the BOS among bank customers. During the year OBOs issued 312 Awards. Thus we can say that Banking Ombudsman are playing effective role in redressing the grievances of customers.

Question 5

The Reserve Bank of India reportedly imposed fines totalling ₹49.5 crore on 22 private and public sector banks in July, 2013 for violating KYC/anti-money laundering norms. In order to avoid such recurrence, what policy framework do you suggest for banks ?
(5 marks)

Answer 5

The banks should follow 'Know Your Customer' (KYC) Guidelines or procedure as issued by the RBI. RBI had advised banks that:

- No account is opened in anonymous or fictitious/benami name (s)
- Bank will not open an account or close an existing account if the bank is unable to verify the identity or obtain documents required by it due to non-cooperation of the customer.

Banks are required to frame their KYC policy incorporating the following four key elements:

- Customer acceptance policy
- Customer identification procedures
- Monitoring of transactions
- Risk management.

Question 6

A wants to transfer funds electronically to B in Brussels and C in Kolkata respectively.

A lives in Mumbai and he has a bank account there. Advise 'A' about right modes of transfer of funds and explain to him various features of electronic funds transfer.
(5 marks)

Answer 6

For transfer of funds to B in Brussels and C in Kolkata, the suitable mode of

transfer is transfer of fund electronically. EFT is a computerized system for processing transactions between financial institutions routed through the clearing house.

Some of the features of electronic funds transfer are as follows;

- Credit transfers between banks from payer's account to the payee's account
- Debit transfers between banks from payee's account to payer's account prior to authorized direct debit agreements.
- Transfer of funds is faster and secured.
- Risk associated with the physical movement of large sums of cash is avoided.
- Convenient for salary payments
- Reduces congestion, lines & thefts
- Reduced paperwork – view your remittance advice and EOBs online
- Easy reconciliation of direct deposits with corresponding electronic remittance advice

Various methods of transfer of funds electronically are:

- (a) *Electronic Clearing System (ECS)* : One of the earliest electronic forms of funds transfer is the Electronic Clearing System. ECS is a retail funds transfer system to effect payments (utility bills, dividends, interest, etc) ECS helps corporates, government departments, public sector undertakings, utility service providers to receive and/or pay bulk payments.)
- (b) *Real Time Gross Settlement (RTGS)* : RTGS is an electronic payment system, where payment instructions are processed on a 'continuous' or 'REAL TIME' basis and settled on a 'GROSS' or 'individual' basis without netting the debits against credits. In India, RBI introduced this system and the system is functioning well. The payments so effected are 'final' and 'irrevocable'. The settlement is done in the books of the central bank (RBI). The RTGS system allows transfer of funds across banks on a real time (immediate) basis. Each participant bank needs to open a dedicated settlement account for putting through its RTGS transactions. Not only does it allow transfer of funds, it also reduces the credit risk. Both customers and banks can transfer funds monies the same day at regular intervals within the banking hours.
- (c) *National Electronic Funds Transfer (NEFT)* : NEFT is a system similar to RTGS with certain differences. RTGS handles big ticket transactions, whereas NEFT handles smaller size transactions. Most branches are using this facility to transfer funds in an efficient manner. Once the applicant for the transfer of funds furnishes full and correct details (correct account details means correct name of the beneficiary, the correct account number, the branch and bank of the beneficiary, and the correct IFS code, etc.) funds can be transferred to the beneficiary's account by the remitting bank. Transfer of funds through NEFT is safe, quick. It reduces the paper work and is cost effective.
- (d) *Indian Financial System Code (IFSC)* : IFSC is an alpha-numeric code that

identifies a bank-branch participating in the RTGS/NEFT system. IFSC has 11 digit code and the first four alpha characters represents the bank, the 5th code is 0 (zero), which is reserved for future use and the last six digits are numeric characters represents the branch. Correct IFSC code is essential for identifying the beneficiary's branch and bank as destination for funds transfers. E.g. Syndicate Bank Cuffe Parade Branch, Mumbai- SYNB0005087.

- (e) *Core Banking Solutions (CBS)* : Core Banking Solutions has helped banks to offer better customer service. It has also reduced the time and increased the efficiency. The Core Banking Solutions mainly work on the support of effective communication and good information technology. It is on account of merger of communication technology and information technology which enables the banks to offer core banking needs of the clients.
- (f) *Cheque Truncation System (CTS)* : Cheques are being used as a medium for exchange of funds, which play a key role in the funds management of customers and banks. The efficient cheque clearing system helps in settlement of receipts and payments. Cheque Truncation is a new system introduced in Indian Banking Scenario. It is a system of cheque clearance and settlement between banks based on electronic data and/or images without the need for exchange of physical cheques and negotiable instruments like demand drafts, pay orders, dividend warrants, etc.

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

CAPITAL, COMMODITY AND MONEY MARKET
(Elective Paper 9.2)

Time allowed : 3 hours

Maximum marks : 100

NOTE : Answer **ALL** Questions.

Question 1

Read carefully the following order passed by an Adjudicating Officer of the Securities and Exchange Board of India :

BEFORE THE ADJUDICATING OFFICER
SECURITIES AND EXCHANGE BOARD OF INDIA
[ADJUDICATION ORDER NO. JJ/AM/AO-35/2014]

UNDER SECTION 15-1 OF THE SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 READ WITH RULE 5 OF THE SEBI (PROCEDURE FOR HOLDING INQUIRY AND IMPOSING PENALTIES BY ADJUDICATING OFFICER) RULES, 1995

In respect of : Ms. Rosy
(PAN - XXXXXXXXXXX)

In the matter of : Fantastic Limited

FACTS OF THE CASE :

- (i) Securities and Exchange Board of India (hereinafter referred to as 'SEBI') carried out an examination in the scrip of Fantastic Limited (hereinafter referred to as 'Company'). The shares of the Company are listed on the Bombay Stock Exchange Limited (hereinafter referred to as 'BSE'). It was observed that Ms. Rosy (hereinafter referred to as 'Noticee') was holding 1,64,800 shares of the Company (representing 5.03% of shareholding of the Company) in the quarter ending March, 2005. It was also observed that the Noticee sold 50,000 shares (representing 1.53% of shareholding of the Company) on 31st May, 2005 and 1,00,000 shares (representing 3.05% of the shareholding of Company) on 3rd June, 2005 in off-market; thereby bringing down her holding to 0.45%. However, it was alleged that the Noticee failed to make disclosures as required under Regulation 13(3) read with Regulation 13(5) of SEBI (Prohibition of Insider Trading) Regulations, 1992 (hereinafter referred to as 'PIT Regulations').

APPOINTMENT OF ADJUDICATING OFFICER

- (ii) The undersigned was appointed as the Adjudicating Officer vide order dated 16th January, 2014 and the said appointment was conveyed vide proceedings of the whole-time member dated 22nd January, 2014 to inquire and adjudge under Section 15A(b) of the Securities and Exchange Board of India Act, 1992 (hereinafter referred to as 'SEBI Act, 1992'), the alleged violation of provisions of Regulation 13(3) read with Regulation 13(5) of PIT Regulations committed by the Noticee.

SHOW CAUSE NOTICE, REPLY AND PERSONAL HEARING

- (iii) A Show Cause Notice (hereinafter referred to as 'SCN') in terms of the provisions of Rule 4(1) of the SEBI (Procedure for Holding Inquiry and Imposing Penalties by Adjudicating Officer) Rules, 1995 (hereinafter referred to as 'Adjudication Rules') was issued to the Noticee on 31st January, 2014, calling upon the Noticee to show cause why an inquiry should not be held against her under Rule 4(3) of the Adjudication Rules and penalty be not imposed under Section 15A(b) of SEBI Act, 1992 for the alleged violations.
- (iv) The aforesaid SCN was duly delivered to the Noticee on 1st February, 2014. Subsequently, vide letter dated 6th February, 2014, the Noticee acknowledged the receipt of the SCN and requested for additional 15 days' time to submit reply. Thereafter, vide Notice of Inquiry dated 21st February, 2014, the Noticee was given an opportunity of personal hearing on 5th March, 2014 and the Noticee was advised to submit her reply, if any, on or before 5th March, 2014.
- (v) On the scheduled date of personal hearing, Mr. James, Authorised Representative (hereinafter referred to as 'AR') of the Noticee appeared and made the following submissions :

"We are making submissions vide letter dated 4th March, 2014. Further, the Company was under BIFR and was discharged in September, 2009. Since the Company was in difficult times, no records were maintained and our interest was only to revive the Company by transferring the shares to the brother-in-law of the Noticee. In view of our submissions, a lenient view may be taken. We have no further submissions to make in the matter."

- (vi) The Noticee had made the following submissions vide her letter dated 4th March, 2014 :

"I was the wife of one of the promoter shareholders of Fantastic Limited and the company was controlled and managed by AOIL. Due to certain family settlements, the entire shareholding of the company was finally transferred to Dr. AK. In this process, the shares held by me were disposed of by way of inter se transfers and market transactions in the year 2005. Since the transaction took place many years ago, I do not recollect whether any disclosures were made by me to the stock exchange under SEBI (Prohibition of Insider Trading) Regulations and I do not have any copies of the same. In case, there has been no filing, it has been only due to sheer ignorance of the requirement and there was no malafide intention. Further, I would also like to submit that there was no change in control of the company and the control remained within our own family after these sales. On the basis of the above submissions, I request you to kindly excuse the non-filing, if any, and drop any further proceedings against me."

ISSUES FOR CONSIDERATION

- (vii) After perusal of the material available on record, I have the following issues for consideration, viz.,
- A. Whether the Noticee has violated provisions of Regulation 13(3) read with 13(5) of PIT Regulations ?

- B. Whether the Noticee is liable for monetary penalty under Section 15A(b) of the SEBI Act, 1992 ?
- C. What quantum of monetary penalty should be imposed on the Noticee taking into consideration the factors mentioned in Section 15J of the SEBI Act, 1992 ?

FINDINGS

- (viii) On perusal of the material available on record and having regard to the facts and circumstances of the case, I record my findings hereunder :

ISSUE 1: Whether the Noticee has violated provisions of Regulation 13(3) read with 13(5) of PIT Regulations ?

- (ix) From the SCN, I note that the Noticee was holding 1,64,800 shares of the Company (representing 5.03% of the shareholding of the Company) in the quarter ending March, 2005. I also note that the Noticee sold/transferred 50,000 shares (representing 1.53% of the shareholding of the Company) on 31st May, 2005 and 1,00,000 shares (representing 3.05% of the shareholding of the Company) on 3rd June, 2005 in off-market. Therefore, the Noticee reduced her shareholding in the Company from 5.03% to 0.45%. Such reduction obliges the Noticee to make required disclosure to the Company under Regulation 13(3) of PIT Regulations within the time-limit prescribed under Regulation 13(5) of PIT Regulations. I note that the Noticee, in her reply dated 4th March, 2014, has submitted that due to certain family settlements the shares held by her were disposed by way of inter se transfers and market transactions in the year 2005. During the course of personal hearing, the AR of the Noticee submitted that the Company was under BIFR and as the Company was in difficult times, no records were maintained and interest of the Noticee was only to revive the Company by transferring shares to the brother-in-law of the Noticee. However, I am of the considered opinion that these do not absolve the Noticee from her duty of making necessary disclosures under Regulation 13(3) of PIT Regulations.

- (x) In view of the above, I hold that the Noticee was under an obligation to make the required disclosures under Regulation 13(3) of PIT Regulations, which the Noticee failed to do. Therefore, the Noticee has violated the provisions of Regulation 13(3) read with Regulation 13(5) of PIT Regulations.

ISSUE 2: Whether the Noticee is liable for monetary penalty under Section 15A(b) of the SEBI Act, 1992 ?

- (xi) I note that the Noticee, in her reply dated 4th March, 2014, has submitted that "In case, there has been no filing, it has been only due to sheer ignorance of the requirement and there was no mala fide intention. Further, I would also like to submit that there was no change in control of the company and the control remained within our own family after these sales." However, the Hon'ble Supreme Court of India in Civil Appeal No.9523-9524 of 2003 in the matter of SEBI vs. Shri Ram Mutual Fund [2006] 68 SCL 216 (SC), has held that "In our considered opinion, penalty is attracted as soon as the contravention of the statutory obligation as contemplated by the Act and the Regulation is established and hence the intention of the parties committing such violation becomes wholly irrelevant."

- (xii) *As already observed, the Noticee disposed substantial shares of the Company but failed to make disclosures as required under Regulation 13(3) read with 13(5) of PIT Regulations. Hence, I find that the Noticee is liable for monetary penalty under Section 15A(b) of the SEBI Act, 1992.*

ISSUE 3: What quantum of monetary penalty should be imposed on the Noticee taking into consideration the factors mentioned in Section 15J of the SEBI Act, 1992 ?

- (xiii) *While imposing monetary penalty, it is important to consider the factors stipulated in Section 15J of the SEBI Act, 1992.*
- (xiv) *In the absence of material on record, the amount of disproportionate gain or unfair advantage made as a result of the default and the amount of loss caused to the investors due to the said default cannot be quantified. The Noticee was under obligation to make the necessary disclosure to the Company which, in turn, would have made the necessary disclosures to BSE, in terms of provisions of PIT Regulations. However, as stated earlier, by virtue of the failure on the part of the Noticee to make the necessary disclosures on time, the fact remains that the investors were deprived of the important information at the relevant point of time. In other words, by not complying with the regulatory obligation of making disclosure, the Noticee has concealed the vital information which is detrimental to the interest of investors in securities market. Further, there is nothing on record to indicate that the default of the Noticee was repetitive.*
- (xv) *In the forgoing paragraphs, it is now established that the Noticee failed to make necessary disclosures under Regulation 13(3) read with 13(5) of PIT Regulations. Considering the facts and circumstances of the case and the violation committed by the Noticee, I find that imposing a penalty of ₹4,00,000 (Rupees Four Lakh only) for violation of Regulation 13(3) read with 13(5) of PIT Regulations on the Noticee would be commensurate with the violation committed by her.*

ORDER

- (xvi) *In terms of the provisions of the SEBI Act, 1992 and Rule 5(1) of the Adjudication Rules, I hereby impose a penalty of ₹4,00,000 (Rupees Four Lakh only) under Section 15A(b) of SEBI Act, 1992 for violation of Regulation 13(3) read with Regulation 13(5) of PIT Regulations on Ms. Rosy.*
- (xvii) *The penalty shall be paid by way of demand draft drawn in favour of "SEBI - Penalties Remittable to Government of India" payable at Mumbai within 45 days of receipt of this Order. The said demand draft shall be forwarded to the Division Chief, Integrated Surveillance Department, Securities and Exchange Board of India, Plot No. C4-A, 'G' Block, Bandra Kurla Complex, Bandra (E), Mumbai - 400051.*
- (xviii) *In terms of the provisions of Rule 6 of the SEBI (Procedure for Holding Inquiry and Imposing Penalties by Adjudicating Officer) Rules, 1995, copies of this Order are being sent to the Noticee and also to the Securities and Exchange Board of India.*

Date: May 15, 2014

Signed / ---

Place: Mumbai

Adjudicating Officer

Assume that Ms. Rosy is aggrieved by the above order and wishes to file an appeal before the Securities Appellate Tribunal against the above order. Draft an appeal in about 1,500 words. (50 marks)

Answer 1

BEFORE THE SECURITIES APPELLATE TRIBUNAL AT MUMBAI

APPEAL NO. __ OF 2014

In the matter of Securities and Exchange Board of India Act, 1992 (15 of 1992)

And

In the matter of SEBI (Prohibition of Insider Trading) Regulations, 1992 (hereinafter, "**PIT regulations**")

And

In the matter of powers conferred under section 15 I of the SEBI Act, 1992 read with rule 5 of the SEBI (Procedure for Holding Inquiry and Imposing Penalties by Adjudicating Officer) Rules, 1995 (hereinafter, "**Adjudication rules**")

And

In the matter of Appeal against the Adjudication Order No JJ/AM/AO-35/2014 dated 15.05.2014 passed by The Ld. Adjudicating Officer, Securities and Exchange Board of India (hereinafter, **respondent**) *inter alia* imposing a monetary penalty of ₹4,00,000/- (Rupees Four Lakh Only) under section 15 A(b) of the SEBI Act, 1992 and rule 5 of the Adjudication rules on the Appellant (hereinafter, "**impugned order**")

In the matter of:

Ms. Rosy)	
C/o Fantastic Limited)	
Dalal Street, Fort,)	
Mumbai – 400 023) Appellant

Versus

The Ld. Adjudicating Officer)	
Securities and Exchange Board of India)	
Having its registered office at)	
SEBI Bhavan, Plot No. C4-A, G-Block,)	
Bandra Kurla Complex, Bandra (East))	
Mumbai – 400 051)	... Respondent

MEMORANDUM OF APPEAL

DETAILS OF APPEAL:

1. Particulars of Appellant

- | | | |
|--|---|---|
| (i) Name of the Appellant | : | Ms. Rosy |
| (ii) Address of Registered office of the Appellant | : | C/o Fantastic Limited
Dalal Street, Fort, Mumbai – 400 023
Tel. No.: 022 - 99999999
E-mail: rosy@fantastic.com |

- (iii) Address of Service of all notices : Mr. Governance Professional
Practice Company Secretary
CBD Belapur, Navi Mumbai – 400 614
- (iv) Telephone, Fax No. and email : Tel. No. 022- 99999999
Address, if any : E-mail: rosy@fantastic.com

2. Particulars of Respondent

- (i) Name of the Respondent : The Adjudicating Officer,
Securities and Exchange Board of
India
- (ii) Office Address of the Respondent : SEBI Bhavan,
Mumbai – 400051
- (iii) Address of Respondent : Same as Above
For Service of all notices:
- (iv) Telephone, Fax No. and email : Tel No. 91-22-2644 9000
Address: : Fax No. 91-22-2644 9019 to 9022

3. Jurisdiction of the Appellate Tribunal

The appellant declares that the matter of Appeal falls within the jurisdiction of the Appellate Tribunal.

4. Limitation

The appellant further declares that the Appeal is filed within the limitation as prescribed in section 15W of the SEBI Act, 1992.

5. Facts of the Case and the Details of the Orders against which Appeal is Filed

This Appeal has been preferred against impugned order passed by respondent imposing a heavy penalty of ₹4,00,000/- (Rupees Four Lakh Only) under section 15 A(b) of the SEBI Act, 1992 r.w. rule 5 of the Adjudication rules for the alleged violation of regulation 13 (3) r/w Regulation 13 (5) of PIT regulations for appellant's dealing in Fantastic Limited (hereinafter, "**Fantastic**"/ "**Company**"). The copy of impugned order dated 15.05.2014 is annexed hereto marked as "**Exhibit-A**"

Briefly stated, the facts of the case are as follows:

- 5.1 The appellant lady is a wife of promoter shareholder of the Company which is controlled and managed by AOIL. The appellant humbly states that she has been functioning as a law abiding citizen with a clean and unblemished track record and has never been penalized by SEBI for any violation of the SEBI Act, 1992 and rules & regulations framed thereunder save and except the present proceedings.

5.2 The list of dates and the chronology of events in the subject matter of the present proceedings are listed below:

SR. NO.	PARTICULARS
1	The appellant was holding 1,64,800 shares representing 5.03% of the total paid up capital of the Company as on 31.03.2005
2	On and around May 2005, under the scheme of family settlement, it was decided that out of her holding of total 1,64,800 shares (5.03%), ownership of 1,50,000 (4.58%) shares would be transferred to her brother- in-law Dr. AK so as to revive the Company.
3	In pursuance thereto, on 31.05.2005 appellant sold/transferred 50,000 shares (1.53 %) to Dr. AK. Thereafter on 03.06.2005 appellant transferred 1,00,000 shares (3.05%) by way of off market transfer to Dr. AK. Thereby her shareholding in the Company was reduced to 0.45%. It was only by execution of aforesaid off market transaction of 1,00,000 shares (3.05%) on 03.06.2005, change of appellant's shareholding in the Company exceeded 2% i.e. from the last disclosure of 5.03 % as on 31.03.2005, it came down to 0.45% hence under regulation 13(3) of PIT regulations, appellant was required to make disclosure to the Company in prescribed form i.e. Form C.
4	During the relevant period, the Company was Sick Company and passing through difficult time hence there was no staff to maintain proper records of the Company. The Company remained under BIFR up to September 2009.
5	Without any communication received from SEBI, present proceeding was initiated against the appellant by issuance of a Show Cause Notice dated 31.01.2014 (hereinafter, " SCN ") i.e. after nearly 8 ½ years from the execution of the impugned transaction calling upon the appellant to show cause as to why an inquiry should not be held against her for the alleged non compliances of disclosure requirements under PIT regulations on execution of the above referred transactions executed way back in June 2005. A copy of the aforesaid SCN dated 31.01.2014 is annexed hereto marked as " Exhibit-B ".
6	An opportunity of personal hearing was granted to the appellant on 05.03.2014 wherein Mr. James , her authorised representative appeared before the respondent and made oral submissions and requested that under the peculiar facts and circumstances of the case, a lenient view may please be taken. A written submissions by letter dated 04.03.2014 were also filed wherein also request was made to drop the proceedings on the ground as mentioned therein. A copy of the proceeding sheet of the

	personal hearing dated 05.03.2014 and reply dated 05.03.2014 is annexed thereto marked as “ Exhibit-C ” and “ Exhibit-D ” respectively.
7	Without considering factors as prescribed under section 15 J of the SEBI Act, 1992 respondent passed impugned order on 15.05.2104 imposing a hefty penalty of ₹4,00,000/- on the appellant.

- 5.3 The appellate humbly states that the contents of her submissions as listed hereinabove are not repeated for the sake of brevity and pleads before the Hon’ble Tribunal to consider the same as if, it is set out herein seriatim.
- 5.4 On the subject matter of present proceedings, the appellant would like to submit as under:
- (i) It was only pursuant to the “*Scheme of family settlement*”, shares of Fantastic owned by her were transferred in two tranches on 31.05.2005 and 03.06.2005. A copy of the family settlement agreement is annexed hereto marked as “**Exhibit-E**”.
 - (ii) The subject matter of examination pertains to a period more than 8 ½ years old and the appellant being an individual is not expected to preserve records beyond six years particularly when the matter is not ‘*subjudice*’. It is possible that she or someone on her behalf, appellant being wife of the promoter shareholder of the Company might have complied with the relevant disclosure requirements particularly when disclosure were required to be made by the appellant to the Company only.
 - (iii) The impugned transaction is an interse transfer of shares between the promoters hence the same did not result in any change in control of the Company. Therefore appellant humbly submits that a disclosure requirement was of no material consequence to the investing public at large.
 - (iv) Further, the impugned transaction which triggered disclosure requirements was carried out through off market and has not taken place on the stock exchange hence had no impact on the trading operation of the Company on the stock exchange.
 - (v) It is indeed most pertinent to mention that there was no intention to suppress any material information from the shareholder of the company and that the Appellant had not consciously or deliberately avoided filing of the requisite information with the Company.
 - (vi) In the view of the aforesaid, the said violation, if any, is only technical, procedural and venial breach and has not caused any adverse consequences to anybody.
- 5.5 Thus appellant is aggrieved by the impugned order passed by respondent, imposing a heavy penalty of ₹4,00,000/- (Rupees four lakh only) under

section 15 A (b) of SEBI Act, 1992 and rule 5(1) of the Adjudication rules which in its humble submission is in violation of the principle of equity and good conscience.

5A. GROUNDS OF APPEAL

Being aggrieved and dissatisfied by the impugned order dated 15.05.2014 passed by respondent, appellant begs to prefer the present Appeal *inter alia* on the following grounds, each without prejudice to the other. The appellant craves leave to add, alter, and amend such grounds if and when necessary.

- i. The respondent has failed to appreciate that the query with regard to disclosure requirement is made after a long gap of 8½ years and failure on the part of appellant to show the evidences ought not to result into imposition of penalty on the appellant.
- ii. In para (xiv) of the impugned order, respondent has erroneously held that the “*investors were deprived of the important information at the relevant point of time*” ignoring that disclosure was triggered pursuant to family settlement, transaction was executed off market between the promoters and that there was no change in management and control of the Company.
- iii. The respondent has failed to take a holistic approach on the submission made by the appellant and has failed to appreciate the peculiar facts and circumstance of the present case in its correct perspective.
- iv. The appellant humbly submits that it had not acted deliberately in defiance of law or was not guilty of conduct contumacious or dishonest or acted in conscious disregard of its obligation.
- v. Penalty imposed by respondent is grossly disproportionate to the alleged violation and grossly ignored the provisions of section 15 J of the SEBI Act, 1992 that no disproportionate gain or unfair advantage accrued to the appellant as a result of the default, if any; there is no investors complaint: no loss is caused to an investor or group of investors as a result of the default; and that even after recoding under para xiv of the impugned order that the nature of the default is not repetitive has not taken heed of any of the aforesaid factors.
- vi. Appellant would like to place reliance on the decision of the Hon’ble Tribunal in *Samrat Holdings Ltd. vs. SEBI & Ors* (Appeal 23 Of 2000) & *Cabot International Capital Corporation Vs. Adjudicating Officer, SEBI* (Appeal 24 of 2000) wherein the Hon’ble Tribunal had considered scope of section 15 J of SEBI Act, 1992 in context of unintentional failure to comply with the regulation and orders were set aside. A copy of the aforesaid orders of Hon’ble SAT are enclosed herewith marked as “**Exhibit-F**” and “**Exhibit-G**” respectively.
- vii. Appellant hereby reserves her right to add, amend or modify any of the grounds mentioned hereinabove as and when needed.

- viii. Appellant craves leave to refer to the contents of all other documents on which it places reliance, as and when produced.

6. RELIEFS SOUGHT

Based on the above submissions, appellant humbly prays for the following relief:

- 6.1 That the impugned Order dated 15.05.2014 (being "Exhibit -A" to the Appeal) passed by the respondent be set aside;
- 6.2 For such other relief's as may be warranted on the basis of the facts and circumstances to this Appeal in furthering justice as this Hon'ble Tribunal deems fit.

7. INTERIM RELIEFS

The Appellant prays:

- (i) that pending the hearing and final disposal of the Appeal, this Hon'ble Tribunal be pleased to stay the operation and implementation of the said order dated 15.05.2014 being Exhibit "A" to the Appeal.
- (ii) that pending the hearing and final disposal of the Appeal, this Hon'ble Tribunal be pleased to restrain the Respondents from acting upon or in pursuance or furtherance of the said impugned order dated 15.05.2014 being Exhibit "A" to the Appeal.

GROUND FOR INTERIM ORDER:

- (i) The balance of convenience requires that the interim relief as prayed for be granted by this Hon'ble Tribunal.
- (ii) No harm, loss, prejudice or damage would be caused to the Respondent or the securities market if such reliefs are granted.

8. MATTER NOT PENDING WITH ANY OTHER COURT ETC.

The appellant declares that no other proceedings have been filed by the appellant in respect to the subject matter of this Appeal and therefore the subject matter of this Appeal is not pending before any Court of Law, Tribunal or other Authority.

9. PARTICULARS IN RESPECT OF FEE PAID

The appellant has paid fees towards this Appeal as per Rule 9 of the Securities Appellate Tribunal (procedure) Rules, 2000, the details whereof are as under:

Amount of Fees :
 Name of the Bank :
 Demand Draft No :
 Demand Draft Date :

10. DETAILS OF INDEX:

An index containing the details of the documents to be relied upon is enclosed.

11. LIST OF ENCLOSURES : As per attached Sheet

Date : July 11, 2014

Place : Mumbai

Ms. Rosy

Appellant

VERIFICATION

I, Ms. Rosy, appellant do hereby declare and verify that the contents of paragraphs number 1 to 11 are true to the best of my personal knowledge and belief and that I have not suppressed material fact.

Date : July 11, 2014

Place : Mumbai

Ms. Rosy

Appellant

Question 2

XYZ Ltd., as on date, has two sets of shareholders, namely, promoters (set 'A') and others (set 'C'). It proposes to make a preferential allotment to a new set of investors (set 'B'). The shareholding pattern before and after the preferential allotment would be as under :

Investors sets	% of Shareholding	
	Pre-preferential Allotment	Post-preferential Allotment
A	50	25
B	0	50
C	50	25

In the light of the relevant provisions, discuss the following :

- Whether 'B' is obliged to make an open offer, under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 on acquisition of 50% of shares through preferential allotment and, if so, what is the minimum size of open offer; (8 marks)*
- Whether 'A' can tender shares in the open offer, which 'B' may make under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011; (7 marks)*
- Whether the shareholding of 'A' would constitute a part of 'public shareholding' under the Securities Contracts (Regulation) Rules, 1957, after the preferential allotment; (8 marks)*
- Whether XYZ Ltd. will be delisted if as a result of open offer, the holdings of 'B' exceed maximum permissible non-public shareholding. (7 marks)*

Answer 2

- (a) 'B' is acquiring 50% share capital of XYZ Ltd. by way of preferential allotment. Since this would entitle it to exercise more than 25% of voting rights of XYZ Ltd., it is obliged to make an open offer under regulation 3(1) of the Takeover Regulation, 2011. Regulation 10 does not exempt this kind of acquisitions from the obligation to make an open offer. Regulation 7(1) requires that the open offer shall be for at least twenty six per cent of total shares of the target company. This is irrespective of the size of public holding.
- (b) 'A' is not an acquirer or a PAC with the acquirer. He can tender shares in the open offer made by 'B'. This is evident from regulation 3(1) read with regulation 7(1) make it clear that the open offer is required to be made by the acquirer and PAC with him. Regulation 7(6) prescribe that open offer shall be made to all shareholders of the target company, other than the acquirer, PAC with him and the parties to any underlying agreement including persons deemed to be acting in concert with such parties. It is thus clear that any shareholder, other than acquirer and PACs with him, can tender shares in the open offer. Even the promoters of the company, not acting in concert with the acquirer, can participate in the open offer and exit by tendering their shares. It has been held in *M/s. Modipon Limited v. SEBI* (Appeal No. 34/2001, SAT Order dated 31.7.2001): "For the reasons stated above, though SEBI's finding that the Appellant is a promoter of MRL is tenable it cannot be held that the Appellant is an acquirer or a person acting or deemed to be acting in concert with the acquirers and thereby ineligible to participate in the public offer. I am of the view that there is no legal backing flowing from the Act, or the Regulations to uphold the SEBI's decision holding the Appellant ineligible to participate in the public offer made vide letter dated May 30, 2001." Therefore 'A' can tender shares in the open offer as it is not an acquirer or a PAC. Even if 'A' continues to be a promoter depending on the nature and extent of preferential allotment, it can still tender the shares.
- (c) 'A' does not remain promoter after the preferential allotment. Under rule 2(d) of the SCRR, public includes all shareholders except the promoters and promoter group. Since 'A' is not a promoter any more, its holding would be a part of 'public holding' under rule 2(e) of the SCRR. Further, clause 35 of the Listing Agreement requires that in all cases wherein the change in capital structure due to restructuring exceeds +/- 2% of the paid up share capital, the company shall file a revised shareholding pattern with the stock exchanges within 10 days from the date of allotment of shares pursuant to such change in the capital structure. This filing would obviously indicate who the new promoters are, if there is any change, and what are their holdings. Hence it is not that once a person becomes promoter, he remains promoter forever. In the instant case, the capital of the XYZ Ltd. increases by 100% and this would necessitate a filing of revised shareholding pattern within 10 days and depending on the nature of preferential allotment, 'A' may or may not continue to be the promoter.

The definition of 'control' is an inclusive one and not exhaustive and has two distinct and separate limbs: (a) the right to appoint majority of directors, or (b) the ability to control the management or policy decisions by various means

referred to in the definition. This control of management or policy decisions could be by virtue of shareholding or management rights or shareholder agreement or voting agreements or in any other manner. In the instant case, the shareholding of 'A' in XYZ Ltd. reduces to 25%. It loses the right to appoint majority of directors and the ability to control management or policy decisions. It has no understanding or agreement whatsoever with 'B' to retain or acquire such right or ability. Therefore, 'A' does remain 'promoter' after the preferential allotment within the inclusive definition of 'control'. As regards non-inclusive aspects of control, reliance can be placed on the ratio in *M/s. Subhkam Ventures (I) Private Ltd. V. SEBI* (Appeal No. 8/2009, Order dated 15.1.10) where it has been held in the context of an acquirer: "Control is a proactive and not a reactive power. It is a power by which an acquirer can command the target company to do what it wants it to do. Control really means creating or controlling a situation by taking the initiative. Power by which an acquirer can only prevent a company from doing what the latter wants to do is by itself not control. In that event, the acquirer is only reacting rather than taking the initiative. The test is whether the acquirer is in the driving seat. To extend the metaphor further, the question would be whether he controls the steering, accelerator, the gears and the brakes. If the answer to these questions is in the affirmative, then alone would he be in the control of the company. In other words, the question to be asked in each case would be whether the acquirer is then driving force behind the company and whether he is the one providing motion to the organization. If yes, he is in control but not otherwise. In short, control means effective control." By this ratio, 'A' does not continue to have control over XYZ Ltd. after the preferential allotment and, therefore, does not remain promoter. 'B' acquires de fact and de jure control with the preferential allotment and becomes new promoter of XYZ Ltd.

- (d) Under regulation 7(5) of the SEBI (SAST) Regulations, 2011, the acquirer cannot make a voluntary delisting offer under the Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009, unless a period of twelve months has elapsed from the date of the completion of the offer period. Therefore, the acquirer is required under regulation 7(4) to bring down the non-public shareholding to the level specified and within the time permitted under the SCRR. As specified under clause 40 of the Listing Agreement, it could be done by: (a) issuance of shares to public through prospectus; or (b) offer for sale of shares held by promoters to public through prospectus /stock exchanges; or (c) sale of shares held by promoters through the secondary market.

Question 3

The confluence of hedgers, speculators and arbitrageurs ensures liquidity and efficient price discovery in the commodity derivatives market. Comment.

(5 marks)

Answer 3

For a market to succeed, it must have all three kinds of participants – hedgers, speculators and arbitrageurs. The confluence of these participants ensures liquidity

and efficient price discovery on the market. Commodity markets give opportunity for all three kinds of participants.

1. *Hedgers* : Hedger is a user of the market, who enters into futures contract to manage the risk of adverse price fluctuation in respect of his existing or future asset. Hedgers are those who have an underlying interest in the commodity and are using futures market to insure themselves against adverse price fluctuations.
2. *Speculators* : A trader, who trades or takes position without having exposure in the physical market, with the sole intention of earning profit is a speculator. A speculator is one who enters the market to profit from the future price movements. Speculators accept the risk that hedgers seek to avoid, giving the required liquidity to the market. Contrary to the hedging, speculation involves risk but no offsetting of cash market position.
3. *Arbitrageurs* : A third category of market participants is the arbitrageurs. Arbitrage refers to the simultaneous purchase and sale in two markets so that the selling price is higher than the buying price by more than the transaction cost, resulting in risk-less profit to the arbitrageur. Arbitrage is making purchases and sales simultaneously in two different markets to profit from the price differences prevailing in those markets.

Question 4

Critically examine the mechanism of mobilisation of resources through American Depository Receipts. (5 marks)

Answer 4

Companies either raise funds from the domestic market or through international market. One of the important mechanism through which investment in Indian Securities takes place in overseas market is through Depository Receipts (DRs). The DR route is attractive to investors because it offers a combination of simplicity, protection and flexibility, as compared to direct investment in foreign market. DR can be issued in the form of American Depository Receipts (ADR) or Global Depository Receipts (GDR). An American Depository Receipt (ADR) is a negotiable security representing ownership in some underlying shares of a non-US company, which can be traded on US stock exchanges. ADRs are denominated in US dollars and function on the lines of the shares of a US company in terms of trading and dividend payment. The following would clear the mechanism of the working of an ADR:

1. Indian company would issue rupee denominated shares to a Depository outside India, where the ADRs are proposed to be issued.
2. Indian custodian would keep these securities in his custody.
3. The investment banker would organize road shows for marketing the issue.
4. The foreign Depository would issue dollar denominated ADRs to foreign investors.
5. Listing of ADRs in American Stock Exchanges would take place.
6. Indian company has to comply with various requirements of SEC requirements.

Question 5

Evaluate the following instruments from the perspective of investors :

(a) *Treasury Bills*

(b) *Certificate of Deposit*

(c) *Commercial Paper.*

(5 marks)

Answer 5

(a) Treasury Bills : Treasury Bills are very useful instruments to deploy short term surpluses depending upon the availability and requirement. Besides, better yields and availability for very short tenors, another important advantage of treasury bills over bank deposits is that the surplus cash can be invested depending upon the staggered requirements. The benefits of treasury bill can be summarized as under:

- (a) No tax deducted at source
- (b) Zero default risk being sovereign paper
- (c) Highly liquid Money Market instrument
- (d) Better returns especially in the short term
- (e) Transparency
- (f) Simplified settlement
- (g) High degree of tradability and active secondary market facilitates meeting unplanned fund requirements.

(b) Certificate of Deposit : Certificate of Deposit (CD) provide higher yield than Treasury bills and savings account. CDs are liquid instruments as they are transferable by endorsement and delivery. The holder can resell his certificate to another. As the rate of interest is fixed, the return on investment is secured despite the rate fluctuations in the market. There is no lock-in period for the CDs.

(c) Commercial Paper : Commercial Paper (CP) is a quick and cost effective way of raising working capital. Investing in CP is the best way to take the advantage of short term interest rate fluctuations in the market. It provides an easy exit option to the investors by quitting the investment. It has a wide range of maturity period.

Question 6

Write a critique on penal provisions in the Forward Contracts (Regulation) Act, 1952.

(5 marks)

Answer 6

Section 20 of the Forward Contracts (Regulation) Act, 1952 deals with the penalty

for contravention of certain provisions of Chapter IV under this Act. Under this section any person who –

- (a) (i) in any return, statement or other document required by or under this Act, makes a statement which is false in any material particular, knowing it to be false, or wilfully omits to make a material statement; or
- (ii) without reasonable excuse (the burden of proving which shall be on him) fails to furnish any return, statement or other document or any information or to answer any question or to comply with any requisition made under this Act or any rules made thereunder; or
- (iii) enters into any forward contract during the period of suspension of business of a recognised association in pursuance of a notification under Section 14; or
- (b) is a member of any association, other than a recognised association, to which a certificate of registration has not been granted under this Act; or
- (c) publishes or circulates information relating to the rate at which any forward contract has been entered into in contravention of any of the bye-laws of a recognised organisation, or
- (d) organises or assists in organising, or is a member of any association in contravention of the provisions contained in the proviso to sub-section (1) of Section 18; or
- (e) enters into any forward contract or any option in goods in contravention of any of the provisions contained in sub-section (1) or sub-section (3A) or sub-section (4) of Section 15, Section 17 or Section 19;

shall on conviction be punishable —

- (i) for a first offence, with imprisonment which may extend to one year or with a fine of not less than one thousand rupees, or with both;
- (ii) for a second or subsequent offence under clause (d), or under clause (e) [other than an offence in respect of contravention of the provisions of sub-section (4) of Section 15 with imprisonment which may extend to one year and also with fine; provided that in the absence of special and adequate reasons to the contrary to be mentioned in the judgement of the Court, the imprisonment shall be not less than one month and the fine shall not be less than one thousand rupees.

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

INSURANCE LAW AND PRACTICE (Elective Paper 9.3)

Time allowed : 3 hours

Maximum marks : 100

NOTE : Answer **ALL** Questions.

Question 1

New Horizon General Insurance Company was granted a licence over a decade ago to transact general insurance business. On 1st April, 2012, it received a proposal from Excellent Polymers to take a fire and allied perils insurance policy. The proposal revealed that the proposer was a manufacturer of PVC granules. According to the proposal form and other information obtained from the proposer, the plant had been commissioned in December, 2011. The coverage required was for building ₹50 lakh, plant and machinery ₹75 lakh and stocks ₹ 1.5 crore. Based on the proposal and other information given, the insurance company issued fire and allied perils policy after collecting the necessary premium. However, the risk was not inspected by the insurance company before granting the insurance.

On 26th August, 2012, the insurance company received a telegram from Excellent Polymers intimating a major fire accident in the factory in the early morning hours of 26th. The insured followed-up the telegram by a letter and claim form claiming loss of entire stocks worth ₹1.5 crore, substantial portion of which was finished goods of PVC granules. As per the claim form, the fire originated in the control section and spread to the stocks. The insurance company deputed Pavitra Surveyors, a surveyor holding a valid licence issued by the insurance regulator, to survey and assess the loss. The surveyor submitted its report assessing the loss at ₹1.5 crore as claimed by the insured. The fire brigade report also stated the probable cause of the fire as accidental.

Immediately, on the receipt of the telegram from the insured, the insurance company rushed Manoj, its claims officer, an engineer, to the factory at around 10.45 AM on 26th August, 2012. Prem, proprietor of the factory was not available but his son Anil, took Manoj around the site. By that time the fire had been extinguished and the fire brigade had also left the site. Manoj observed that the control section was separated from the manufacturing section by a distance of around 25 feet. He also observed that electrical wiring on the wall was at a safe distance from the machinery and stock.

Among other documents, the insurance company called for copies of bank statements, invoice, books of accounts and electricity bills from the inception of the policy as available. Though the purchase (raw material) and sales (finished goods) submitted were for sizeable amounts, the bank statements showed that the average monthly transactions for payments and receipts did not exceed `5 lakh. As per the electricity bills, the average consumption of power was negligible.

One of the electricity bill also had a remark 'premises closed'. These facts aroused some suspicion in the minds of the officials in the insurance company. The insurance company, therefore, deputed Avinash, a qualified Chartered Accountant, to investigate the claim.

The insured complained to the insurance regulator that the insurance company was adopting delaying tactics and avoiding settlement despite assessment of the loss by a licenced surveyor. The insurance regulator called for the explanation of the insurance company. The company explained the reasons for entrusting the matter for investigation. The insurance regulator sent the explanation of the company to the insured and sought its comments. The insured has not replied to the regulator till date.

Avinash submitted his investigation report on 1st February, 2013. The main points in his report were that most of the purchase invoices were from parties who were non-existent. Also, the sales tax registration numbers on these bills were fake. He produced confirmation from sales tax authorities to support his findings.

On 15th February, 2013, New Horizon General Insurance company wrote to Excellent Polymers repudiating the claim. It quoted the relevant provision of the insurance policy that "if the claim be in any respect fraudulent or the damage be occasioned by any willful act all benefits under the policy shall be forfeited". It also complained to the insurance regulator alleging misconduct on the part of Pavitra Surveyors. However, it did not lodge any police complaint against Excellent Polymers for the alleged or attempted fraud. It however, confidentially circulated brief particulars of the claim among members of the general insurers association.

It is understood that Excellent Polymers is contemplating filing a suit against New Horizon General Insurance company for recovery of the loss mainly on the strength of the survey report and the fire brigade report.

Irrespective of the future outcome of the court case or the complaint against the surveyor, you as an insurance expert are required to comment on the following with reasons —

- (a) *Is the repudiation of the claim by the insurance company justified ?* (15 marks)
- (b) *Is the surveyor guilty of misconduct ?* (15 marks)
- (c) *Is the insurance company legally and ethically right in not lodging a police complaint for the attempted fraud ?* (20 marks)

Answer 1(a)

Yes, the repudiation of claim by New Horizon General Insurance Company is very well justified because of the following reasons:

Presence of unusual conditions

The presence of unusual conditions at the site of loss raises suspicion about the authenticity of the claim made by the insured i.e. Excellent Polymers. The unusual conditions prevailing at site are as given below

- The fire had been extinguished and the fire brigade had also left the site before arrival of Claim officer of Insurance Company.

- Separation of The control section from the manufacturing section by a distance of around 25 feet.
- Remote possibility of electric short circuit as Electrical wiring was at a safe distance from the machinery and stock.

Doubts created on account of contradicted facts and documents

The facts and document submitted by insured were in contradiction. The insured raised the insurance claim regarding loss of stock for Rs. 1.5 crore. Though, the purchase and sales figures as submitted by insured were for sizeable amounts but the bank statements showed that the average monthly transactions for receipts and payments did not exceed Rs. 5 lakh.

According to the proposal made by the Excellent Polymers, the plant had been commissioned in December, 2011. However, as per electricity bills the average consumption of power was negligible. Further, one of the electricity bill had a remark "premises closed".

Facts in the report submitted by Investigating Officer

As per the investigation report submitted by investigating officer, the following facts were found to fall under the category of fraudulent claims:

Purchase invoices were from the parties who were non-existent. This fact was confirmed by sales tax authorities as sales tax registration number quoted on bills were fake.

Keeping in view, the aforementioned facts of the given case, the act of repudiating the claim on the grounds of the relevant provision in the Insurance policy is justified as the insurance contracts are based on the principle of "Uberrimae fidei" i.e; utmost good faith and suppression of any material fact is a clear violation of this principle of good faith.

Answer 1(b)

In case of general insurance Business, a surveyor or a loss assessor is appointed by the Insurance so as to assess the actual amount of loss incurred by the insured. The nature of general insurance contracts is indemnity contracts and the main feature of indemnity contract is to indemnify the insured for the loss incurred by him. The job of an insurance and loss surveyor is to assess the actual loss incurred by the insured and his role is very important. The surveyors are also subject to follow professional ethics and conduct in their working.

In the given study, the loss surveyor submitted its report assessing the loss at Rs 1.5 crore as claimed by the insured. Though the case study does not contain enough details so as to judge whether the surveyor has used due diligence in carrying out the survey but the presence of many unusual conditions stating above gives a hint that the claim was fabricated. In view of this, it may be argued that surveyor has not used due diligence in carrying out the survey and he may be subject to professional misconduct.

Answer 1(c)

The New Horizon General Insurance Company repudiated the claim of the insured (Excellent Polymers) and forfeited all benefits under the claim. It complained to the insurance regulator alleging misconduct on the part of Pavitra Surveyors. However, it did not lodge any police complaint against the insured. Ideally, the Insurance company should have lodged police complaint against the insured but as per legal consideration there is nothing wrong in the New Horizon General Insurance Company's not lodging a police complaint for attempted fraud on the part of the insured. Lodging an FIR for a fraud or an attempted fraud depends on the anti fraud policy of the company. Very often in practice, insurance companies do not go beyond repudiation of a fraudulent claim.

Question 2

Kumar, holder of a life insurance policy for a sum assured of '10 lakh, died in an accident. The accident was widely reported in the press. Mrs. Sheela Kumar, his wife, was the nominee under the policy. Nayar, the agent who had canvassed the insurance, met Tandon, the Regional Vice-President of the insurance company and requested for a prompt settlement of the claim assuring that he will get the documentation completed by Mrs. Kumar. Nayar was a leading agent of the company. Tandon took an intimation letter from Nayar and instructed the accounts department to handover the receipted voucher and claim cheque to Nayar. Tandon, however, forgot to inform his action to Sharma the claims officer of the insurance company.

Nayar handed over the cheque, voucher and claim form to Mrs. Kumar stating that he will collect the documents next day. Since he did not turn up the next day, she mailed the claim form, discharged voucher and the policy bond to the insurance company. Sharma, who received the documents, not knowing the earlier action of Tandon, approved the claim and arranged for a cheque for '10 lakh to be mailed to Mrs. Kumar.

The insurance company wrote to Nayar intimating that the amount of '10 lakh will be recovered in installments from his agency commission. Nayar replied that such an action will be in violation of the agency law and agreement.

Answer the following questions stating reasons :

- (a) Can the company legally recover the money from Nayar ?*
- (b) Can the company legally recover the money from Mrs. Kumar ?*
- (c) Can the company legally recover the money from the children of Mrs. Kumar?
(10 marks each)*

Answer 2(a)

Mr. Nayar, is the agent of the insurance company in which Mr. Kumar was the holder of a life insurance policy. The relationship of Mr. Nayar (being an agent) and the Insurance Company (Being an employer) are governed by the Indian Contract Act, 1872 and Sections 182 to 238 of the Indian Contract Act, 1872 governs the relationship between a Principal and an Agent.

An Agent is a person employed to do any act for another or to represent another in dealings with third persons. The function of an agent is to bring his principal into

contractual relations with third persons. A Principal is a person for whom the above act is done or who is so represented. An agent, who acts within the scope of authority conferred by his or her principal, binds the principal in the obligations he or she creates against third parties.

In the present case, The company may not be entitled to recover the money from the agent Mr. Nayar as the negligence occurred on the part of Insurance Company official Mr. Sharma and Mr. Nayar, the agent is not responsible for the double disbursement of claim to the insured i.e. Mrs. Kumar.

Answer 2(b)

Yes, the excess money paid could be legally recovered from Mrs. Kumar.

There are generally several clauses in the policy agreement that forbid double indemnification. The Insurance Company generally reserves the right to recover the amount from the Policyholder or the member of policy holder's family or any other person, if it is found that the benefits are erroneously paid due to the fault of the Policyholder. Further, in case the insurer is not in a position to recover such amounts from the member or any other person, the Policyholder will be liable to pay the said amount to the insurer within the prescribed time limit from the date of its demand.

The Policyholder however, will not be liable or responsible for any wrong payments made by the Company without any fault on the part of the Policyholder but nothing stops the company in recovering the excess amount paid to Mrs. Kumar.

Answer 2(c)

The Insurance Company generally reserves the right to recover the amount from the Policyholder or the member of policy holder's family or any other person, if it is found that the benefits are erroneously paid due to the fault of the Policyholder. However, the Policyholder will not be liable or responsible for any wrong payments made by the Company without any fault on the part of the Policyholder. In this case since the cheque has been issued in the name of Mrs. Kumar, it is doubtful that the company can legally recover money from the children of Mrs. Kumar.

Question 3

Distinguish between 'nomination' and 'assignment' with an example. (5 marks)

Answer 3

Following are the points of Difference between 'Nomination' and 'Assignment'

<i>S.no.</i>	<i>Nomination</i>	<i>Assignment</i>
1.	Nomination is appointing some person(s) to receive policy benefits only when the policy has a death claim.	Assignment is transfer of rights, title and interest of the policy to some person(s).
2.	In other words, by merely nominating someone, the right, title and interest of the insured over	In other words, the insurer is bound to pass over the benefits, claims and/or interests to the assigned person(s). Even

<i>S.no.</i>	<i>Nomination</i>	<i>Assignment</i>
	the policy is not transferred straight forwardly to that nominated person and remains with the insured person only.	during the time the insured is alive (or even prior to the death of the insured person).
3.	Nomination is done at the instance of the insured.	Along with the instance of the insured, consent of insurer is also required.
4.	It can be changed or revoked several times.	Normally assignment is done once or twice during the policy period. Assignment can be normally revoked after obtaining the "no objection certificate" from the concerned Assignees.
5.	No attestation is prescribed in the case of nomination.	Attestation is required in case of assignment.
6.	In case of nomination, the money will be paid to the nominee if he survives the assured.	In case of assignment, money under the policy shall be paid to the assignee.
7.	Nomination is made without consideration.	Assignment of a life policy may be with or without consideration.

Question 4

Distinguish between 'agent' and 'broker'.

(5 marks)

Answer 4

Following are the points of difference between 'Insurance agents' and 'Insurance brokers'.

<i>S.No.</i>	<i>Insurance Agent</i>	<i>Insurance Broker</i>
1.	Section 2(10) of the Insurance Act, 1938, defines an Insurance Agent as an insurance agent licensed under Section 42 of the said Act and who received or agrees to receive payment by way of commission or other remuneration in consideration of his soliciting or procuring insurance business including business relating to the continuance, renewal or revival of policies of insurance.	Regulation 2(i) of the IRDA (Insurance Brokers) Regulations, 2002, defines Insurance Broker as a person for the time being licensed by the Authority under Regulation 11, who for remuneration arranges insurance contracts with insurance companies and/or reinsurance companies on behalf of his clients.
2.	In simple words Insurance agents	Insurance brokers can be best described

S.No.	Insurance Agent	Insurance Broker
	are insurance professionals that serve as an intermediary between the insurance company and the insured. As a broad statement of law, an agent's liability to their customers is administrative.	as a kind of super-independent agent. Brokers can offer a whole host of insurance products for you to consider.
3.	An Insurance Broker represents the client.	An Insurance Agent represents the insurance company
4.	An Insurance Broker is licensed to recommend the products of any insurance company.	Insurance Agent at any point of time can sell the insurance products of only one insurance company with which he is attached.
5.	The main duties of agents are timely and accurate processing of forms, premiums, and paperwork.	Brokers have the duty to analyze a business and secure correct and adequate coverage for the business.

Question 5

State, whether the following statements are true or false :

- (a) *Personal accident policy is a pure contract of indemnity.*
- (b) *Insurance covers speculative risks.*
- (c) *Insurance premium can be paid after the inception of the risk.*
- (d) *There can be liability policies with retro-active cover.*
- (e) *Contribution can be applied to benefit policies.*

(5 marks)

Answer 5

- (a) FALSE.
- (b) FALSE.
- (c) FALSE.
- (d) TRUE.
- (e) FALSE.

Question 6

Can an Indian insurance company invest its policy holders fund abroad ? Also, cite the relevant legal provisions.

(5 marks)

Answer 6

No, an Indian insurance company cannot invest its policy holders funds abroad. Section 27C of Insurance Act, 1938 Prohibits Insurance company from investing the funds outside India. The provision states that : "(1) Without

prejudice to anything contained in sections 27, 27A and 27B, the Authority may, in the interests of the policy-holders, specify by the regulations made by it, the time, manner and other conditions of investment of assets to be held by an insurer for the purposes of this Act.”

- (2) The Authority may give specific directions for the time, manner and other conditions subject to which the funds of policy-holders shall be invested in the infrastructure and social sector as may be specified by regulations made by the Authority and such regulations shall apply uniformly to all the insurers carrying on the business of life insurance, general insurance, or re-insurance in India on or after the commencement of the Insurance Regulatory and Development Authority Act, 1999.
- (3) The Authority may, after taking into account the nature of business and to protect the interests of the policy-holders, issue to an insurer the directions relating to the time, manner and other conditions of investment of assets to be held by him:

Provided that no direction under this sub-section shall be issued unless the insurer concerned has been given a reasonable opportunity of being heard.

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

INTELLECTUAL PROPERTY RIGHTS – LAW AND PRACTICE
(Elective Paper 9.4)

Time allowed : 3 hours

Maximum marks : 100

NOTE : Answer **ALL** Questions.

Question 1

Sitca Healthcare (hereinafter referred as 'Applicant') filed a divisional patent application on 11th May, 2007 numbered as 00077/NP/2007 for an invention "CRYSTAL MODIFICATION OF ACTIVE PHARMACEUTICAL INGREDIENT" for the patent application number 00072/NP/2007 having German Priority patent application number 1404/97 dated 10th June, 2003.

It was observed during substantial examination that claims 1-10 of parent application were reproduced verbatim in the claimed invention as claims 1-10. If the subject matter of any claimed invention relates to more than one invention, applicant can file further application any time before the grant of patent u/s 16(1) of the Patents (Amendment) Act, 2005.

Since claims of the claimed invention and claims of the parent application are verbatim, hearing was offered to the applicant to decide allowability of divisional status to the claimed invention u/s 16 of the Act. The Applicant replied that the Controller can offer hearing for deciding the divisional status only after sending a gist of objections to the applicant and giving him an opportunity to file a reply. He further stated that the Controller cannot decide the divisional status unless examined and passed through sections 12, 14 and 15 of the Patents Act. There is no such direction or any other guiding principle laid down in the Act as to how a Controller should proceed with divisional status of an application.

The Controller observed that application shall define distinct subject matter when compared with claims of parent application, which is first and foremost requirement to qualify as divisional application u/s 16 of the Act. Once claims of the claimed invention fulfil the requirement for the divisional application u/s 16, it can be further allowed for substantial examination, which will save time and effort of the patent administration and also it is logical approach as well. Since subject matter of claims 1-10 is verbatim with claims 1-10 of the parent application, there is no need for conducting substantial examination to assess the novelty, inventive step and other patentability criteria for the present application. The applicant claims the same set of claims submitted in the parent application in different multiple further applications. The Controller further observed that the reason for filing such a divisional application is to prosecute once again the same set of claims already claimed in the abandoned parent application and also to extend the life of the application. If the subject matter of claims of the further application is not distinct with the claims of the parent application, divisional status shall not be granted. It is, therefore, wilful attempt to obtain multiple patents for a single subject matter

through many further applications by misusing the provision of section 16 of the Act. Even though, each and every component of the claims 1-10 of the divisional application is verbatim with the claims 1-10 of parent case, the intention of the applicant by hook or crook is to extend the life of the application utilising divisional route, that too, on the last date of submitting reply to first examination report (FER) of the parent case.

There were 10 claims at the time of filing the claimed invention where claims 1-9 related to 'modification A of the compound 1-(2, 6-difluorobenzyl)-1H-1,2,3-trizole-4-carboxamide (namide)' (hereinafter referred as 'product claims') and claim 10 related to pharmaceutical preparation.

On 15th July, 2011, the applicant amended originally filed 10 claims into 12 claims by filing Form-13 u/s 57 and u/s 81(1) of the Act and Rules. The applicant amended 'modification A of the compound namide' in all the claims 1-10 into 'crystal modification A of the compound namide' and also added two new claims relating to 'method of preparing A of the compound namide' which is neither claimed in the International application nor in the National Phase application.

In response to the FER, the applicant further amended claim 11 by incorporating many additional features including identity and quality of the solvent for recrystallisation, filtration conditions necessary to generate a suspension with initial crystal, stirring time and temperature.

The patent application was opposed by way of pre-grant representation u/s 25(1) of the Act, by Indian Pharmaceutical Alliance, a Society registered under Societies Registration Act, 1860 (hereinafter referred as 'Opponent'). After hearing notice was served, the Applicant further amended all the 'product claims' into '21 method claims as method for preparing crystal modification A of the compound namide'. In the earlier amendment, the applicant introduced new matter in claim 11 & 12 'method of preparing A of the compound namide' but the later amendment converted all the claims into 'method for preparing crystal modification A of the compound namide,' the principal claim.

The applicant submitted a set consisting 13 method claims which they desired to rely on during hearing, (hereinafter referred as 'amended claims').

The patent agent for the applicant submitted that Rule 55 (5) of the Patents Rules, 2003 gives power to the Controller to require the complete specification to be amended to his satisfaction during the opposition, before proceeding to refuse the application.

The patent agent for the applicant submitted that amendment of claims is a primary right conferred upon the applicant by the Patents Act and it is possible to amend the claims to avoid overlapping with the citations; and the Controller should require the same rather than proceeding to reject the application. It is further submitted that the amended claims on file now fall well within the scope of section 59.

The patent agent submitted that it is well accepted fact that 'product claims' cover in its scope the process of its manufacture as well and therefore the amendment made to claims of this application satisfies section 59 of the Act in that the amendment is made by way of 'disclaimer' wherein the scope of the product is

disclaimed and the claims are now restricted to the process of its preparation. Also that the scope of the claims is not extended and no new subject matter is added. The process claims are well supported by the description especially on the page 2 and last 3 lines, page 3 and 2nd para, and in examples 1, 2, 3, 4 and 5.

Keeping the above in view, prepare your arguments for opponent of the patent, covering division of patent, right of opposition under the Patents Act and the legal provisions applicable to modification of specification. (50 marks)

Answer 1

ISSUES IN THE PRESENT CASE

1. Can the Applicant Impose upon Controller to have and accept the division Application
2. Does the applicant have right to amend the patent specification and how.
3. Can the applicant amend of the specification by replacing product claims into process claims in compliance within the provisions of the Patent Act 1970.

The Opponents would respectfully like to draw the kind attention of the Learned Controller towards followings findings and facts in the matter of the finally amended claims.

Section 16 of Patent Act, 1970 dealt with power to Controller of make orders respecting division of application.

A person who has made an application for a patent under this Act may, at any time before the grant of the patent, if he so desires, or with a view to remedy the objection raised by the Controller on the ground that the claims of the complete specification related to more than one invention, file a further application in respect of an invention disclosed in the provisional or complete specification already filed in respect of the first mentioned application.

Since claims of the claimed invention and claims of the parent application are verbatim. There is no such direction or any other guiding principal laid down in the act, as to how controller should proceed with divisional status of an application. Further application shall define distinct subject matter when compared with claims of parent application, which is first and foremost requirement to qualify as divisional application u/s 16 of the Act.

Applicant cannot claim same set of claims claimed in the parent application in different multiple further applications. It is observed that the reason for filling such a divisional application is to prosecute once again same set of claims.

If the subject matter of claims of the further application is not distinct with the claims of the parent application, divisional status shall not be granted.

The case of *LG Electronics Inc. vs. Controller of Patents, Hon'ble Intellectual Property Appellate Board (IPAB)* held that the applicant cannot take undue advantage of section 16 for extending to prosecute the same subject matter.

Section 57 deals with Amendment of application and specification or any document relating thereto before Controller.

1. Subject to the provisions of section 59, the Controller may, upon application made under this section in the prescribed manner by an applicant for a patent or by a patentee, allow the application for the patent or the complete specification or any document relating thereto to be amended subject to such condition, if any as the Controller thinks fit:

Provided that the Controller shall not pass any order allowing or refusing an application to amend an application for a patent or a specification or any document relating thereto under this section while any suit before a court for the infringement of the patent or any proceeding before the High Court for the revocation of the patent is pending, whether the suit or proceeding commenced before or after the filing of the application to amend.

2. Every application for leave to amend an application for a patent or a complete specification or any document relating thereto under this section shall state the nature of the proposed amendment, and shall give full particulars of the reasons for which the application is made.
3. Any application for leave to amend an application for a patent or a complete specification or a document related thereto under this section made after the grant of patent and the nature of the proposed amendment may be published.
4. Where an application is published under sub-section (3), any person interested may, within the prescribed period after the publication thereof, give notice to the Controller of opposition thereto, and where such a notice is give within the period aforesaid, the Controller shall notify the person by whom the application under this section is made and shall give to the person and to the opponent an opportunity to be heard before he decides the case.
5. An amendment under this section of a complete specification may be, or include, an amendment of the priority date of a claim.
6. The provisions of this section shall be without prejudice to the right of an applicant for a patent to amend his specification or any other document related thereto to comply with the directions of the Controller issued before the grant of a patent.

In General amendments to patents and application are governed by Section 57 of The Indian Patents Act, which stipulate that the applicant should state the nature of the proposed amendment, and shall give full particulars of the reasons for which the amendment is made without addition of new subject matter. Applicant of subject application has never stated in their reply why they wish to amend the claims and applicant addition of the claims which are not filed initially or originally can not be allowed.

Therefore, new final set of claims filed.

Section 59 provides Supplementary provisions as to amendment of application or specification.

1. No amendment of an application for a patent or a complete specification or any document relating thereto shall be made except by way of disclaimer correction or explanation and no amendment thereof shall be allowed except

for the purpose of incorporation of actual fact, and no amendment of a complete specification shall be allowed, the effect of which would be that the specification as amended would claim or describe matter not in substance disclosed or shown in the specification before the amendment, or that any claim of the specification as amended would not fall wholly within the scope of a claim of the specification before the amendment.

2. Where after the date of grant of patent any amendment of the specification or any other documents related thereto is allowed by the Controller or by the Appellate Board or the High Court, as the case may be.
 - a) The amendment shall for all purposes be deemed to form part of the specification along with other documents related thereto;
 - b) The fact that the specification or any other documents related thereto has been amended shall be published as expeditiously as possible; and
 - c) The right of the applicant or patentee to make amendment shall not be called in question except on the ground of fraud;
3. In construing the specification as amended, reference may be made to the specification as originally accepted.

Section 59 is quite clear that first whatever amendments made by the applicant shall fall within the scope of a claim of the specification before the amendment.

Further, no amendment shall be made except by way of disclaimer, correction or explanation, and no amendment thereof shall be allowed, except for the purpose of incorporation of actual fact. Now question is that the whether the further addition of the claims which have not been filed initially or originally can be allowed.

Further, According to Intellectual Property Appellate Board (IPAB) decision (Order No. 189/201, *M/s Diamcad N V Vs. The Assistant Controller of Patents and Design, Chennai*) dated 3rd August 2012, amendment of claims which is not within the scope of the claimed filed initially are not allowed.

Therefore, the present set of claims which are different and additions over the claims as originally filed cannot be allowed in accordance with the provisions of Section 57 and 59 of The Indian Patents Act, 1970

Hence it is respectfully submitted that the subject application should be straight away rejected on the basis of the non-compliance of the mandatory provisions of Section 57 the Indian Patent Act for not providing reasons for Amendment.

Also Section 59 provides that the no effect of amendment can be given of any part of specification including claims if the amended matter would not fall wholly within the scope of the original claims filed.

Question 2

Telly Toy brought into market a play toy named as "Jump Bhola", a spring balance, in which children can stand on and jump. It became very popular among the kids. The spring was, however, made up of plastic and hence it had many practical problems.

MeraKhilona, another competitor company, came up with a similar toy with a

different name "Jump Bheem" made of a material which solved all the practical problems that "Jump Bhola", had.

Keeping the above in view, answer the following :

- (i) Can MeraKhilona claim patent protection for its product ?*
- (ii) Assuming that MeraKhilona adopted the same logo and style of writing as that of Telly Toy, can MeraKhilona claim trade mark protection for its product ?*
(15 marks each)

Answer 2(i)

What is Patent

A patent is an exclusive right granted to a person who has invented a new and useful article or an improvement of an existing article or a new process of making an article. The exclusive right is to manufacture the new article invented or manufacture an article according to the invented process for a limited period. During the term of the patent the owner of the patent, i.e. the patentee can prevent any other person from using the patented invention.

Invention must be New and Useful

It is a fundamental principle of Patent Law that a patent monopoly is granted only for inventions which are new and useful, and which have industrial application. This is embodied in the definition of "invention". The question whether a particular invention is new and useful is often extremely difficult to decide as it depends upon the state of the prior art in the particular field which includes prior publication on the subject and prior user.

Invention

As per Section 2(1)(j) of the Patents Act, 1970 : 'Invention' means a new product or process involving an inventive step and capable of industrial application.

Under Section 2(1)(ja) of the Patents Act, 1970 : 'Inventive step' means a feature of an invention that involves technical advance as compared to the existing knowledge or having economic significance or both and that makes the invention not obvious to a person skilled in the art.

As per Section 2(1)(l) of the Patents Act, 1970 : 'New invention' means any invention or technology which has not been anticipated by publication in any document or used in the country or elsewhere in the world before the date of filing of patent application with complete specification, i.e. the subject-matter has not fallen in public domain or that it does not form part of the state of the art.

Subject – Matter of Invention

The question whether there is an invention is a question of fact in each case. A new and useful application of an old principle may be a good subject-matter. An improvement on something known may also afford subject-matter; so also a new combination of different matters already known. A patentable combination is one in which the component elements are so combined as to produce a new result or to arrive at an old result in a better or more expeditious or more economical manner.

Improvements

The definition of invention includes within its scope any new and useful improvement of any manner of manufacture, article or substance whether patented or otherwise. But the improvement in order to be patentable must independently satisfy the test of invention.

In the present case **M/s Mera Khilona** come up with the same Toy but with a material which solved the pre-existing practical problem, and hence with improvements qualifying the test of invention **Mera Khilona** can claim Patent in the present matters.

Answer 2(ii)

The law of trade mark, practically all over the world is based on three board concepts:

- (1) Distinctiveness or distinctive character, or capable of distinguishing,
- (2) Deceptive similarity or similarity or near resemblance of marks and
- (3) Same descriptive or similarity of goods. The purpose of the Act, as stated in the preamble, is to provide for the registration and better protection of trade marks for goods and services and to prevent the use of fraudulent marks. In consonance with this object the following fundamental principles of trade mark law are embodied in the various provision of the Act:

Since registration confers on the proprietor a kind of monopoly right over the use of the mark, which may consist of a word or symbol legitimately required by other traders for bona fide trading or business purposes, certain restrictions are necessary on the class of words or symbols over which such monopoly right may be granted. This principle is recognized in the qualifications for registration laid down in section 9.

Registration of a trade mark should not interfere with the bona fide use by other persons of names or words in ordinary usage. This principle is embodied in section 13 and section 3.

Property rights in a trade mark acquired by use are superior to similar rights obtained by registration under the Act; this is clear from the preamble which refers to "better protection of trade marks", thereby necessarily implying the existence and availability of some protection under common law. It, therefore, follows that prior users of trade marks should be protected against any monopoly rights granted under the Statute. This principle is enacted in section 34.

There are obviously two main interests to be protected when a mark is presented for registration. There is first the interest of the public. A trade mark ought not to be registered if its use will be apt to mislead that public as to the origin of the goods they are purchasing. There is also the interests of other existing traders who are entitled to object if the use of the trade mark proposed for registration will be calculated to enable the applicant's goods to be passed off on the public as such other traders goods. These interests are protected by ss. 9 and 11.

In view of above **M/s Mera Khilona** will not be able to claim trade mark protection for its products as it likely to create confusion among the general public and customer as the conflicting trade mark being in the same business.

Question 3

Industrial design plays an important role in the trading of consumer goods or products as well as helps economic development by encouraging creativity in the industrial and manufacturing sector. Discuss the salient features of the Designs Act, 2000. (5 marks)

Answer 3**Salient Features of Design Act, 2000***Objectives and Justification for Design Protection*

The process of acquiring design rights is of importance from the perspective of the creator of design. Basically, the evolution of design rights was based on the keen interest to encourage and protect those who produce new and original designs, thereby facilitating competitive development and industrial progress.

Being a creation of intellectual mind, the designs also need to be protected. Designs protection through registration has been source of tremendous progress in the field of science and technology which has revolutionized the manufacturing during process.

Subject matter of Design Law

The subject matter which is protected by the design system is the application of the design to an article. The two fundamental characteristics of the design law are – firstly, it is concerned with the visual aspects of the articles and secondly, it concerns designs applied to article, which means concepts like garden designing, the architectural drawings and designs, book jackets, labels, tokens, medals, buildings and structures have been excluded from design protection.

The term Design as per the Design Act, 2000

A design refers to the features of shape, configuration, pattern, ornamentation or composition of lines or colours applied to any article, in two or three dimensional (or both) forms. This may be applied by any industrial process or means (manual, mechanical or chemical) separately or by a combined process, which in the finished article appeals to and judged solely by the eye.

Who can apply for Registration

Any persons or the legal representative or the assignee can apply separately or jointly for the registration of a design. The term “person” includes firm, partnership and a body corporate. An application may also be filed through an agent in which case a power of attorney shall be filed.

What are excluded from Design Protection

Designs that are primarily literally or artistic in character are not protected under the Design Act. These will include:

- Book jackets, calendars, certificates, forms and other documents, dressmaking patterns, greeting cards, leaflet, maps and plans cards, post cards, stamps, transfers, medals.

- Labels, tokens, cards, cartoons.
- Any principle or mode of construction of an article.
- Mere mechanical contrivance
- Buildings and structures
- Parts of article not manufactured and sold separately
- Variations commonly used in the trade
- Mere workshop alterations of components of an assembly
- Mere change in size of article
- Flags, emblems or signs of any country
- Layout designs of integrated circuits

What do you mean by new/ original design

A design must have something new before the law will allow it to be registered. The design should be new or original; this is evident from Section 5(1) of the Act which provides that the application for registration should be for “any new or original design”.

The words new or original, involve the idea of novelty, either in the pattern, shape or ornament itself or in the way an old pattern, shape or ornament is to be applied to an article. Novelty may consist not in the idea itself but the way in which the idea is to be rendered applicable to an article.

Question 4

A patent search is a search conducted in patent data base to check whether any invention similar to the invention in respect of which patent is obtained, already exists. Discuss the patent search, patent data base and various types of searches used in patent documentation. (5 marks)

Answer 4

The object of Patent search is to evaluate the subject matter invention in comparison to the prior Art.

Prior art refers to scientific and technical information that exists before the effective date of a given patent application. Prior art may be found in any public documents such as patents, technical publications, conference papers, marketing brochures, products, devices, equipment, processes and materials.

A prior art search refers to an organized review of prior art contained in public documents, prior art searches can be of various kinds: patentability searches conducted by an inventor before filing a patent application;

Searches are conducted using different kinds of databases, from public databases of issued patents on the internet to exhaustive databases including technical literature.

Searches can be done by legal professional, by scientists or by researchers. Sometimes, defendants in patent litigation even offer bounties for invalidating prior art.

Patentability search may be conducted before the filing of a patent application to gauge the prospects of obtaining broad claim coverage. The purpose of conducting such a search is to find references related to the claimed invention in order to make an assessment of its patentability.

Searches are typically fast and inexpensive since the patent agent's clients often do not want to pay for an expensive, thorough search. Also, it is often presumed that the inventor himself will have a good sense of novelty based on his reading of the literature in his field and by communication with his peers.

Searches are good way to get information on developments in the field of invention. Prior art searches may sometimes reveal what competitors consider worth protecting. Search results may be a critical factor in deciding whether to file a patent application. If a prior art search reveals references that anticipate the claimed invention, the inventor and the patent agent should consider how they can "avoid the prior art" by drafting the claims to overcome. In some cases, a prior art search may reveal patent references that are problematic. Just because you see a reference that seems similar to the invention does not mean the proposed application should be abandoned.

Question 5

Write a note on 'patent co-operation treaty'.

(5 marks)

Answer 5

The **Patent Cooperation Treaty (PCT)** is a multilateral treaty that became effective in 1978. The PCT is administered by **International Bureau of the World Intellectual Property Organization (WIPO)** whose headquarters is in **Geneva, Switzerland**. The member countries of the PCT are called PCT Contracting States. As of August 1, 2006, there were 133 PCT Contracting States.

The PCT enables a patent application to file one "international" patent application to seek protection in any or all of the PCT Contracting States.

Patents are granted or rejected by each PCT Contracting State or regional office individually under their respective patent laws. Thus, an applicant must still prosecute a patent application in each country or regional office in which he seeks protection and pay the national or regional fees.

The main advantage of filing a PCT application is the additional time gained before having to prosecute applications in other countries after the initial filing. Without the PCT the applicant generally has 12 months to file patent applications in other Paris Convention countries after filing the initial application in contrast, by using the PCT the application has at least 30 months (and more in many countries) from the date of initial filing to begin prosecuting his application in other countries –effectively gaining 18 months. This delay provides time to obtain knowledge as to the patentability and commercial prospects of an invention. It also postpones the major costs of internationalizing a patent application such as paying national / regional fees, translating the patent application and paying fees to local patent agents in the various countries.

The PCT procedure consists of two main phases; the “international phase” and the “national phase”.

The international phase consists of :

- (1) Filing of the international application either with a national / regional “Receiving Office” or the International Bureau of **WIPO**
- (2) Novelty search on the patentability of the invention (including an international search report and a written opinion on potential patentability)
- (3) Publication of both the PCT application and the international search report by **WIPO**, and
- (4) **(Optional step)** request for an international preliminary examination of the international application.

National Phase

After the international phase, the application enters the “national” phase, which consists of processing the international application before each Contracting State that has been designated in the international application and in which the applicant wishes to pursue patent protection. Certain requirements must be fulfilled in order to enter the national phase. These requirements include paying national fees and, if necessary, furnishing a translation of the application (as filed and/ or amended). Note that the filing of the PCT request together with the application constitutes the designation of all Contracting States that are bound by the Treaty on the international filing date. In the national phase, the applicant selects the particular States in which he wishes to obtain protection for his invention.

A PCT application must contain the following elements: request, description, one or more claims, one or more drawings (where drawings are necessary for the understanding of the invention) and an abstract. The request is simply a form that is filed with the international application.

Any national or resident of one of the PCT Contracting States may file an international patent application.

Question 6

Explain 'deceptive similarity of a trade mark' with example. (5 marks)

Answer 6

Deceptive similarity of Trade Mark is that a given two trade marks are such as to their nature that it is likely to deceive the public or cause confusion. The following examples will clarify the position of deceptive similarity

- (a) Lakhshmandhara and Amrit dhara deceptively similar
- (b) “Simatul” likely to cause confusion and deceptively similar to “Cibatul”
- (c) “Trevicol” was held to have Phonetically deceptive similarity to “FEVICOL”

In *Cadila Healthcare Ltd. Vs. Cadila Pharmaceutical Ltd.*, the Supreme Court

held that in an action for passing off on the basis of an unregistered trade mark generally for deciding the question of deceptive similarity the following factors are to be considered:

- (a) The nature of the marks i.e. whether the marks are word marks or label marks or composite marks, i.e. both words and label works.
- (b) The degree of resemblance between the marks, phonetically similar and hence similar in idea
- (c) The nature of the goods in respect of which they are used as trade marks;
- (d) The similarity in the nature, character and performance of the goods of the rival traders;
- (e) The class of purchasers who are likely to buy the goods bearing the marks they require, on their education and intelligence and a degree of care they are likely to exercise in purchasing and/or using the goods;
- (f) The mode of purchasing the goods or placing orders for the goods ;and
- (g) Any other surrounding circumstances which may be relevant in the extent of dissimilarity between the competing marks.

Weightage to be given to each of the aforesaid factors depends upon facts of each case and the same weightage cannot be given to each factor in every case.

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

INTERNATIONAL BUSINESS LAWS AND PRACTICES (Elective Paper 9.5)

Time allowed : 3 hours

Maximum marks : 100

NOTE : Answer **ALL** Questions.

Question 1

"Telecom Industry in India"

The telecommunication industry in India was one of the most swiftly growing sectors in the world with stupendous growth over the last decade. It was regarded as the third largest in the world and the second largest among the emerging economies of Asia. Besides the public sector, the private segment had made significant contribution that had turned the industry into one of the key contributors to the Indian success story. It had an impressive growth trajectory, adding nearly 9 million subscribers per month, bringing the mobile subscriber base to over 903 million by January, 2012. BCG, in January, 2011, indicated that the Indian telecom market would surpass the US \$100 billion mark by 2015. This report contradicted the prevalent common belief that growth in the telecom sector had reached a saturation point.

In 1994, when mobile phones were introduced in India, the country was divided into 23 circles and licences were issued as per these circles. The circles were classified into four categories — Metros, A, B and C - on the basis of revenue potential; Metro and A circles were expected to have the highest potential. The telecom market in India was highly competitive compared to other countries, and there were over 11 operators in each circle, which was unheard of anywhere else in the world. Different players included Airtel, Reliance, Vodafone (earlier Hutch), Idea, Tata, state-owned BSNL and many more. All dominant players offered GSM technology, while Reliance and Tata also offered CDMA technology space. Overall, GSM had a total share of 88% of subscriber base. There were a few new players such as Aircel, Unitech-Telenor, Etisalat DB and Shyam-Sistema, which had obtained licence and spectrum to launch mobile services. Among these new players, Shyam-Sistema had been planning to launch mobiles with CDMA services, while the others were in the beneficial GSM space.

Some of the key factors that were expected to fuel the growth of the sector included increased access to services owing to the launch of new telecom technologies such as 3G and broadband wireless access (BWA), changing preferences of the consumers, emerging technologies such as cloud computing and supportive government policies. An important characteristic of the telecom industry in India was its relatively high penetration level in urban areas as compared to that in rural areas. In order to capitalise on the growing disposable income levels of the rural population, the mobile operators had started to explore and expand into uncovered

areas. Adopting telecommunication as a means of social change in sectors such as health care, banking and education in rural areas, enabled mobile services such as m-Health, m-Commerce and m-Learning respectively, to be major enablers of economic growth and social modernisation in India.

About the TELENOR

Headquartered in Fornebu, Norway, Telenor is a telecommunication company with operations in 11 countries and over 146 million mobile subscribers. Started in 1855 in telegraphs, the company had evolved to the present status of housing 30,000 employees with revenues reaching NOK 98.5 billion (US \$16.5 billion) for the year 2011.

Telenor used a dual strategy in its global expansion. In countries such as Denmark, Hungary, Montenegro, Norway, Pakistan, Serbia and Sweden, Telenor provided communication services by establishing its own subsidiaries, either through acquisitions or mergers. However, in many Asian economies, it chose to enter into joint ventures with the local partners. Initiating this odyssey, Telenor created a joint venture with DiGi in 1995 with 49% of stake in Digi Telecommunications. Headquartered in Malaysia, DiGi was one of the forerunners in the provision of innovative telecommunication service there. In 2001, Telenor partnered with CAT Telecom Public Company Ltd. formerly known as the Communications Authority of Thailand, to create DTAC, under a 27-year "Build-Operate-Transfer" concession granted by CAT. Grameenphone, one of the biggest teleservice providers in Bangladesh, was once again a joint venture between Telenor and Grameen Telecom Corporation of Bangladesh. In India, Telenor entered into a joint venture with Unitech Wireless in 2008 to form Uninor.

Apart from telecommunication services, Telenor also was one of the foremost service providers of television and broadcasting services to both households and enterprises in the Nordic region. The Telenor Group of Business also had its own subsidiaries and joint ventures to develop Telenor's core business and few of these had been seen as pure financial investments.

The Telenor Group was also associated with many other companies such as VimpelCom Ltd. of the Netherlands, C More Entertainment of Sweden, A-pressen of Norway, Evry of Oslo and Kjedehuset of Norway. Telenor had a significant influence on the financial and operational decisions of these companies but did not have control over their policies. Telenor's joint venture with Unitech Wireless Ltd. had resulted in the formation of Uninor Telecommunications Ltd.

The Supreme Court of India cancelled the 2G (Second Generation) Mobile Licences issued in 2008 to numerous companies. Uninor was the telecom company most affected when the 2G scam surfaced. A total of 22 licences that had been issued to Uninor were cancelled.

Other Players with Foreign Investments

(a) MTS India

Formerly known as Sistema Shyam TeleServices Limited (SSTL), MTS India was a joint venture between the Shyam Group of India and Sistema of Russia. Sistema was incorporated in Russia in 1993 and had emerged as one of that country's Top 10 companies in terms of revenue. Its line of business included

various sectors such as construction, electronics, oil refining, real estate, telecommunication, tourism and trade. Initially, in 2007, Sistema acquired 10% shares of SSTL, but finally, Sistema became the majority shareholder in this joint venture with a 74% equity stake; while the Shyam Group owned a 23.5% minority stake and the remaining 2.5% was public partake.

(b) *Etisalat-DB*

Headquartered in Abu Dhabi, United Arab Emirates, Etisalat partnered with two Indian entities, Dynamic Balwa (DB) Reality Ltd. and Reliance Communications Ltd., to venture into the Indian telecommunication sector. DB Reality was incorporated in 2007 and had built a strong reputation in quality residential, commercial and gated community projects. Reliance Communications was one of the businesses of the Reliance Group headed by Anil Ambani and an offshoot of the group founded by Dhirubhai Ambani.

Etisalat-DB was one of the latest entrants in the burgeoning Indian telecom industry. The company was given 2G licences to operate in 15 circles, but all were later cancelled by the Supreme Court of India. Etisalat was in talks with Reliance Communications to buy a 25% stake in the company; however, the deal was not finalised.

(c) *IDEA Cellular*

Another company headquartered in Mumbai, IDEA cellular, was initially an amalgamation of three business groups — Birlas, Tatas and AT&T of United States with each of them holding one-third of the equity. The stakes held by Tatas and AT&T were sold off when Tata decided to start its own telecommunication company and AT&T merged with Cellular Wireless in 2004. IDEA Cellular had equities owned by Aditya Birla Group of India, Axiata Group of Malaysia and Providence Equity of the United States. IDEA Cellular was one of the largest mobile service operators in India with its wireless revenue market share at 13.9% in the first quarter of the fiscal year 2012. All 13 licences issued to IDEA Cellular were cancelled by the Supreme Court of India.

(d) *S Tel*

A joint venture between the Indian company Siva Group (formerly Sterling InfoTech Group) and Bateleo (Bahrain Telecommunication Company), S Tel was one of the latest and youngest entrants in the Indian telecom sector. It had launched its mobile telephone services in India at the end of 2009.

Some of the other domestic players to whom the 2G licences were issued included Loop Mobile (formerly known as BPL Mobile) owned by the Khaitan Holding Group, Videocon Telecommunications Ltd. owned by the Videocon group of India and Tata Teleservices owned by the Tata Group. Twenty-one Licences each of Loop Mobile and Videocon and three of Tata Teleservices were also cancelled under the verdict of Supreme Court of India.

The major violations observed in the licence grant procedure were as follows:

- The entry fee for the spectrum licence issued in 2008 was pegged with the 2001 price. There were neither any revisions nor any changes made to the pricing of the licence despite the huge demand-pull inflation that had

soared multi-fold during that period. The number of mobile users was 4 million in 2001 but had shot up to 350 million by 2008. This was a clear indicator that should have ensured a change in the prices before the auctioning started.

- *Many new entrants with no prior experience in the telecom sector were allowed in the bidding process, including Unitech and Swan Telecom.*
- *Rules were changed once the bidding process had begun, cut-off date for the bidding of the licence was advanced by a week without any prior notification.*
- *The licences were issued on a first-come-first-served (FCFS) basis and the then telecom minister, ignored the recommendations of the Finance Ministry, Law Ministry and TRAI. TRAI had recommended auctioning of the spectrum licence at market rates. It was not followed and hence the market price was not achieved.*
- *A total of only nine companies were issued licences in spite of the fact that there was no restriction on the number of operators.*

In 2012, the Supreme Court of India had quashed 122 licences awarded in 2008 by the then telecom minister. The licences were cancelled on the grounds that the entire allocation was made in an arbitrary and unconstitutional manner. However, the affected companies were allowed to continue their operations until new rules were finalised. The Supreme Court pointed out the basic flaw in the first-cum-first-served (FCFS) basis in matters that involved the use of public property. It involved a component of chance, thereby leading to intrinsically risky repercussions.

The verdict though hailed by anti-corruption crusaders, left the investors, vendors, and banks upset about their billions of dollars going down the drain. The global telecom operators had followed the government policies in force at the time and had set-up their operations in India through joint ventures with companies to whom the licences were already awarded in the controversial sale.

The ruling ultimately turned out to be a serious attack on lawful investments made by foreign operators in India notably Norway's Telenor and Russia's Sistema. Both these companies approached the Govt. of India to resolve the licence related disputes without jeopardising their investments, citing bilateral treaties.

As a result of the cancellation of the licences, Telenor, the majority stakeholder in Uninor, revoked its contract with the Indian partner Unitech and brought a claim against it seeking indemnity and compensation for the investment made. The shares of Telenor at the Oslo Stock Exchange in Norway fell on 2nd February, 2012 as a consequence of the Supreme Court verdict. Telenor excluded India from its financial outlook for 2012. It held Unitech liable for breach of warranties related to the cancellation of licences and sought compensation for its entire investment, guarantees and damages caused by the Supreme Court order. It was also all set to write-off its investments as a precautionary measure.

India had been a difficult market filled with constant surprises and the Supreme Court's decision could allow Telenor to quit the Indian market where it had always struggled. With TRAI recommending a ten-fold higher base price for the revised

spectrum auction, Telenor's prospective costs could well exceed its limit, leaving the exit option as the only viable choice. On the other hand, Telenor Group planned to set-up a new Indian company to take operations forward in that country. This move could allow Telenor Group to take up 74% ownership, allowing the telecom giant to float a new joint venture and continue to focus on its long-term objectives of staying and expanding in India.

Telenor has two possible options : off-load the liability onto Unitech Wireless as Telenor had highly over-paid for the licences; or exit the business, putting the responsibility on Unitech to bear the exit charges of the business.

Answer the following :

- (a) Should Telenor try to win back the licences or should it exit operations in India? Give reasons in support of your answer.
- (b) Should Telenor explore diplomatic interventions through Norwegian government?
- (c) What are the risks for MNCs entering into foreign markets especially countries such as India ?
- (d) Why are MNCs vulnerable to political risks ? What are the influences that prompt a firm to pull-out of a particular market ?
- (e) When an MNC is forced to withdraw its operations from a country, what are the strategic considerations and the different withdrawal alternatives/exit strategies available ? (10 marks each)

Answer 1(a)

In the given case, the licenses were cancelled by the Government of India. Telenor had also approached the government for resolving the disputes related to licenses. The company had already revoked its contract with the Indian partner had brought a claim against it seeking indemnity and compensation for the investment made. Since, the Telenor has made investment in the Uninor and the attempt to winning back the licenses will increase its cost very high, it is wise of the company to exit the business and some of ideal options that could be adopted by the company are:

- (i) *Sale to a Local Company* : Selling the business to a local company may have its benefits such as quick recovery of capital based on the market valuation of the business. But the major disadvantages are that the local company may not agree to enter into non-equity agreements and may not be willing to assure safeguarding trade secrets such as the technology used, patents, etc.
- (ii) *Sale to an MNC* : This could be a viable option for Telenor, as selling to another MNC has advantages such as safe recovery of capital, reduced foreign exchange losses, avoiding the problem of blocked funds and arranging marketing agreements for a third market. However, the disadvantages could include lack of non-equity ties and loss of technology to a competitor.
- (iii) *Management Buyout* : This process involves selling the business to a local management team, The various strategic advantages of this option are that

the company can still have an indirect presence in the market and a reasonable degree of control, can enter into non-equity and buy-back agreements and can protect patents and technology to make sure they do not fall into the hands of competitors. A Major drawback could be that the local management team may not be financially able to support such a buyout, and hence the parent company may have to agree to a negotiated price that may be substantially less than the market value of the business.

Answer 1(b)

Government intervenes in trade and investment to achieve political, economic or social objectives. Commercial diplomacy plays a significant role in global trade. It is frequently used to cover different types of activities.

- i) *Activities relating to trade policy/makeup (multi trade negotiations, trade consultations and dispute settlement)*: This category is also referred to trade diplomacy and is designed to influence foreign government policy and regulatory decisions that affect global trade and investment
- ii) *Business support activities* : In commercial diplomacy when the nature is diplomatic service, commercial service has to fit into the context of home country's export promotion programs and wider economic policy objectives.

The spectrum of actions in commercial diplomacy ranges from

- i) The high policy level (head of state, prime minister or a member of parliament) like in the famous takeover Arcelor steel plant by Lakshmi Navas Mittal
- ii) Ambassador and the lower level of specialized diplomatic envoy known as trade representative commercial attaché or commercial diplomat.

The USA, Germany, UK, Finland, Japan and Singapore all maintained modern and well performing commercial diplomacy centers and business support services to assist business development. In the case of, hostile takeover bid of Arcelor, Lakshmi Mittal became a diplomatic offensive in Paris and defense minister had said that he doubted that the two cultures could function and live together. The politicians in France, Belgium and Luxemburg had expressed concerns over the deal, though ultimately the deal was finalized. In the Telenor Case, it may be argued that intervention by Norwegian government may not be an advisable step because of the following reasons:

- The 2G spectrum licenses were cancelled not at the instance of the Indian Government but in the wake of the Supreme Court judgment which had passed structures against the Indian government action because of procedural irregularities. Telenor was not an exceptional case and there was no discrimination against it by the government.
- The Supreme Court judgment was not cherished by the government because it had highlighted the government's utter disregard of laid down policies. It had also highlighted the need for fair sense of play.

Answer 1(c)

International business, along with its financial decision-making process, calls for a detailed understanding and deliberation of the various risk factors that may be involved

in entering new markets. As a matter of fact, the domestic market involves various levels of uncertainty as well, but there are certain unique risks that may accompany any international business. These may not only affect a company but may also have a great impact on the relationship between the two countries involved.

When a foreign player enters a market, one aspect usually overlooked is the strategy of how to exit when necessary. In a few instances, firms are forced to exit from the market due to actions of host governments, including confiscation, nationalization and expropriation. Through there are many risks involved when investing in emerging economies, little organized inquiry exists into the relative importance of individual risks when investors apportion FDI.

Country risk analysis presents the potentially adverse impact of a national environment on the cash flow of MNCs due to exposure to political, economic and social upheavals. These have a greater scope of risk than the risk from government action as they also include credit risk and other economic performances.

For any firm investing in foreign markets, understanding risk is not enough – they also should know how to mitigate those risks. The various risks that may be involved may include the following:

- i) *Political risk* : Political risk refers to the potential losses to foreign investors from adverse political developments in the host country (of the country from which the benefits are being reaped). These are the hurdles or hindrances that may be created by the host country. Hurdles could include imposing quotas on imports/exports, restrictions on transferring activities, restriction on the type of MNC and the industry concerned, banning of trade between certain countries and many more. Political risks cover a wide range from outright expropriation of investor's assets held by the foreign companies in the host country to concern about unexpected changes in tax laws that may hurt the profitability of foreign projects. Due to the degree of uncertainty, political risks increase the risk of foreign investment. In India especially, the risks include a slow decision-making process due to political instability, labor unrest and industrial action and adverse changes or unpredictability in policies.
- ii) *Commercial Risk* : Before entering into a new foreign market, companies prepare a forecast of the demand for their product. Such demand forecasts were made by Whirlpool, Coca-Cola and Pepsi before entering India and had started marketing their products, but they had found at a later stage that actual sales volumes were far less than the estimated demand. Such risks are referred to as commercial risks and include property risks, liability risks and loss of business income, among others. These risks usually occur because of decline in demand due to either to cultural differences or income levels. Various advantages of an effective commercial risk management are having an improved stability, protection of assets, good long term effectiveness and guarding future opportunities. Resources utilized such as time, money assets and people, can be quite cost effective. Commercial risk management should management should be practical, proactive, systemic and an integral part of the entire management activities of a firm.
- iii) *Risk of Sources of Funds* : Many countries impose restrictions on the sources

of funds that MNCs may wish to invest. The Indian government had enforced 49 percent as the maximum share that could be held by a MNC in India, but the percentage was liberalized later. Similar conditions were enforced by the Eritrean government, which stipulated that 50 percent of the capital should be provided by local investors.

- iv) *Risk Due to Tax System* : Different countries have different tax system, and this needs to be carefully understood by any MNC that plans to enter a new foreign market. For Example, China imposes a tax of only 5 percent on all foreign companies that have establishments in the Special Export Zone (SEZ), but in India the tax rate is more than that applicable to domestic companies.
- v) *Risk Due to Exchange Rate Fluctuations* : Many countries depreciate or appreciate their currencies according to their political situation, balance of payments position and many more reasons. India had devaluated its currency many times, and this has discouraged foreign investments to a great extent. The exchange rate fluctuates quite often these days, mostly in favor of the hard currencies of advanced countries.

Answer 1(d)

Political risks are perceived as those events, processes or actions that have a potential to – directly or indirectly – significantly and negatively affect the goals of foreign investments made in the host country. MNCs have to be aware of the political risks as these could make operations and the environment in the industry more complex. Managing government policy risks are harder to hedge. Firms that are engaged in international business often use a combination of insurance, legal contracts are trade in financial instruments to shield their income from investments in foreign countries against currency or price fluctuations. As this offers very little protection against risks related to government policies, there is a need to systematically review the political risks and take necessary steps accordingly.

According to Simon, “political risks include any governmental or societal actions and policies, originating either within or outside the host country, and negatively affecting either a select group or a majority of foreign business operations and investments.” With an explicit political schedule, organized groups tend to intervene in the operations of MNCs. In a few cases, they influence the firms to leave the host country market that was otherwise attractive and that they had already invested heavily in. Besides the interventions from the organized groups, the widening of the interest levels between the home and the host countries expose MNCs to political risks. In such cases, the business heads of the MNCs would be forced to make some strategic decisions based not on market-related factors but on non-market-related criteria. As the most MNCs are poorly prepared to handle such political/legal pressures, introducing non-economic factors in the decision-making process makes it a complex procedure. However, from the perspective of management, for effective operation it is imperative to understand the operations of different social, political and economic groups, the extent of influence they exert on the conduct of business and the strategies adopted by them to consolidate support as well as understanding the competitive environment in the market.

Influencers of political risk mainly include a focus on government action the extent of political stability, actions by legal bodies like the Supreme Court and High Courts,

actions by a broader group of political leaders, probability of change of government and threat of war. Stability of the government is considered to be one of the most important factors influencing the conduct of business. Next comes the extent to which the government is able to implement policies as well as control corruption as this is one of the biggest threats to the investments. Policies framed by the government should be transparent and stable. This is a must for foreign investors as they are the major supporters of corporate governance practices and might not be willing to operate in an environment where they do not have clear and holistic pictures.

Answer 1(e)

It is very undesirable for any MNC to be forced to withdraw its operations from a country as this affects the company image. In Such cases, MNCs have to take some drastic measures and important strategic decisions to ensure that the withdrawal does not have a big impact on operations outside the country of withdrawal. Depending upon the level of withdrawal threat and the level of potential futurity of the market, the company can have various exit alternatives.

- If there is a very high level of threat and good futurity of the market, then the company can think of options such as management buyout, sale to a trust or temporary suspension of activities.
- In case of low levels of threat and low scope of market, then the firm can decide to sell to a local company or even close down operations.
- In case of a high level of threat and low scope of market responsiveness, the options that could be taken are management buyout, sale to a local company, sale to another MNC or closing down operations.
- Where there is a low level of threat and high market opportunity, then the ideal solution is to continue operations in the market.

Question 2

(a) *Futuristic Technology Ltd., a company incorporated in India, is desirous of entering into a joint venture with an IT company in the USA.*

Draft the following :

- (i) *Arbitration clause*
- (ii) *Clause indicating investment in foreign security by way of swap or exchange of shares in the foreign technology collaboration agreement.*
(5 marks each)

(b) *Distinguish between the following in brief :*

- (i) *'Global strategy' and 'international strategy'.*
- (ii) *'Indirect exporting' and 'direct exporting'.*
- (iii) *'Focus market scheme (FMS)' and 'focus product scheme (FPS)'.*
- (iv) *'Revocable letter of credit' and 'irrevocable letter of credit'.*

(v) 'Market access scheme (MAS)' and 'market development assistance (MDA)'. (10 marks)

(c) "Subsidies are used for a variety of purposes including employment, production and exports". Discuss. (10 marks)

Answer 2(a)

THIS AGREEMENT made today of 15/07/2014 BETWEEN **Futuristic Technology Limited**, a company registered in India under the Companies Act, 2013 or 1956 having its registered office in India (hereinafter referred to as the Indian company) which expression shall, unless repugnant to the context or meaning thereof, is deemed to include its successors and assigns of the **ONE PART AND IT Company**, a USA corporation, with place of registry in and having an office in USA (hereinafter referred to as the Foreign Company) which expression shall, unless repugnant to the context or meaning thereof, be deemed to include its successors and assigns of the **OTHER PART**.

WHEREAS –

- 1
- 2
- 3
- 4

NOW THIS AGREEMENT WITNESSETH and is hereby agreed by and between the parties as follows:

- (i) *Arbitration* : In case of any dispute or difference arising between the parties hereto or any claim or thing herein contained or the construction thereof as to any matter in any way connected with or arising out of these presents or the operations thereof the rights, duties liabilities of either party thereof, then and in every such case, the matter, differences and dispute shall be referred to an arbitrator in India in case parties agree upon one, otherwise two arbitrators in India, one being nominated by each party to this agreement in accordance with and subject to the provisions of the Arbitration and Conciliation Act, 1996 or any other enactment or statutory modifications thereof for the time being in force.
- (ii) *Consideration* : In consideration thereof, investment in foreign security by way of swap or exchange of shares, amount of investment shall not exceed US \$100 million or 10 times of export earning of Futuristic Technology Limited in preceding financial year including all investment in same financial year. ADR/GDR issue of Futuristic Technology Limited shall be listed outside India and 80 % of average turnover of Futuristic Technology Limited in three previous financial years is from activity included in schedule or Futuristic Technology Limited has an annual average export earning of at least ₹100 crores in previous three financial years from its activities. ADR/GDR issue shall be backed by fresh equity shares by Futuristic Technology Limited.

Answer 2(b)(i)**'Global Strategy' and 'International Strategy'**

<i>Global Strategy</i>	<i>International Strategy</i>
<ul style="list-style-type: none"> In global strategy, assumptions are made that customer needs are similar worldwide. It is argued that markets are converging and increasingly people's needs and desires have homogenized. Therefore, firms can sell standardized products in the same way everywhere, for example, steel, pharmaceuticals, cement, petroleum, etc. When given a choice between a low-priced standard product and a high-priced nationally customized product, many customers will go for low-priced product. Thus, firms offering standardized products globally have competitive advantage in the form of lower costs resulting from economies of scale in product development, production and marketing. Firms pursue a global strategy when they seek to operate with world-wide consistency, standardization of products and practices, and a system wide perspective to extend competitive advantage. 	<ul style="list-style-type: none"> In the initial stages of globalisation, a firm may not be in a position to opt for either global strategy or multi-domestic strategy for its overseas business. They adopt international strategy which involves creating an international division and exporting the products through that division to those countries where the products are needed. At this stage of globalisation, a company is really focused on the domestic market and just exporting what is demanded abroad. As the product becomes successful abroad, the company may set-up manufacturing and marketing facilities with certain degree of differentiation based on product customization. The key characteristic of this strategy is that all control is retained at the home office regarding product and marketing functions. Many multinational corporations have adopted this procedure.

Answer 2(b)(ii)**'Indirect exporting' and 'direct exporting'**

<i>Indirect Exporting</i>	<i>Direct Exporting</i>
<ul style="list-style-type: none"> Indirect exporting is exporting the products either in their original form or in the modified form to a foreign country through another domestic company. For Example : Various publishers in India sell their products i.e books to UBS publishers of India, which in turn exports these books to various foreign countries. 	<ul style="list-style-type: none"> Direct exporting is selling the products to a country directly through its distribution arrangement or through a host country's company. For Example: Baskin robins initially exported its ice-cream to Russia in 1990 and later on opened 74 outlets with Russian partners. Finally, in 1995, it established its ice-cream plant in Moscow.

Answer 2(b)(iii)**‘Focus Market Scheme (FMS) ‘ and ‘Focus Product Scheme (FPS)’**

<i>Focus Market Scheme (FMS)</i>	<i>Focus Product Scheme (FPS)</i>
<ul style="list-style-type: none"> The objective of focus market scheme (FMS) is to offset high freight cost and other externalities to select international markets with a view to enhancing India's export competitiveness in these countries. Under FMS, exporters of all products to notified countries (as shall be entitled for Duty Credit Scrip equivalent to 3 % of FOB value of exports (in free foreign exchange) for exports made from 27/08/2009 onwards. 	<ul style="list-style-type: none"> Focus Product Scheme (FPS) objective is to incentivize export of such products which have high export intensity/employment potential so as to offset infrastructure inefficiencies and other associated costs involved in marketing of these products. Exports of notified products to all countries (including SEZ units) shall be entitled for Duty Credit Scrip Equivalent to 2% of FOB value of exports (in free foreign Exchange) for exports made from 27/08/2009 onwards.

Answer 2(b)(iv)**‘Revocable letter of credit’ and ‘irrevocable letter of credit’**

<i>Revocable letter of credit</i>	<i>Irrevocable letter of credit</i>
<ul style="list-style-type: none"> Revocable letter of credit may be revoked or modified without the consent of the exporter by the issuing bank. It is rarely used in international trade as it is not beneficial for the exporters. It has to be stated in the LC that the credit is revocable otherwise credit will be deemed to be irrevocable. 	<ul style="list-style-type: none"> Irrevocable letter of credit cannot be revoked or changed without the consent of the issuing bank, the confirming bank and the beneficiary/exporter. An irrevocable letter of credit from the issuing bank insures the beneficiary that if the required documents are presented and the terms and conditions are complied with, the payment will be made.

Answer 2(b)(v)**‘Market Access Scheme(MAS)’ and ‘Market Development Assistance(MDA)’**

<i>Market Access Scheme(MAS)</i>	<i>Market Development Assistance(MDA)</i>
<ul style="list-style-type: none"> Under the market access scheme, financial assistance is provided for promotion activities on focus country on focus product basis. 	<ul style="list-style-type: none"> Under the Market Development Assistance (MDA) scheme, financial assistance is provided for a range of export promotion activities

Market Access Scheme(MAS)	Market Development Assistance(MDA)
<ul style="list-style-type: none"> A whole range of activities including market studies / survey, setting up of showrooms / warehouses, participation in international trade fairs, publicity campaigns, brand promotion, testing changes for engineering products abroad, assistance for contesting anti-dumping litigations, displays in international departmental stores, can be funded under the MAI scheme. 	<p>implemented by Export Promotion Councils and Trade Promotion Organization on the basis of approved annual action plans.</p> <ul style="list-style-type: none"> Assistance includes participations in trade fairs and buyer-seller meets abroad or in India, export promotions seminars, financial assistance with travel grant to exporters travelling to focus areas (Latin America, Africa, CIS region, ASEAN countries, Australia and New Zealand).

Answer 2(c)

Meaning of subsidy

- In common parlance, the term 'subsidy' means money granted by the state or a public body to keep the prices of commodities under control.
- Subsidies may take the form of direct or indirect government grants or productions or exportation of goods including any special subsidy on transportation of any product.
- The subsidy is usually given to remove some type of burden.
- Subsidies are often regarded as a form of protectionism or trade barrier by making domestic goods and services artificially competitive against imports.
- According to the Agreement on Subsidies and Countervailing Measures (Agreement on SCM) subsidy means any financial contribution provided by a government or a public body in the form of transfer of funds, tax incentives, provision of goods or services or any other form of income or price support by which a benefit is conferred.

Purposes of subsidies

- There are many forms of subsidies given out by the government for various purposes including welfare payments, housing loans, student loans and farm subsidies. For example, if a domestic industry like farming, is struggling to survive in a highly competitive international industry with low prices, a government may give subsidies to farms so that they can sell at the low market price but still achieve financial gain.
- Textile export is important for India's economy as the sector is the largest job provider in the country. The Government has been providing several incentives to exporters the wake of downturn in global trade reducing demand for exports. In December 2012, the government had announced extension of two percent interest subsidy on some labor-intensive industries including textiles, garments and handicrafts, for one more year till March 2014. The decisions to extend

the interest subvention scheme was taken in view of country's overall exports falling by 5.95% year-on-year to us \$189 billion during the first eight months of 2012-2013.

- Seeking to promote export of farm produce, developing nations including India are pressing for reductions of trade distorting agriculture subsidies by the US and the EU.
- In the WTO negotiations on industrial goods, developed countries want and some prominent developing countries like India, China and Brazil to take commitments of complete duty elimination in specific sectors like electronic goods, chemicals and industrial machinery. India has reservations on an account of the effect of products which are critical for employment generation and economic growth.
- OECD nations provide \$280 billion per year in subsidies to their farmers including \$133 billion in the EU, \$49 billion in Japan, and \$147 billion in the USA.
- In the case of rice, Japan imposes a tariff of nearly 500% in an effort to protect its farmers from international competitions while the maximum tariff on dairy products in the EU is over 200 %
- The French govt. has provided large subsidies to Air France. The Closing Case focuses on European Govt. support to Air Bus SAS, the leading European manufacturer of commercial aircraft.
- In China, several leading corporations such as China Minmetals and Shanghai Automotive are provided huge financial resources by the Chinese Govt.
- In Europe and the USA, governments provide agricultural subsidies to supplement the income of farmers and help manage the supply of agricultural commodities.

Question 3

"One of India's major attractiveness as an investment destination is its vast pool of skilled and professional workforce. However, India is yet to catch the eye of foreign investors as an export platform or a manufacturing base."

Do you agree with the statement ? Justify your answer in the context of FDI policy framework in India. (5 marks)

Answer 3

There is no denying the fact that India has a vast pool of skilled and professional workforce. But the foreign investors have been shying away to make huge investments in India due to a plethora of reasons or issues.

- (i) The multi-national corporation has to operate under political risk in India as compared to their domestic counterparts.
- (ii) In many cases, there are charges against multi-national corporations on the usage of transfer pricing system for dubious activities. Hence, it becomes a

source of conflict between the MNCs and the host government.

- (iii) The reach of corruption is global. Fifteen percent of all companies in industrialized nations have to pay bribe to win or retain business. Ethical issues in business have become complicated because of the global and diversified nature of many large corporations.
- (iv) Multi-national companies face a number of different cultural problems. One of the main cultural challenges faced by multi-national companies is the diversity of cultural perspectives which causes problems of management and policy development and makes it difficult for the organizations to make company-wide policy decisions.
- (v) MNCs face the difficult task of developing a unified organizational culture. Concepts of team work and unity may have different meaning across national boundaries.
- (vi) When it comes to recruiting, HR manager find themselves having to overcome cultural barriers to find qualified candidates for positions abroad.
- (vii) MNCs run the risk of developing products and strategies that run contrary to cultural norms of the people to which they attempt to market the products.
- (viii) Differences in communications make it difficult to comprehend norms in countries in which MNCs operate.

Indian economy is capable of absorbing US \$50 billion in FDI per year. Though the Govt has relaxed FDI regime in various sectors, there is a lot of politics and uncertainty over FDI in multi-brand retail. These are FDI restrictions to international players like Wal-Mart, Gap, Ikea and Tesco. However, favorable demographics and growth opportunities keep India an 'attractive' destination for merger and acquisitions (M&A) activities across diverse sectors including consumer goods and pharmaceuticals. The FDI cap was raised from 49% to 74% in broadcasting and ARCs. Foreign investment has also been allowed in power exchanges while foreign institutional investors (FIIs) have also been allowed to invest up to 23% in commodity exchanges without seeking prior approval from the Govt. In short, it may be said that Indian landscape offers a plethora of opportunities to foreign investors as the economy is booming and vibrant as compared to its global peers. The right political moves and favorable macro-economic data coupled with pro-active policies to attract foreign investment would augur well to make India a sought after destination for foreign investment.

Question 4

How does technological environment affect business decisions in the global world? Explain. (5 marks)

Answer 4

- Technological environment refers to the sum total of knowledge providing ways to do things. It may include inventions and techniques which affect the ways of doing things i.e. designing, producing and distributing products.
- Technological environment affects an organization in the way it is organized and faces competition.

- Technology influences the social situation. The size of groups, membership of groups, pattern of interpersonal interactions, opportunity to control activities etc. are influenced by technology in a variety of ways.
- Technology influences the cost of production and quality of the product or service.
- The major strategic implications of technological environment are:
 - (i) It can change relative competitive cost position within an organization.
 - (ii) It can create new markets with new business segments.
 - (iii) It can merge with independent business by reducing or eliminating their segment cost barriers.
- Technology has contributed to the emergence of affluent societies. New varieties of products, superior in quality, free from pollution and more comfortable, are produced and supplied to the affluent sections. This calls for substantial investment in R&D. For Example: one important compulsion for investing in technological advances in Japan is its customer's high expectation regarding design sophistication, quality, delivery schedules and prices.
- Technology has resulted in complexity. Modern machines work better and faster but they fail often due to their complexity.
- With the advent of technology, Jobs tend to become more intellectual or upgraded. Introduction of new technology dislocates some worker unless they are re-skilled to work on new machine.
- Not only Jobs become more intellectual and knowledge-oriented, have even the incumbents tended to become highly professional and knowledgeable. Motivation of such employees is a difficult task. Being Cosmo Politian in their outlook, these professional employees are known for organizational rootlessness and job-hopping.
- A by-product of technological advancement is the ever increasing regulation imposed on business by the government of the land and stiff opposition from the public. The host government has the power to investigate and ban products that are directly harmful or hurt the sentiments of a section of society. For Example: Imports of animal tallow have been banned by the government of India because the alleged mixture of tallow with Vanaspati oil hurts the feelings of Hindus.

Question 5

The main goal of the United Nations Conference on Trade and Development (UNCTAD) is to promote development-friendly integration of developing nations into the world economy. Critically evaluate UNCTAD's effectiveness in the present economic scenario. (5 marks)

Answer 5

The United Nations Conference on Trade and Development (UNCTAD) was established in 1964 to promote the development-friendly integration of developing countries into the world economy. It has progressively evolved into an authoritative knowledge-based institution whose work aims to help shape current policy defects

and thinking on development, with a particular focus on ensuring their domestic policies and international actions are mutually supportive in bringing about sustainable development.

In recent years, the UNCTAD has -

- (i) Further focused its analytical research on the linkages between trade, investment technology and enterprise development.
- (ii) Put forward a 'positive agenda' for developing countries in international trade negotiations, designed to assist developing countries in better understanding the complexity of multi-lateral trade negotiation and in formulating their positions.
- (iii) Expanded work on international investment issues, following the merger into UNCTAD of the New York based United Nations Centre on Transnational Corporations in 1993.
- (iv) Expanded and diversified its technical assistance which today covers a wide range of areas, including training, trade negotiations and addressing trade-related issues; debt-related issues; debt management, investment policy reviews and the promotion of entrepreneurship; commodities, competition law and policy; and trade and environment.

The UNCTAD believes that enhanced cooperation between private and public sector is essential to the effective integration of developing countries including the global economy and seeks way to involve civil society organizations, academia, trade unions, parliamentarians and business associations in its works.

Generalized System of Preference (GSP), International Commodities Agreements, Code of Conduct for Linear Conference, Control of Restrictive Business Practices, Global System of Trade Preference (GSTP) among developing countries are some of the major agreements launched under the UNCTAD.

India wants UNCTAD to focus on certain aspects such as enhanced and predictable market access for agricultural and better terms of trade, removal of market entry barriers to trade , financial support, volatility in the capital market, trade diversifications and moving upon the value chain into technology intensive manufactured exports, greater policy space to develop local industries, strengthening of technological capacity and the need for a more benign and development sensitive international technology and Intellectual Property Right(IPR) regime.

Question 6

Identify a few companies providing Third Party Logistics (3PL) services and compare the services provided and cost involved. (5 marks)

Answer 6

3PL refers to outsourcing transportations, warehousing and other logistics related activities to a 3PL provider that were originally performed in-house. 3PL companies provide a wide variety of services apart from simple distribution and storage procedure. The Indian 3PL industry can be divided into the distinct tiers—National Major 3PL

companies with nation-wide presence, regional 3PL companies with strong presence in one or two regions and small remote 3PL companies.

- Some of the large Indian corporate such as Reliance, Tata, Mahindra & Mahindra, TVS Group and Essar Shipping has forayed into the logistics business. Initially, these corporates formed divisions to handle internal logistics but sensing the potential of the market; they have started offering logistics solutions to outer Indian corporates and have turned these logistics divisions into profit centers.
- Some large express cargo and courier companies such as Transport Corporation of India (TCIL), Gati, Safexpress and Blue Dart have started providing 3PL services.
- TCIL is one of the India's largest private deemed integrated supply chain and logistics solutions provider and a pioneer in the sphere of cargo transportation in India. Leveraging on its extensive infrastructure, strong foundation and skilled manpower , TCIL offers seamless multimodal transportation solutions.
- In recent years, many freight providers have developed their operations to introduce value-added services or both ends of the supply-chain to become globally integrated service providers. Europe is the largest market for freight forwarding logistics services with a share of just over a third followed by Asia Pacific(29%) and North America(27%). The global logistics and freight forwarding market is in the process of rationalization and consolidation with a handful of major players that have global coverage. DHL global Forwarding, with a 9 % share, is the largest provider followed by Kuehne and Nagel(7%), Schenker(6%), panalpina (4%) and others.
- Companies such as DHL, FedEx, ups and TNT provide a cost-effective means for delivering cargo virtually anywhere in the world. They also increasingly provide traditional distributor functions such as ware housing, inventory management, and order tracking. FedEx, a leading express shipping company, delivers several millions packages per day and offer supply-chain management services. The firm delivers to more than 210 countries and territories covering virtually the entire planet with its fleet of over 640 aircraft and nearly 50,000 cars, trucks and trailers. FedEx's business in Brazil, China and India has grown rapidly.
- DHL international is ahead of competitors in Europe in the courier, express and parcel market due to its efficient national express networks. DHL is acquisition of 81% of the Indian express company Blue Dart Strengthens the company's ability to offer customers and international express services in the key Asia market of China and India.
- DHL is also focusing on building services with the more lucrative, value-added contract logistics management in automotive, pharmaceutical, healthcare, electronics, telecommunications, consumer goods and textile/ fashion sectors.

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