

GUIDELINE ANSWERS

PROFESSIONAL PROGRAMME

JUNE 2012

MODULE I



**THE INSTITUTE OF
Company Secretaries of India**
IN PURSUIT OF PROFESSIONAL EXCELLENCE
Statutory body under an Act of Parliament

GUIDELINE ANSWERS

PROFESSIONAL PROGRAMME

JUNE 2012

MODULE I



**THE INSTITUTE OF
Company Secretaries of India**

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

ICSI House, 22, Institutional Area, Lodi Road, New Delhi 110 003

Phones: 41504444, 45341000; Fax: 011-24626727

E-mail: info@icsi.edu; Website: www.icsi.edu

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

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

C O N T E N T S

Page

MODULE I

- | | |
|--|----|
| 1. Company Secretarial Practice | 1 |
| 2. Drafting, Appearances and Pleadings | 20 |

(i)

NOTE : Guideline Answers of the last Four Sessions need to be updated in the light of changes and references given below :

PROFESSIONAL PROGRAMME
UPDATING SLIP
COMPANY SECRETARIAL PRACTICE
MODULE – I – PAPER 1

| <i>Examination Session</i> | <i>Question No.</i> | <i>Updation required in the answer</i> |
|----------------------------|---------------------|---|
| June 2010 to Dec. 2011 | — | <p>The Ministry of Corporate Affairs has issued a number of circulars and notifications during the years 2010, 2011 and 2012. These are placed at the website of Ministry at the following address :</p> <p>http : //www.mca.gov.in/Ministry/Companies_act.html.</p> <p>Students are advised to go through each and every circular and notification to update themselves.</p> |

PROFESSIONAL PROGRAMME EXAMINATION

JUNE 2012

COMPANY SECRETARIAL PRACTICE

Time allowed : 3 hours

Maximum marks : 100

NOTE : 1. Answer SIX questions including Question No. 1 which is **COMPULSORY**.

2. All references to sections relate to the Companies Act, 1956 unless stated otherwise.

Question 1

Draft **any four** of the following (a) in case of a resolution, the body to consider the same and the type of resolution; and (b) in other cases person authorised to issue the same. In all cases, the basis which gives rise to drafting should also be mentioned :

- (i) Resolution recommending payment of dividend on equity shares out of current profits.
- (ii) Resolution for transmission of shares.
- (iii) An affidavit verifying the contents of the petition on behalf of the company.
- (iv) Notice of adjourned Board meeting.
- (v) A resolution to borrow money, not being a temporary loan, which will make the total borrowed sum exceed the aggregate of company's paid-up share capital and free reserves. (5 marks each)

Answer 1(i)

Body to consider the Resolution : Board Meeting

Type of Resolution : Board resolution with simple majority

Basis giving rise to drafting the resolution: Section 205 of the companies Act, 1956 read with Articles 85 to 87 of Table A to the Act.

"RESOLVED THAT in accordance with the provisions of Section 205 and other applicable provisions, if any, of the Companies Act, 1956 and the Companies (Transfer of Profits to Reserves) Rules, 1975, the Board of directors of the company do hereby recommend a dividend at the rate of ₹ per equity share out of the profits of the company for the year ended on 31st March 2012 on the fully paid equity shares of the company absorbing ₹ out of the profits of the year and that, subject to the declaration by the members of the company at the ensuing annual general meeting, such dividend be paid to the registered holders of the equity shares whose names would appear on the register of members on..... 2011."

Answer 1(ii)

Passing Authority : Board of Directors

Nature of Resolution : Resolution with simple majority

Basis : Regulation 26 of Table A read with Section 291 of the Companies Act, 1956.

“RESOLVED THAT the application(s) for transmission of the equity shares as described in the share transfer register being transmission nos.....tofor transmission of.....equity/preference shares of the company be and are hereby approved and the persons mentioned in the column transferees in the share transfer register be registered members of the company in the place of the respective deceased shareholders.”

Answer 1(iii)

Authorised person – Board authoriting the Company Secretary to issue affidavit. (section 291 of the Companies Act, 1956)

Basis – In all matters before the Court/CLB, there is a need as per the requirements of respective rules to file affidavit attesting truth and correctness of the contents in the petition (which becomes a legal document).

Affidavit

I _____ son of _____ age _____ resident of _____ do hereby solemnly affirm and declare as under:

1. That I am the Company Secretary of the Company named _____ and that I am competent and authorized to make this affidavit on behalf of the Company.
2. Being fully aware of the facts and circumstances of the case, I make this affidavit stating that the contents of the petition in paragraphs _____ are true based on the record and documents available with the Company and the contents of paragraph _____ are based on the true facts of the case and the contents in paragraphs _____ based on the legal advice obtained by the Company from its Solicitors and Advocates.

DEPONENT

Verified at _____ on this _____ day of _____, 2011 that the contents of the said affidavit are true to the best of my knowledge and belief and nothing has been concealed therefrom.

DEPONENT

Answer 1(iv)

- Authorised Person* : *The Board of Directors authorized to adjourn the Board meeting. Notice is usually issued by the Company Secretary.*
- Basis* : *Regulation 73 of Table A of Schedule I to the Companies Act, 1956.*

JKL Co. Ltd.

Registered Office: Address

Notice of Adjourned Board Meeting

Notice is hereby given that the meeting of the Board of Directors of the company convened and held on _____ at _____ a.m./p.m. at the Registered Office of the Company and adjourned to a date to be determined by the Chairman has been decided to be convened and to be held on _____ at _____ a.m./p.m. at the Registered Office of the Company to transact the business left incomplete at the said meeting of the Board held on _____.

You are requested to make it convenient to attend the meeting.

Sd/-
Mr. _____
Company Secretary

Place : Delhi
Date : 1st April, 2011

Answer 1(v)

Body : *General Meeting*
Type of resolution : *Ordinary resolution*
Basis : *Section 293(1)(d) of the Companies Act require the consent of company at general meeting for borrowing money exceeding the aggregate of paid up share capital and free reserves.*

“**RESOLVED** that pursuant to the provisions of Section 293(1)(d) of Companies Act, 1956 or any amendment or modifications thereof, the consent of the members of the company be and is hereby accorded to the Board of Directors of the Company, to borrow and raise such sum or sums of money from time to time as may be required for the purposes of the business of the Company, in excess of the aggregate of the paid-up capital of the Company and free reserves of the Company, that is to say, reserves not set apart for any specific purpose, subject to the proviso that such borrowing shall not exceed ₹ 200,000,000 (Rupees Twenty Crores only) over and above the aggregate of the paid-up capital of the Company and its free reserves and shall exclude all temporary loans obtained by the Company from its bankers in the ordinary course of its business, on such terms and conditions as the Board may consider necessary and expedient in the best interest of the Company.

RESOLVED FURTHER that for the purpose of giving effect to this resolution the Board be and is hereby authorized to do all such acts, deeds, matters and things as it may in its absolute discretion consider necessary, proper or desirable and to settle any question, difficulty or doubt that may arise in this regard.”

Question 2

Distinguish between any four of the following :

- (i) *'Adjournment of a meeting' and 'postponement of a meeting'.*
 - (ii) *'Additional director' and 'alternate director'.*
 - (iii) *'Dematerialisation of securities' and 'rematerialisation of securities'.*
 - (iv) *'Inspection' and 'investigation'.*
 - (v) *'A company limited by guarantee' and 'an unlimited liability company'.*
- (4 marks each)*

Answer 2(i)

‘Adjournment of a meeting’ and ‘postponement of a meeting’

To adjourn means to defer or suspend the meeting to a future time with appointed date or indefinitely /sine/die) or as decided by the members present at the scheduled time to the meeting. Adjournment can take place either before the commencement of the meeting where quorum is not present or after commencement of the meeting, when agenda remains unfinished.

To postpone a meeting means to put off for the time being. A meeting need not be held again and for its reconvening, the complete procedure is to be complied with.

The adjourned meeting is merely the continuation of the original meeting and unless the articles provide otherwise, a fresh notice of the adjourned meeting is not necessary, if it is not adjourned beyond 30 days or sine die.

At the adjourned meeting only the unfinished business of the original meeting should be considered.

Answer 2(ii)

‘Additional Director’ and ‘Alternate Director’

Additional Director : The Articles of Association of companies usually authorize their Board of Directors to appoint additional directors. Additional Director holds office only upto the date of the next AGM of the company. The total number of directors and additional directors shall not exceed the maximum strength of directors fixed for the Board by the Articles of the company (Section 260). If the AGM of the company is not held or cannot be held, the person appointed as additional director vacates his office on the last day on which the AGM should have been held in terms of section 166 of the Act.

Alternate Director : According to the provisions of section 313 of the Companies Act, 1956, an alternate director is a person appointed by the Board, if so authorized by the Articles or by a resolution passed by the company in the general meeting to act for a director, the original director, during his absence for a period of not less than three months from the date is which meetings of the Board are ordinarily held. Generally, the alternate directors are appointed for a person who is non-resident Indian or for foreign collaborators of a company. His tenure lasts till the original director returns to the city/place of his usual residence and is in a position to attend the meetings or when the term of the original director expires.

Answer 2(iii)

‘Dematerialisation of securities’ and ‘rematerialisation of securities’

Issue of Securities in electronic form or conversion of physical certificates into dematerialized holdings at the request of the investor is called ‘dematerialisation’. A Dematerialization Request Form ‘DRF’ issued by the depository participant is to be filed and deposited with the concerned depository participant together with certificates after writing ‘surrendered for dematerialisation’ on the face of each certificate. Further Section 68B of the Companies Act, 1956 requires every listed public company making initial public offer of any security for a sum of Rs.10 crores or more shall issue the same only in demat form by complying with the provisions of the Depositories Act,1996.

The conversion of dematerialised holdings back into physical certificates is called rematerialization. If the investor wishes to get back his securities in physical form, all he has to do is to request his depository participant for rematerialization of the same by filling up ‘Rematerialisation Request Form’ (RRF).

Answer 2(iv)

Inspection and Investigation

Inspection of books of accounts and other books and papers of the company is authorised under Section 209A of the Companies Act, while investigation can be ordered under Section 235 or 237 or 239 of the Act.

Inspection of books of account and other books and papers is not an investigation though it may lead to investigation in case anything wrong or objectionable is found during inspection. Its object is to ensure that there is nothing objectionable to the books of account and other books and papers.

Investigation into the affairs of the company is wider in scope. It includes investigation of all the business affairs, profit and loss, assets including goodwill, contracts and transactions, investment and other property interests and control of subsidiary, holding and other related companies too.

Inspection can be done either by the Registrar or by an officer authorised by the Central Government. But Investigation can be conducted by only competent persons appointed as Inspectors by the Central Government. Inspectors may be appointed by the Government from the officers of the Government or persons from outside the Government.

Under Section 209-A, to inspect books of account and other books and papers the inspecting authority need not assign any reason. Further, no prior notice of inspection to company is necessary. The object of inspection is to keep a watch over the companies to ensure that the statutory books and papers are maintained and the business of the company is being managed at proper level of efficiency.

But investigation may be ordered by the Central Government under Section 235(1) on the report of the Registrar or it must be ordered by the Central Government under Section 235(2) on declaration made by the Company Law Board on a petition by specified number of members of the company. Under Section 237(a) the Central Government is bound to order investigation into the affairs of the company if the company by special resolution or the Court by order declares that the affairs of the company ought to be investigated. Clause (b) of Section 237, however, gives discretionary power to the Government to order investigation, if in the opinion of the Company Law Board there are circumstances suggesting that the affairs of the company are being conducted with a view to defraud members or other persons or for fraudulent or unlawful purpose or in manner oppressive to any members or the managerial personnel are guilty of fraud, misfeasance or other misconduct towards the company or any of its members or the members have not been given all the information about the affairs of the company. Investigation of ownership of the company may also be ordered by the Central Government under Section 247.

Answer 2(v)

'A company limited by guarantee' and 'an unlimited liability company'

A company limited by guarantee : As per section 12(2)(b), it is a company where liability of members is limited by its memorandum of association as per the undertaking of respective members in the memorandum. This undertaking is for making contribution to company's asset in the event of winding up. Both the memorandum and the articles must state the number of members with which the company is proposed to be incorporated. A company limited to guarantee can have shares also but it is not mandatory. It can be incorporated even on the basis of guarantee. It can be a public company or a private company.

An unlimited liability company : As per section 12(2)(c), an unlimited liability company is one where the members' liability is not limited. In the event of winding up, the members shall have to pay from its personal property and the entire personal property may be used up. However, the liability of the members is only to the company and not to creditors/lenders and it is only the liquidator who can call for amounts from the members to treat company's debts and obligations. This type of companies can also have share capital. The Articles of this type of companies must

have their distinct regulations and should mention the number of members with which they are incorporated. An unlimited liability company can get converted into a limited liability company in terms of section 32 of the Act.

Question 3

- (a) (i) *Who all are required to sign annual return of companies having share capital under the Companies Act, 1956 ?*
- (ii) *Mention any four particulars that an annual return of companies having share capital must contain. (2 marks each)*
- (b) *Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s) :*
- (i) *A copy of the compliance certificate should be attached with _____ where the company does not have a whole-time Company Secretary.*
- (ii) *Secretarial Standard - 7 relates to _____ .*
- (iii) *Interim dividend _____ be paid on preference shares.*
- (iv) *E-form _____ is a return in respect of buy-back of securities. (1 mark each)*
- (c) *State, with reasons in brief, whether the following statements are true or false:*
- (i) *Rights shares means shares which are issued by a newly formed company.*
- (ii) *A company should file its annual return within six months of the close of the financial year.*
- (iii) *The shareholders of a company which has adopted Table-A of the Companies Act, 1956 can increase the rate of dividend recommended by the Board of directors in its annual general meeting.*
- (iv) *Debentures with voting rights can be issued only if permitted by the articles of association. (2 marks each)*

Answer 3(a)(i)

In accordance with section 161 of the Companies Act, 1956, the annual return is required to be signed both by a director and by the Manager or Secretary of the Company, where there is one. In case there is no Manager/Secretary, then by two directors, one of whom should be the managing director, where there is one.

In case of listed companies the annual return should also be signed by a Secretary in whole-time practice.

Answer 3(a)(ii)

As per Section 159(1) of the Companies Act, 1956, the annual return is required to contain the particulars specified in part I of Schedule V, as they stood on that day regarding:

- (a) Registered office; (b) Register of members; (c) Indebtedness of the company; and (d) Directors, Managing Directors, Manager and Secretaries, Past and Present; (e) shares and debenture holders.

Note : Any other matter contained in section 159(1) of the Act may be mentioned.

Answer 3(b)

- (i) A copy of the compliance certificate should be attached with **Board's Report** where the company does not have a whole-time Company Secretary.
- (ii) Secretarial Standard-7 related to **Passing of resolution by circulation**.
- (iii) Interim dividend **can** be paid on preference shares.
- (iv) E-form **4C** is a return in respect of buy-back of securities.

Answer 3(c)

- (i) Section 81 of the Companies Act, 1956 provides for the provisions on Right shares. According to it, in case of further issue of share capital, existing shareholders has the statutory right to have offered the new shares. Thus, company's existing shareholders have the pre-emptive right to get further shares.

Hence, the given statement is incorrect.

- (ii) A company should file its annual return within six months of the close of the financial year. This statement is incorrect.

Section 159 of the Companies Act, 1956 states that a company should file its annual return within sixty days from the date of the Annual General Meeting is held.

- (iii) The given statement is incorrect.

In accordance with Regulation 85 of Table A of the Companies Act, 1956, the Company in general meeting may declare dividends, but no dividend shall exceed the amount recommended by the Board.

Therefore, the shareholders of a company cannot increase the rate of dividend recommended by the Board of Directors.

- (iv) Debenture with voting rights can be issued only if permitted by the Articles of Association. This statement is incorrect.

As per section 117 of the Companies Act, 1956, no company shall issue any debentures carrying voting rights at any meeting of the Company, whether generally or in respect of any particular classes of company.

Question 4

- (a) *Bring out the procedure for incorporation of a company as subsidiary of an existing company.* (8 marks)

- (b) *Write the most appropriate answer from the given options in respect of the following :*

- (i) *Default in filing of annual return makes the company and officer in default liable to be punished with fine which may extend to -*

- (a) ₹ 500 per day
- (b) ₹ 50 per day
- (c) ₹ 100 per day
- (d) ₹ 1,000 per day.

- (ii) Which one of the following forms needs to be filled-in for filing the order of the Company Law Board/High Court -
- (a) e-Form 21
 - (b) e-Form 61
 - (c) e-Form 23
 - (d) e-Form 18.
- (iii) Intimation to keep the books of account at a place other than the registered office of the company is required to be filed within how many days from the date of passing of the Board resolution -
- (a) 30 days
 - (b) 7 days
 - (c) 60 days
 - (d) 120 days.
- (iv) The satisfaction of charge is required to be notified to the Registrar of Companies in -
- (a) e-Form 8
 - (b) e-Form 17
 - (c) e-Form 21
 - (d) e-Form 23
- (1 mark each)
- (c) Do you agree with the following statements? Give brief reason(s) in support of your answer:
- (i) In a scheme of amalgamation, shareholders of Company-A were offered shares of Company-B in lieu of shares held by them in Company-A. Can the offer letter issued by Company-B to the shareholders of the Company-A be regarded as prospectus ?
 - (ii) Preference shareholders have the same voting rights as the equity shareholders.
- (2 marks each)

Answer 4(a)

Procedure for incorporation of a company as subsidiary of an existing company

Section 4 of the Companies Act, 1956 provides for the meaning of subsidiary company. As per sub-section (1), a company shall, be deemed to be a subsidiary of another if, but only if,-

- (a) that other controls the composition of its Board of directors; or
- (b) that other-
 - (i) where the first-mentioned company is an existing company in respect of which the holders of equity shares, exercises or controls more than half of the total voting power of such company;
 - (ii) where the first-mentioned company is any other company, holds more than half in nominal value of its equity share capital; or
- (c) the first-mentioned company is a subsidiary of any company which is that other's subsidiary.

Therefore, in order to make the subsidiary company, say CD Ltd. of the existing

company say AB Ltd., AB Ltd. must control the composition of Board of directors of CD Ltd. or it must exercise or control more than half of the total voting power in CD Ltd. or it must hold more than half of nominal value of the equity share capital of CD Ltd.

The articles of association of CD Ltd. must contain the provisions in this regard that AB Ltd. shall have the power to appoint, remove, replace majority of the directors in the subsidiary company; or AB Ltd. shall hold majority of the shares, having voting rights, in CD Ltd. and the aforementioned provisions in the articles of association of CD Ltd. shall not be altered.

Keeping the above provisions in view, the existing company AB Limited will be required to follow the procedure for the formation and registration of its subsidiary company.

- Authorize the formation of a subsidiary. Call a meeting of the board of directors for the same.
- Selecting Name of the Company and Ascertaining its availability from ROC;
- Drafting and Printing of Memorandum and Articles of Association. The articles of association of CD Ltd. must contain the provisions in this regard that AB Ltd. shall have the power to appoint, remove, replace majority of the directors in the subsidiary company; or AB Ltd. shall hold majority of the shares, having voting rights, in CD Ltd. and the aforementioned provisions in the articles of association of CD Ltd. shall not be altered.
- After the printing and stamping, Signing of Memorandum and Articles is required to be done. The memorandum and articles are then dated, but the date must be a date of stamping or later than the date of their stamping and not, in any event, a date prior to the date of their stamping.
- e-form 1, 18 and 32 are then filed with the ROC for Registration alongwith the prescribed registration fee and fee for filing of forms as per the rates contained in Schedule X to the Companies Act, 1956.
- On receipt of the aforementioned documents, office of the Registrar of Companies will scrutinise them and if they are found complete in all respects, the Registrar will register the company.
- After the registration of the company, the Registrar will issue under his hand and seal of his office, the Certificate of Incorporation in the name of the company.

Answer 4(b)(i)

- (a) ₹ 500 per day

Answer 4(b)(ii)

- (a) e-form 21

Answer 4(b)(iii)

- (b) 7 days

Answer 4(b)(iv)

- (b) e-form 17

Answer 4(c)(i)

No, the offer Letter issued by company- B to the shareholders of company - A cannot be regarded as a prospectus.

Section 2(36) defines the prospectus as any document described or issued as prospectus and includes any notice, circular or other document inviting offers from the public for subscription or purchase of shares body corporate.

The invitation must be to the public if the document is to be a prospectus.

The offer has been made to specified persons only and no person other than those can avail the offer. The test for determination of the nature of offer is not who receives the offer but who can avail the offer. If offer can be availed only by the person to whom offer has been made, it is not a prospectus.

Answer 4(c)(ii)

No, the preference shareholders do not have the same voting rights as the equity shareholders.

As per the provisions of 87(2) of the Companies Act, 1956, every member of a company limited by shares and holding any preference share capital therein shall, in respect of such capital, have a right to vote only on resolutions placed before the company which directly affect the rights attached to his preference shares.

It is further provided that any resolution for winding up the company or for the repayment or reduction of its share capital shall be deemed directly to affect the rights attached to preference shares. Also preference share holders shall be entitled to vote on every resolution with regard to the dividend due on such capital or any part of such dividend has remained unpaid.

Question 5

- (a) *"Failure to file annual return is a continuing offence." Comment. (4 marks)*
- (b) *Boss Ltd. issued 2,00,000 equity shares of ₹10 each. You are allotted 100 shares. Explain any eight rights you have as a member of the company. (4 marks)*
- (c) *Amulya Ltd. has received an application for transfer of 1,000 equity shares of ₹10 each fully paid-up in favour of Amar. On scrutiny of the application form, it was found that Amar is a minor. Advise the company regarding the contractual liability of a minor and whether shares can be allotted to Amar by way of transfer. (4 marks)*
- (d) *How does a director resign from the Board of directors in a private limited company, if the Board of directors fails to accept his resignation ? (4 marks)*

Answer 5(a)

Failure to file annual return is a continuing offence as decided by Andhra High Court in Kishan Prasad Palaypu vs Registrar Of Companies in year 2006. The relevant extracts from the case law which conclude the above are:

“As per Section 162 of the Companies Act, 1956, i.e. Penalty and interpretation, If a company fails to comply with any of the provisions contained in Sections 159, 160 or 161, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to fifty rupees for every day during which the default continues.

A reading of Section 162 of the Act makes it clear that if a company fails to comply with any of the provisions contained in Sections 159, 160 or 161, which enjoining of filing annual return and other documents within 60 days from the date on which the annual general meeting is held, the company, and every officer of the

company who is in default, shall be punishable with fine which may extend to fifty rupees for every day during which the default continues.

Violation of Section 159 of the Act is also made liable under Section 162 and Section 159 of the Act makes it obligatory on the part of the company to prepare and file with the Registrar a return containing the particulars specified in Part I of Schedule V regarding the various items enumerated thereunder.

The Division Bench after considering the judgments of the Supreme Court in Deokaran Nenshi AIR 1973 SC 908 and in Bhagirath Kanoria AIR 1984 SC 1688 held that the offence punishable under Section 162(1) is a continuing offence.

It further held that the decision of the Division Bench in National Cotton Mills [1984] 56 Comp Cas 222 (Cal), can no longer be taken as good law particularly, in view of the earlier Division Bench decisions in *Wire Machinery Manufacturing Corporation Ltd. v. State* [1978] 2 Cal HN 293 (Cal) : and *Krishna Kumar Dalmia v. State* [1981] 2 Cal HN 301 (Cal), relied on in National Cotton Mills [1984] 56 Comp Cas 222 (Cal), having been overturned by the Supreme Court, and the earlier decision of the Supreme Court in Deokaran Nenshi AIR 1973 SC 908, referred to therein having been duly explained and distinguished by the Supreme Court in Bhagirath Kanoria's case .

We have gone through the judgments on which reliance is placed by learned Counsel for the petitioner. In view of subsequent judgment of the Supreme Court in Bhagirath Kanoria, we cannot agree with the view expressed by the Calcutta, and Karnataka High Courts in National Cotton Mills and Chandra Spinning and Weaving Mills P. Ltd., respectively, and we fully agree with the view taken by the latter Division Bench of the Calcutta High Court in *Luxmi Printing Works Ltd. v. Assistant Registrar of Companies and the Kerala High Court* in Rani Joseph [2001] 103 Comp Cas 928. Once Section 162(1) of the Act imposed penalty at the rate of Rs. 50 for every day till the default continues, it must be held default in complying with the provisions of Section 220(1) of the Act is a continuing default covered by Section 472 of the Code of Criminal Procedure.

Accordingly, we answer the reference as under:

The contravention of Section 220(1) of the Act made punishable under Section 220(3) is a continuing offence and the period of limitation prescribed under Section 468 of the Code of Criminal Procedure does not attract the prosecution launched against the company for the offence alleged and is governed by Section 472 of the Code of Criminal Procedure.”

Answer 5(b)

Members of a company enjoy certain rights in their individual capacity, which they can enforce individually. These rights are contractual rights and cannot be taken away except with the written consent of the member concerned. In this case, Boss Ltd. has issued 100 shares of ₹ 10 each to you. That means you have .05% shareholding (total equity shares 2,00,000). You have the following rights as per the provisions of the Companies Act, 1956:

- (1) Right to receive copies of the following documents from the company:
 - (i) Abridged balance-sheet and profit and loss account in the case of a listed company and balance-sheet and profit and loss account otherwise (Section 219).
 - (ii) Report of the Cost Auditor, if so directed by the Government.
 - (iii) Contract for the appointment of the managing director/manager (Section 302).

(iv) Notices of the general meetings of the company (Sections 171-173).

(2) Right to inspect statutory registers/returns and get copies thereof on payment of prescribed fee.

The members have been given right to inspect the following registers etc.:

- (i) Debenture trust deed (Section 118);
- (ii) Register of Charges (Section 141);
- (iii) Register of Members, Register of Debenture holders, Index of Members, Index of Debenture holders and Annual Returns (Section 163);
- (iv) Shareholders' Minutes Book (Section 196);
- (v) Register of Contracts, Companies and Firms in which directors are interested (Section 301);
- (vi) Register of directors (Section 303);
- (vii) Register of Directors' Shareholdings (Section 307); and
- (viii) Copy of agreement of appointment of the managing director/manager (Section 302).

The members can also get the copies of the aforesaid registers/returns on payment of prescribed fee except those of Register of Directors and Register of Directors' Shareholdings. Members can also get copies of memorandum and articles of association on payment of a fee of Re. One (Section 39).

(3) Right to attend meetings of the shareholders and exercise voting rights at these meetings either personally or through proxy (Sections 165, 166, 169, 176 and 177).

(4) Other rights.

Over and above the rights enumerated at Item Nos. 1 to 3 above, the members have the following rights:

- (i) To receive share certificates as title of their holdings [Section 84 read with the Companies (Issue of Share Certificates) Rules, 1960].
- (ii) To transfer shares (Sections 82 and 108 and Articles of Association of the company).
- (iii) To resist and safeguard against increase in his liability without his written consent.
- (iv) To receive dividend when declared.
- (v) To have rights shares (Section 81).
- (vi) To appoint directors (Section 255).
- (vii) To share the surplus assets on winding up (Section 511).
- (viii) Right of dissentient shareholders to apply to court (Section 107).
- (ix) Right to be exercised collectively in respect of making application to the Central Government for investigation of the affairs of the company (Section 235), and for appointment of Government directors (Section 408).

- (x) Right to make application collectively to the Company Law Board for oppression and mismanagement (Sections 397 and 398).
- (xi) Right of Nomination.

Note Any eight rights may be indicated.

Answer 5(c)

The Companies Act, 1956 does not prescribe any qualification for membership. Membership entails an agreement enforceable in a court of law. Therefore, the contractual capacity as envisaged by the Indian Contract Act, 1872 should be taken into consideration. It was held in the case of *Mohri Bibi v. Dharmadas Ghose* (1930) 30 Cal. 531 (P.O.) that since minor has no contractual capacity, the agreement with a minor is void. Therefore, a minor or a lunatic cannot enter into an agreement to become a member of the company. However, the Punjab High Court held in the case of *Diwan Singh v. Minerva Films Ltd.* (AIR 1956 Punjab 106) that there is no legal bar to a minor becoming a member of a company by acquiring shares by way of transfer provided the shares are fully paid up and no further obligation or liability is attached to these. The same view was upheld by the Company Law Board in the case of *S L Bagree v. Britannia Industries Ltd.* (1980).

In view of the above, M/s. Amulya Ltd. can give membership to the Minor through 1000 shares, received by way of transfer, because the shares are fully paid up and no further liability is attached to these.

Answer 5(d)

The Companies Act, 1956 does not contain any provisions governing resignation of director. Section 284 of the act deals with the removal of the director before the expiry of his period under various conditions enumerated therein. Whereas Section 262 of the act provides for filling of casual vacancies among directors if the office of any directors appointed by the company in general meeting is vacated before his term of office. Further, Section 283 of the act deals with the vacation of office by the directors and the circumstances under which the office is vacated.

Palmer's Company Precedents states that in the absence of any express power to resign, it is submitted that, unless the articles are specially framed, a director may by notice to the company resign his directorship. In case of resignation, it should be sufficient for the director to establish proof of delivery of such information with the company to discharge him of any liability in this regard, or of events taking place subsequent to his having intimated his decision to resign. A copy of the resignation letter should also be forwarded to the ROC within a reasonable period by the Director along with proof of delivery to the company. This is necessary to avoid misuse of this choice through retroactive communications. [*Saumil Dilip Mehta v. State of Maharashtra* (2003)].

The Companies Act under section 303(2) casts a legal obligation on the company to inform the registrar of the companies by filling form no.32 giving particulars of changes, if any, in the office of director. If such a form is filed with the registrar of companies it is a proof of a director ceasing to be a director but, it is not an act to be complied with in order to make resignation valid.

Question 6

- (a) *The articles of association of a listed company has fixed payment of sitting fee for each meeting of directors subject to a maximum of ₹ 10,000. In view of increased responsibilities of independent directors of listed companies, the*

company proposes to increase the Sitting fee to ₹25,000 per meeting. As a Company Secretary, advise the company about the requirements under the Companies Act, 1956 to give effect to this proposal. (6 marks)

(b) What is meant by compoundable and non-compoundable offences? State whether the following offences are compoundable or non-compoundable also mentioning the authority which can compound the offence in case of compoundable offences :

- (i) Failure to hold an annual general meeting of the company.*
- (ii) Failure to file copies of annual accounts with the Registrar of Companies.*
- (iii) An officer of a company who in spite of court's order to vacate the company's property, continues to occupy the same.*
- (iv) Non-distribution of dividend to the members within the prescribed time . (6 marks)*

(c) Explain the provisions of the Companies Act, 1956 relating to 'resolutions requiring special notice'. Identify the resolutions that require 'special notice' under the Companies Act, 1956. (4 marks)

Answer 6(a)

Under section 310 of the Companies Act, 1956, approval of the Central Government shall not be required where sitting fee for each meeting of the Board or a Committee thereof does not exceed the prescribed sum under Rule 10-B of the Central Government's (General Rules & Forms, 1956) as under:

- | | |
|---|---------------------------------------|
| 1. Companies with paid up capital of ₹ 10 crores and above or turnover of ₹ 50 crores and above | Sitting fee not to exceed ₹ 20,000/-. |
| 2. Other companies | Sitting fee not to exceed ₹ 10,000/-. |

Any increase in the sitting fee will require amendment of relevant provision of the Articles of Association. In the given case, the proposed sitting fee of ₹ 25,000/- will require approval of the Central Government as the same exceeds the prescribed limits.

The company can pay the sitting fee upto ₹ 20,000/- depending upon the aforesaid parameters laid down in Rule 10-B.

Answer 6(b)

Compoundable offences are those offences under the Companies Act, 1956 which can be compounded by the Regional Director if the maximum amount of fine is upto ₹ 50,000 and by the Company Law Board if the maximum amount of fine exceeds ₹ 50,000. There are certain offences punishable with imprisonment or with fine or both, which can be compounded with the permission of the Court under Section 621A(6)(a) of the Companies Act, 1956.

Non-compoundable offences are those punishable with imprisonment only or with imprisonment and also with fine under section 621A (6)(b) of the Act.

- (i) Failure to hold the annual general meeting of the company is compoundable under section 168 of the Act because there is only a monetary penalty.*
- (ii) Failure to file copies of annual accounts with the Registrar of Companies is also compoundable under section 220(3) because there is monetary penalty only.*

- (iii) Under section 630(2) of the Act, the officer who in spite of Court's order to vacate company's property continues to occupy the same is punishable with imprisonment upto two years. Hence, the offence is non-compoundable.
- (iv) Non- distribution of dividend to the members within the prescribed time limit of 30 days under section 207 is non-compoundable because it is punishable with imprisonment and also fine.

Answer 6(c)

Section 190 of the Companies Act, 1956 deals with resolutions requiring special notice. Accordingly, the section provides that where under any provision contained in the Companies Act or in the Articles, special notice is required to be given of any resolution, notice of intention to move the resolution should be given to the company, not less than 14 days before the meeting at which it is to be moved, exclusive of the day on which the notice is served or deemed to be served and the day of the meeting.

Special notice is required to move, besides the resolution mentioned in the Articles, in the following resolutions:

- (i) A resolution appointing an auditor other than the retiring one. (Section 225).
- (ii) A resolution providing expressly that the retiring auditor shall not be reappointed. (Section 225).
- (iii) A resolution purporting to remove a director before the expiry of his period of office. (Section 284).
- (iv) A resolution to appoint another director in place of the removed director. (Section 284).

Question 7

- (a) *Mention the provisions of the Singapore Companies Act relating to formation of companies. (8 marks)*
- (b) *"The provisions of the Hong Kong Companies Ordinance relating to formation of an incorporated company are broadly similar to the provisions of the Companies Act, 1956." Comment. (8 marks)*

Answer 7(a)

Formation of companies under the provisions of Singapore Companies Act

Any person may, whether alone or together with another person, by subscribing his name or their names to a memorandum and complying with the requirements as to registration, form an incorporated company.

A company may be —

- (a) a company limited by shares;
- (b) a company limited by guarantee; or
- (c) an unlimited company.

Any company, association or partnership consisting of more than 20 persons cannot be formed for the purpose of carrying on any business that has for its object the acquisition of gain by the company, association or partnership, or by the individual members thereof, unless it is registered as a company under this Act, or is formed in pursuance of some other written law in Singapore or letters patent.

A company must have at least one member.

The first consideration is to decide on the right business entity that will meet the business needs. The most common three business entities available in Singapore are Sole Proprietorship, Limited Liability Partnership and Private Limited Company.

Singapore Private Limited Company

Private Limited Company is the most popular business entity in Singapore. It has a separate legal status from its shareholders and directors who have limited liabilities for the debts and losses of the company. It usually has the words 'Pte Ltd' or 'Ltd' as part of its name. In many European countries or the US, it is commonly known as a Corporation.

Limited Liability Partnership

A Limited Liability Partnership (LLP) is a perfect blend of a partnership with private limited company setup. A LLP gives owners the flexibility of operating as a partnership while having a separate legal identity like a private limited company. This type is highly suitable for individuals engaged in professional services such as lawyers, architects, accountants and management consultants. Singapore citizens, residents, and employment pass holders can register a LLP. Foreign individuals and companies may also register a LLP but must appoint a local manager.

Sole Proprietorship

A Sole Proprietorship is the simplest form of business entity with only one owner who is the decisive authority and responsible for all assets and liabilities belonging to the business. Citizens, residents, Employment Pass holders may register a sole proprietorship.

Summary of Setup Requirements for a Sole Proprietorship

- Minimum one owner
- A Singapore registered office address
- For foreign individuals and companies only: minimum one manager who must be a Singapore resident

The following documents are needed for registration of a Sole Proprietorship:

- Proposed Sole Proprietorship name
- Copies of NRIC and/or Passport information of the business owner
- Brief description of business activities
- Registered office address for the Sole Proprietorship

Answer 7(b)

The statement that “the provisions of the Hong Kong Companies Ordinance relating to formation of an incorporated company are broadly similar to the provisions of the Companies Act, 1956”, appears to be correct for the following reasons:

- (i) In Hong Kong a company may be formed by one person or more than one person by subscribing his/their names to a memorandum of association. In India, the process is the same i.e. subscribing to a memorandum but by at least two persons as against even by one person in Hong Kong (vide section 12 of 1956 Act).

- (ii) The types of companies that can be formed in Hong Kong are – (a) company limited by share; (b) company limited by guarantee; (c) company limited by guarantee and not having a share capital; and (d) unlimited liability company having a share capital. Under the Companies Act, 1956 same types of companies can be incorporated. (vide section 12 read with section 13 of the Companies Act, 1956).
- (iii) A company which is being incorporated in Hong Kong need to deliver to the Registrar the memorandum and articles of the company. In India, requirements are broadly the same. Sections 26, 33 of Companies Act, 1956 similarly requires submission of memorandum in all cases to the Registrar for incorporation of the company and also of the articles in prescribed format (except a public company limited by shares where Table A may be deemed as the Articles). This means that a public company limited by shares must also have its articles registered or allow a deeming of Table A as its articles.
- (iv) Once memorandum and articles are registered by a company in Hong Kong, the Registrar shall certify in his hand that the company has been incorporated. The certificate so issued shall be the conclusive evidence that all matters requiring compliance have been complied with and the entity so certified will have perpetual succession with a common seal. A compliance certificate by an advocate of High Court or by one of the directors or Secretary named in the Articles to the Registrar is a precondition for issue of certificate of incorporation.

Companies Act, 1956 also requires a declaration by a professional (Advocate, CA, CS etc.) who took part in the formation of the company on the above lines as a necessary precondition. A certificate of incorporation issued by the Registrar is conclusive evidence that all requirements relating to incorporation have been complied with. Also, Section 34 provides for perpetual succession and common seal.

Question 8

- (a) *Outline the procedure involved for striking off the names of companies by the Registrar of Companies under section 560. (6 marks)*
- (b) *Love All Ltd. was registered in the year 2005 under the Companies Act, 1956. The management of the company decides to make donation to recognised political party. Advise the management about the restrictions and the extent upto which such donation can be made. Will it make any difference if Love All Ltd. was registered in the year 2009 ? (6 marks)*
- (c) *The principal business of Grow Fast Ltd. was the acquisition of vacant plots of land and to build/erect houses. In the course of transacting the business, the Chairman of the company acquired the knowledge of arranging finance for the development of land. Grow Fast Ltd. introduced a financier to another company Ajay Ltd. and received an agreed fee of ₹2 lakh for arranging the finance. The memorandum of association of the company authorises the company to carry on any other trade or business which in the opinion of the Board of directors can be advantageously carried on by the company in connection with the company's general business. Referring to the provisions of the Companies Act, 1956, examine the validity of the contract carried out by Grow Fast Ltd. with Ajay Ltd. (4 marks)*

Answer 8(a)

ROC is authorized under section 560 to strike off the name of the company which is defunct or not in operation since one year without any proper reason, subject to giving notice to the company and published notice in the official gazette.

Striking off name can be done in two types:

- (1) Striking off by the Registrar on its own motion.
 - (2) Striking off on company's application.
1. Procedure involved in striking off names of companies by Registrar on his motion is as follows:
 - (a) *Letter of Enquiry* : when the registrar has reason to believed that the company is not in operation, he shall send a letter of inquiring whether the company is in operation or not.
 - (b) *Notice informing striking off* : If the registrar does not receive any reply from the company within one month of previous letter, he will send second letter to the company and stating that if again no reply is being received within one month from the letter, then a notice is being published in the official gazette to strike off the name of the company.
 - (c) *Final notice of removal* : If the registrar, in response to the letter, received reply that the company is not in operation or do not received any reply then he may proceed to strike off the name of the company. it can strike in two ways:
 1. send a notice for publishing in the official gazette that with the expiration of three month from the date of notice, the name of the company will be struck off the register and the Company will be dissolved; and
 2. send to the company as well as to the Income Tax authorities the above mentioned notice by registered post.
 - (d) After the expiry of three month from the notice if no reason has been shown by the company, the name of the company may be struck off from the register by the Registrar and published in the official gazette. On publication in the official gazette, the company shall stand dissolved.
 2. Procedure involved in striking off names of companies by Registrar on an application received by him from the company is as follows:
 - (a) *Board resolution* : Pass a resolution by the Board of Directors of the company to the effect that an application be made to the Registrar of Companies to have the company struck off the Register of Companies under section 560.
 - (b) *Application to Registrar* : An application shall be made to the Registrar for striking the company off the Register, pursuant to the Board resolution. The application should be accompanied by:
 - (i) an affidavit by at least two directors to the effect that the company has no assets or liabilities and that it has not been carrying on any business or operation, should be filed with the Registrar of Companies duly supported by the latest balance sheet.
 - (ii) an indemnity bond by two directors to the effect that liabilities of the company, if any, will be met by them, even after the name of the company is struck off from the register under section 560 of the Companies.
 - (c) *Notification and striking-off* : On receipt of the application, the Registrar, if satisfied about the correctness of the application as regards the basic condition stipulated in section 560 and Ministry of Corporate Affairs guidelines for striking companies off, may proceed to strike the name of company off the Register, and shall publish notice in the Official Gazette.

Answer 8(b)

According to section 293A of the Companies Act, 1956, no government company and no other company which has been in existence for less than three financial years shall contribute any amount or amounts directly or indirectly (i) to any political party, or (ii) for any political purpose to any person.

Any other company may however, contribute any amount directly or indirectly to any political party or for any political purpose to any person, provided that the aggregate of the amount so contributed by the company in any financial year shall not exceed 5% of its average net profits determined in accordance with the provisions of section 349 and 350 of the Act during the three immediately preceding financial years.

Thus, Love All Ltd., in the present case, can contribute to the recognized political party provided it is not a government company. Further, if it was registered before April 1st in the year 2009, then it would make no difference; the same provisions as stated above would be applicable. But if it was registered on or after 01 April, 2009, then since three financial years have not been completed till March 2012, it would not be able to donate as per provisions of section 293A of Companies Act, 1956.

Answer 8(c)

The principal business of Grow Fast Ltd. was acquisition of vacant plots of land and to build/erect houses. The company had entered into contract for arranging finance for the development of land to the company Ajay Ltd.

The company can do so after making alteration to the Memorandum of Association in accordance with the provisions of section 17 of the Companies Act, 1956. Section 17(1) (d) allows the alteration of the provisions of memorandum by passing special resolution if such alteration is carried out to carry on some business which under the existing circumstances may conveniently or advantageously be combined with the business of the company.

The provision in the memorandum is not sufficient which says that the company is authorized to carry on any other trade or business which can be advantageously carried on the by the company in connection with the company's general business.

The contract is not valid until alteration of memorandum as suggested above.

DRAFTING, APPEARANCES AND PLEADINGS

Time allowed : 3 hours

Maximum marks : 100

NOTE : Answer SIX questions including Question No. 1 which is **COMPULSORY**.

Question 1

- (a) "Hypothecation is an extended form of pledge." Explain the statement and make suggestions for improvement in the law of hypothecation citing case law(s). (10 marks)
- (b) Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s):
- (i) Drafting may be defined as the synthesis of _____ and _____ in a language form.
 - (ii) According to section 128 of the Indian Contract Act, 1872, the liability of the surety is _____ with that of the _____ unless it is otherwise provided by the contract.
 - (iii) In a leave and license agreement, the _____ possession of the premises is deemed to remain with the licensor and the licensee is said to be in _____ possession of the said premises.
 - (iv) A debtor cannot _____ or take advantage of non-payment of for assignment.
 - (v) Articles of association being _____ document of the company, have _____ in matters which involve dealing of the company with its own members or third parties. (2 marks each)

Answer 1(a)

"Hypothecation is an extended form of pledge"

Hypothecation is a form of transfer of property in goods. Hypothecation agreement is a document by which legal property in goods passes to the person who lends money on them, but the possession does not pass. This form of transfer is not regulated in India by any statute but hypothecation of movable property is accepted by Courts in India under general equity principles.

Hypothecation may be created orally or in writing in India. Hypothecation is an extended form of pledge. Pledge has been codified by the Indian Contract Act. Sections 172 to 176 deal with pledge of goods. A pledge is a bailment of the goods as security for payment of a debt or performance of a promise. The pawnee can retain the goods pledged as security for payment of a debt and he is also entitled to receive from the pawnor or the pledger any extra-ordinary expenses he incurs for the preservation of the goods pledged with him.

Section 176 deals with the rights of a pawnee and provides that in case of default by the pawnor, the pawnee has the right to sue upon the debt and to retain the goods as collateral security and to sell the goods after reasonable notice of

the intended sale to the pawnor. After such sale, the right of the pawnor to redeem the goods is extinguished. However, the pawnee is bound to apply the sale proceeds towards satisfaction of the debt and pay the surplus, if any, to the pawnor.

In hypothecation, the rights of the lender and the borrower are strictly governed by the terms and conditions of the hypothecation agreement executed by the parties. No assumptions can be drawn in such a case.

Hypothecation is resorted to mostly by banks and other financial institutions for securing their long-term and medium-term loans and limits of working capital, bill discounting, letters of credit and guarantees to limited companies, partnerships etc. Such lending institutions take various documents like hypothecation agreement, demand promissory note, collateral personal guarantees of managing directors, directors and other persons having substantial interest in the borrowing entities, second charge on fixed assets like land and building and plant and machinery permanently attached to land by legal or equitable mortgage and so on and so forth.

Hypothecation agreements usually cover moveable machinery, equipment, stocks of finished and semi-finished goods, raw materials, consumable stores, present and future available in factories and godowns of the borrower etc. While these items as moveable assets, remain in the possession of the borrower and he has absolute right to convert them, sell them and deal with them in any manner the borrower likes in the course of his business, the legal title vests in the lending institution by virtue of the hypothecation agreement.

In the case of *Rehaboth Traders by Partner R. ... vs. Canara Bank and Ors.* On 22 August, 1997 Madras High Court held that Hypothecation of goods is nothing but an extended form of pledge and 'to pledge' means 'to give the goods as security'. Hypothecation means pledge of goods i.e., to give goods as security without possession.

It is true that the word 'hypothecation' has not been expressly defined in the law of contracts, but the scope of the word 'hypothecation' has been explained in a number of judgements of the Honourable Apex Court, as well as various High Courts in the country. It is also true that there is no transfer of interest of property in the goods by the hypothecator to the hypothecatee. The concept of hypothecation simplicitor involves creation of an equitable charge in favour of the hypothecatee, and delivery of possession is not a sine qua non for the creation of charge. The possession of goods is always left to the hypothecator to enable him to deal with the goods, subject to the rights of the hypothecatee. In other words, the hypothecator is simplicitor an agent of the hypothecatee, the Bank is deemed to be and is always in constructive possession of the security, namely the goods hypothecated.

Answer 1(b)

- (i) Drafting may be defined as the synthesis of **law** and **fact** in a language form.
- (ii) According to section 128 of the Indian Contract Act, 1872, the liability of the surety is **co-extensive** with that of the **principal debtor** unless it is otherwise provided by the contract.

- (iii) In a lease and license agreement, the **juridical** possession of the premises is deemed to remain with the licensor and the licensee is said to be in **constructive** possession of the said premises.
- (iv) A debtor cannot **claim** or take advantage of non-payment of **consideration** for assignment.
- (v) Articles of association being **public** document of the company, have **evidentiary value** in matters which involve dealing of the company with its own members or third parties.

Question 2

(a) Explain the following :

(i) Preliminary submissions/objections in legal pleadings.

(ii) Special advantages of 'mortgage by deposit of title deeds'.

(4 marks each)

(b) What are the different forms of defence that may be adopted by a defendant while replying to opponent's pleadings ? (8 marks)

Answer 2(a)(i)

Preliminary submissions / objections in legal pleadings

While taking Preliminary submissions / objections one should ensure that the legal provisions and / or interpretation, thereof, is very clear and directly applicable to the issues involved in the matter. Thus, here an unregistered agreement / contract forms the basis of a claim set up by a party and such an agreement / contract compulsorily requires registration under Section 17 of the Registration Act, a legal plea should be taken that since the agreement / contract is not a registered document, the same could not be looked into or relied upon by the Court for the reasons that the same cannot be read in evidence. Similarly, all other legal submissions which go to the root of the controversy and which are sufficient as well as material for adjudication of the issues involved, should be taken in opposition to the claims put forth by the opponent. Some illustrations are as under:

- (i) Suit is not maintainable for want of statutory notice etc.
- (ii) Plaintiff does not disclose cause of action.
- (iii) Plaintiff has no right to sue.
- (iv) Suit barred by principles of *res judicata*.
- (v) Suit barred by principles of waiver, estoppel, acquiescence.
- (vi) Suit is barred by special enactment.
- (vii) Court has no jurisdiction.
- (viii) Suit is barred by limitation.
- (ix) Suit is premature, and so on.

Answer 2(a)(ii)**Special advantages of 'mortgage by deposit of title deeds'**

Mortgage by Deposit of Title Deeds is called in English law as equitable mortgage.

- It is created by depositing the original title deeds with the mortgagee without a formal mortgage deed. Intent to create security by deposit of title deeds should be present at the time of such deposit in the mortgagor.
- Such intention is expressed in a document known as Memorandum of Deposit of title deeds and it is executed by the mortgagor in favour of the mortgagee.
- The title deeds must be delivered in Mumbai, Chennai, Kolkata and other specified towns to which the facility is extended by a State Government from time to time through Gazette notification though the property may be located in a non notified area.
- In case of a company, the title deeds are deposited through its nominee or its authorized agent.
- In this type of mortgage, neither the ownership nor the possession is transferred to the mortgagee.
- Time barred debts as well as present and future advances can be covered under this type of mortgage.
- An important feature of this type of mortgage is that it need not be registered while all other types of mortgages are to be registered. This is a preferred type of mortgage for moneys to be lent by banks and financial institutions when they take immovable property of the borrower as a collateral security as it saves time, inconvenience of lengthy and cumbersome documentation, registration, etc.

Answer 2(b)

Forms of Defence : A defence may take the form of

- (i) a "traverse", as where a defendant totally and categorically denies the plaint allegation, or that of
- (ii) "a confession and avoidance" or "special defence", where he admits the allegations but seeks to destroy their effect by alleging affirmatively certain facts of his own, as where he admits the bond in suit but pleads that it has been paid up, or that the claim is barred by limitation, or that of
- (iii) "an objection in point of law" (which was formerly called in England "a demurrer"), e.g., that the plaint allegations do not disclose a cause of action, or that the special damages claimed are too remote.

Another plea may sometimes be taken which merely delays the trial of a suit on merits, e.g., a plea that the hearing should be stayed under Section 10, C.P.C., or that the suit has not been properly framed, there being some defect in the joinder

of parties or cause of action and the case cannot be decided until those defects are removed.

A defendant may adopt one or more of the above forms of defence, and in fact he can take any number of different defences to the same action. For example, in a suit on a bond he can deny its execution, he can plead that the claim is barred by limitation, he can plead that, as no consideration of the bond is mentioned in the plaint, the plaint does not disclose any cause of action, he can plead that the bond being stated to be in favour of two persons the plaintiff alone cannot maintain the suit. He can as well plead one form of defence to one part of the claim, and another defence to another part of it.

Question 3

- (a) *In the context of court rulings on merger, discuss and decide the following issues :*
- (i) *Can the exchange ratio approved by shareholders of the merging company be questioned by a small group of dissenting shareholders?*
 - (ii) *Is the transferring company justified in excluding assets held on lease and licence arrangement from those transferred to the transferee company ?*
 - (iii) *Whether there was contravention of section 393(l)(a) of the Companies Act, 1956 in as much as the fact that the Chartered Accountant entrusted with the valuation of the shares was a director of the amalgamating company had not been disclosed ?* (4 marks each)
- (b) *State, with reasons in brief, whether the following statements are true or false :*
- (i) *Under section 17 of the Telecom Regulatory Authority of India Act, 1997 (TRAI), as amended in 2002, a Company Secretary can appear and plead for his company's case before the TRAI Appellate Tribunal without obtaining a certificate of practice from the Institute of Company Secretaries of India.*
 - (ii) *Recitals in a deed, if ambiguous, can operate as estoppel.* (2 marks each)

Answer 3(a)(i)

In *Hindustan Lever Employees Union v. Hindustan Lever Ltd.* (1994). 4 Comp. L.J. 228 (Bom.) the court held that where the exchange ratio has been approved by an overwhelming majority of persons affected and there is no basis to doubt their judgement and valuation has been confirmed to be fair by firms of auditors the objections to the same cannot be sustained. In view of the above ruling, the exchange ratio approved by shareholders of merging companies cannot be questioned by a small group of dissenting shareholders unless it is unfair and unreasonable.

Answer 3(a)(ii)

The Supreme Court held in *Hindustan Lever Employees' Union v. Hindustan Lever Ltd.* (1995) Com., Cases 30, AIR 1995 SC 470, that the Court did not attach

importance to the fact that certain leasehold assets and properties held under licence were excluded from valuation. Such assets, the court said, were neither transferable nor heritable. They are in the nature of a personal privilege. Therefore, the transferor company is justified in excluding assets held on leave and licence arrangement, from those transferred to the transferee company.

Answer 3(a)(iii)

Under Section 393(1)(a) of the Companies Act, 1956 the explanatory statement circulated in connection with the scheme of Compromise / arrangement, should among others, set out 'any material interests of the director' and the effect on those interests, of the compromise or arrangement, if and in so far as, it is different from the effect on the like interests of other persons. The interest referred to is not simple interest but material interest. In *Hindustan Lever Employees' Union v. Hindustan Lever Ltd. and others* (1994) 4 Comp. LJ 267 (SC), the Supreme Court of India has interpreted this interest as 'interest material for consideration of the scheme by the shareholders.' The Chartered Accountant entrusted with the valuation of the shares who is also director of amalgamating company is a professional and who undertook the task as a professional has no material interest in the Scheme. He will not in any way be unduly benefitted consequent on his undertaking the assignment of valuation of the shares. Consequently, this interest which is not material interest need not be disclosed in the explanatory statement.

Answer 3(b)(i)

False

Section 17 of the Telecom Regulatory Authority of India (TRAI) Act, 1997 authorizes Company Secretary to present his case before the Appellate Tribunal. As per the Explanation appended to the section, 'Company Secretary' means a Company Secretary as defined in clause (c) of sub-section (1) of Section 2 of the Company Secretaries Act, 1980 and who has obtained a certificate of practice under sub-section (1) of Section 6 of that Act.

Answer 3(b)(ii)

True

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

Question 4

Write notes on any four of the following :

- (i) Irrevocable power of attorney*
- (ii) Amendment of the pleadings with reference to the general rule 'no pleadings, no evidence'*
- (iii) Extinction of a trust*

(iv) *Letters of authority*

(v) *Mode of transfer of actionable claims.*

(4 marks each)

Answer 4(i)

Irrevocable power of attorney

The donee of a power of attorney is an agent of the donor. If a donee himself has an interest in the matters covered by the power of attorney, which forms the subject matter thereof, the power of attorney in the absence of express contract cannot be terminated to the prejudice of such interest. In other words, agency coupled with interest cannot be terminated without the consent of the other party (Section 202 of the Indian Contract Act, 1872). Therefore, a power of attorney executed, in which the donee himself has an interest, is irrevocable. Such irrevocable powers of attorney are executed in favour of the financial institutions by a company who offer financial assistance to the latter. Through such irrevocable powers of attorney, powers are given to the financial institutions for executing a security document for securing the financial assistance in the event of a company failing to execute such a document by a certain date. Such a power of attorney will need registration.

Answer 4(ii)

Amendment to the pleadings with reference to the general rule 'no pleadings, no evidence'

The sole purpose of pleadings is to bind the parties to a stand. When the plaintiff makes certain allegations, the defendant is supposed to disclose his defence to each and every allegation specifically and state true facts to the court and once the facts are stated by both the parties, the court has to frame issues and ask the parties to lead evidence. It is settled law that the parties can lead evidence limited to their pleadings and parties while leading evidence cannot travel beyond pleadings. If the parties are allowed to lead evidence beyond pleadings then the sacrosanctity of pleadings comes to an end and the entire purpose of filing pleadings also stand defeated. The other purpose behind this is that no party can be taken by surprise and new facts cannot be brought through evidence which have not been stated by the defendant in the written statement. The law provides a procedure for amendment of the pleadings and if there are any new facts which the party wanted to bring on record, the party can amend pleadings, but without amendment of pleadings, a party cannot be allowed to lead evidence beyond pleadings.

The Supreme Court in AIR (1975) 1 SCC 212; *Harihar Prasad Singh & Ors. v. Balmiki Prasad Singh* has held that evidence adduced cannot travel beyond the pleadings. In AIR (1987) 2 SCC 555; *Ram Sarup Gupta by LRs v. Bishun Narain Inter College & Ors.*, the Supreme Court again reiterated that the evidence cannot travel beyond the pleadings.

Answer 4(iii)

Extinction of a trust

A trust is extinguished:

(a) when its purpose is completely fulfilled; or

- (b) when its purpose becomes unlawful; or
- (c) when the fulfilment of its purpose becomes impossible by destruction of the trust property or otherwise; or
- (d) when the trust, being revocable, is expressly revoked.

Answer 4(iv)

Letters of authority

Letters of authority is nothing but a power of attorney. They are executed on plain paper and not on stamp paper. Letters of authority are usually issued for collecting some documents or papers, dividend interest etc. on behalf of another. By and large, the law relating to the powers of attorney will apply to letters of authority.

Answer 4(v)

Mode of transfer of actionable claims

Section 130 of the Transfer of Property Act, 1882 lays down the mode of transfer of actionable claim. It prescribes:

- (1) The transfer of an actionable claim whether with or without consideration shall be effected only by the execution of an instrument in writing signed by the transferor or his duly authorised agent, and shall be complete and effectual upon the execution of such instrument, and thereupon all the rights and remedies of the transferor whether by way of damages or otherwise, shall vest in the transferee, whether such notice of the transfer as is hereinafter provided be given or not;
- (2) The transferee of an actionable claim may, upon the execution of such instrument of transfer as aforesaid, sue or institute proceedings for the same in his own name without obtaining the transferor's consent to such suit or proceedings, and without making him a party thereto.

Question 5

(a) *Drafting of a sale deed of immovable property requires comprehensive coverage of technicalities like offer, transfer, etc. Mention eight important covenants of sale deed of ABC Company's factory premises. (8 marks)*

(b) *Match the following :*

- | | |
|-----------------------------|------------------------------|
| (i) <i>Principal debtor</i> | (a) <i>Meetings</i> |
| (ii) <i>Del credere</i> | (b) <i>Arbitration</i> |
| (iii) <i>Award</i> | (c) <i>Written statement</i> |
| (iv) <i>Notice</i> | (d) <i>Guarantee</i> |
| (v) <i>Dilatory pleas</i> | (e) <i>Agency</i> |
| (vi) <i>Declaration</i> | (f) <i>Application</i> |
| (vii) <i>Petition</i> | (g) <i>Testatum</i> |
| (viii) <i>Deed</i> | (h) <i>Affidavit.</i> |

(1 mark each)

Answer 5(a)**Drafting of Deed of Sale of Immovable Property**

The following points are worth noting while drafting a Deed of Sale of Immovable Property:

- (1) The title to the property should first be investigated. It must be good and marketable. It is normally done by an expert in the field like an advocate or professional property consultant who should confirm that the property is free from encumbrances.
- (2) A deed of transfer of property should contain various parts. They must be complied with.
- (3) If a company is to buy an immovable property, it should be ensured that the purchase is permitted by the Memorandum and Articles of Association and its Board of Directors have passed the necessary resolution in conformity with the provisions of the Companies Act, 1956.
- (4) The other party to contract also should have the capacity to contract. If the seller is also a company, in addition to the above, the powers of the Board of Directors to sell under Section 293(1)(a) must be checked.
- (5) The property must have been purchased as a part of a legal transaction with the object being lawful and for a consideration.
- (6) The transfer deed should explain the transfer of all interests. In a sale transaction, absolute interest, i.e., right to possess, enjoy and ownership is transferred on the property along with easement right, right on rents or profits etc. The interest transferred shall not be conditional or restrictive.
- (7) The property transferred should be free from encumbrances.
- (8) Justification for transfer may be given in the document to establish bonafides and to avoid any eventuality of fraud and multiple litigation therefrom.

Answer 5(b)

Match the following:

- | | |
|----------------------|-----------------------|
| (i) Principal debtor | (d) Guarantee |
| (ii) Del credere | (e) Agency |
| (iii) Award | (b) Arbitration |
| (iv) Notice | (a) Meetings |
| (v) Dilatory pleas | (c) Written Statement |
| (vi) Declaration | (h) Affidavit |
| (vii) Petition | (f) Application |
| (viii) Deed | (g) Testatum |

Question 6

- (a) Draft a deed of sub-lease with the permission of Vijay, the original lessor between Amar (sub-lessor) and Binod (the sub-lessee) in respect of Survey No. 786, Part I, being used as agricultural land admeasuring 50 acres situated on the eastern bank of Varuna river in Varanasi District (UP) demised to the original lessor, Vijay, for a period of 30 years w.e.f. 1st January, 2012 and covenanted for renewal for three consecutive periods of 30 years each; though the sub-lease has to be initially valid for 30 years only. (12 marks)
- (b) Select the odd term out and briefly justify your answer :
- (i) (a) Deed pool; (b) deed poll; (c) indenture; (d) cyrographum.
- (ii) (a) Compromise; (b) amalgamation; (c) merger; (d) takeover.
- (2 marks each)

Answer 6(a)**Deed of Sub-Lease**

THIS LEASE made this day of(month)..... (year) between Amar of ..., etc. (hereinafter called “the sub-lessor”), of the one part, and Binod of ... , etc. (hereinafter called “the sub-lessee”), of the other part.

WHEREAS by a lease (hereinafter referred to as “the original lease”) dated 1st January, 2012 and made between Vijay as owner and Amar as lessee and registered in Book I, Vol. pages to bearing No. for the year in the Office of Sub-Registrar of etc., the premises (or, etc.) described in the original lease were demised to the said original lessee for a period of 30 years with effect from the 1st day of January, 2012 on a yearly rent and subject to the covenants and conditions to be performed and observed as therein contained.

AND WHEREAS the original lessee has agreed to grant and the sub-lessee has agreed to accept a sub-lease of the premises (or, etc.) hereinafter described upon the conditions hereinafter contained:

NOW THIS DEED WITNESSES that in consideration of the rent hereinafter reserved and the covenants by the sub-lessee hereinafter contained, the original lessee do hereby grant to the sub-lessee a lease of ALL THAT premises (or, etc.) known by the name of, etc., and situate at, etc., together with the appurtenances; TO HOLD the same unto and to use of the sub-lessee for the period of 30 years, commencing with effect from the day of at the monthly rent of Rupees SUBJECT to the following conditions:

The sub-lessee hereby agrees with and covenants with its lessor, viz., the lessee as follows:

- (a) To pay the said rent, clear of all deductions, on the..... day of..... every current month in advance during the term of the lease.
- (b) To pay all taxes and outgoings now payable or hereafter to become payable in respect of the leased premises (or, etc.).

- (c) To keep the said premises (or, etc.) in good and tenantable repair, and not to make any alteration therein without the written consent of the landlord.
- (d) To perform all the covenants, conditions and stipulations contained in the original lease affecting the property hereby leased and to be observed and performed by the original lessee except payment of rent and not to do, execute or perform any act, deed or thing or suffer anything to the contrary whereby or by reason or means whereof the original lease may be avoided or forfeited and to allow the original lessee to enter upon the leased premises (or, etc.) for the purpose of inspection of the premises and performing any of such terms of agreement contained in the original lease, which may be necessary to prevent its forfeiture.
- (e) To keep the original lessee indemnified against all actions, claims, demands and expenses on account of performance or non-performance by the sub-lessee (of any of the terms, conditions and stipulations of this agreement).

The original lessee does agree and covenant with the sub-lessee as follows:

- (a) That upon the sub-lessee paying the rent hereby reserved and observing and performing the conditions and covenants herein contained, shall quietly and peacefully possess and enjoy the property, hereby leased during the said term without any interruption and disturbance by the original lessee or any person claiming under or in trust for him, provided that in case of any breach of any of the conditions and covenants to be observed and performed by the sub-lessee, the lease shall, at the option of the original lessee, stand determined who shall be entitled to repossess the property as his former estate without prejudice to his right to recover all arrears of rent and/or any damages for breach of such conditions or covenants.
- (b) The original lessee shall duly and punctually pay the rent reserved, observe and perform all the covenants and conditions contained in the original lease, and keep the same alive and in full force and virtue and will further, at all times, keep the sub-lessee and his estate indemnified against all actions, claims, proceedings and demands on account of any breach of any of the conditions and covenants contained in the original lease.
- (c) The original lessee acknowledges the right of the sub-lessee as to production of the original lease and to delivery of copies thereof and undertakes for the safe custody thereof.

It is further agreed that the terms "the original lessee" and "sub-lessee" used herein shall, unless inconsistent with the context, include as well their respective successors and assigns.

IN WITNESS, etc.

Signed, sealed and delivered

Amar

Binod

Answer 6(b)

- (i) (b) Deed poll – Deed poll is executed by a single party, all other documents require atleast two parties for execution. Hence, this is the odd term.
- (ii) (a) Compromise – Compromise is the odd term as it is without including another company while other terms require involvement of two or more companies.

Question 7

(a) *State the ten essential ingredients of an affidavit conforming to the provisions of Order XIX, Rule 1 of the Code of Civil Procedure, 1908.*
(10 marks)

(b) *Distinguish between the following :*

- (i) *'Performance guarantee' and 'fidelity guarantee'.* (3 marks)
- (ii) *'Set-off'*

and 'counter claim' in the light of case law on counter claim.

(3 marks)

Answer 7(a)

The following rules should be remembered when drawing up an affidavit:

- (1) Not a single allegation more than is absolutely necessary should be inserted;
- (2) The person making the affidavit should be fully described in the affidavit;
- (3) An affidavit should be drawn up in the first person;
- (4) An affidavit should be divided into paragraphs, numbered consecutively, and as far as possible, each paragraph should be confined to a distinct portion of the subject;
- (5) Every person or place referred to in the affidavit should be correctly and fully described, so that he or it can be easily identified;
- (6) When the declarant speaks of any fact within his knowledge he must do so directly and positively using the words "I affirm" or "I make oath and say";
- (7) Affidavit should generally be confined to matters within the personal knowledge of the declarant, and if any fact is within the personal knowledge of any other person and the petitioner can secure his affidavit about it, he should have it filed. But in interlocutory proceedings, he is also permitted to verify facts on information received, using the words "I am informed by so and so" before every allegation which is so verified. If the declarant believes the information to be true, he must add "and I believe it to be true".
- (8) When the application or opposition thereto rests on facts disclosed in documents or copies, the declarant should state what is the source from which they were produced, and his information and belief as to the truth

of facts disclosed in such documents;

- (9) The affidavit should have oath or affirmation written out at the end.

The affidavit should have the following oath or affirmation written out at the end:

"I swear that this my declaration is true, that it conceals nothing, and that no part of it is false".

or

"I solemnly affirm that this my declaration is true, that it conceals nothing and that no part of it is false".

Any alterations in the affidavit must be authenticated by the officer before whom it is sworn.

An affidavit has to be drawn on a non-judicial Stamp Paper as applicable in the State where it is drawn and sworn.

An affidavit shall be authenticated by the deponent in the presence of an Oath Commissioner, Notary Public, Magistrate or any other authority appointed by the Government for the purpose.

- (10) Affidavits are chargeable with stamp duty under Article 4, Schedule I, Stamp Act, 1899. But no stamp duty is charged on affidavits filed or used in Courts. Such affidavits are liable to payment of Court fee prescribed for the various Courts.

Answer 7(b)(i)

'Performance guarantee' and 'fidelity guarantee'

Performance guarantee is a guarantee which ensures the contracted performance of another person and under which the surety undertakes to compensate the person in whose favour the guarantee is given, in the event of failure on the part of the person on whose behalf the guarantee is given.

Under fidelity guarantee, a surety's liability for the faithful discharge by another of his duties depends in each case on the exact terms of that guarantee. The surety is not discharged from the liability for the principal debtor's default on the ground that the default would not have happened if the creditor had used all the powers of superintending the performance of the debtor's duty. On the other hand the surety is discharged if the employer of a servant whose fidelity has been guaranteed continues to employ him even after a proved act of dishonesty without notice to the guarantor.

Answer 7(b)(ii)

'Set-off' and 'counter claim'

- (a) Set-off is for an ascertained sum or arises out of the same transaction as the plaintiff's claim. A counter claim may not arise out of the same transaction.

- (b) Set-off is a defence and as such has to be pleaded in the written statement. Counter-claim on the other hand is a weapon of offence enabling a defendant to enforce his claim against the plaintiff as effectively as in an independent action. It is a sort of cross-action. A set-off, on the other hand, can be used as a shield and not as a sword.
- (c) In the case of set-off the plaintiff in order to establish his plea of limitation has to prove that set-off was barred when the plaintiff commenced his action. In a counter-claim the plaintiff has to prove that it was barred when it was pleaded.
- (d) Set-off is a claim by the defendant in defence which exceed the plaintiff's claim. A counter claim by the defendant may, however, exceed the plaintiff's claim being in the nature of a cross-action.

Relevant case law – *Munshi Ram v. Radha Krishna*, AIR 1975 Pun. & Haryana 112.

Question 8

Examine and comment on the following :

- (a) *Applicant company's request to convene an extraordinary general meeting was rejected by the respondent company on the ground that the Company Secretary is not authorised to sign the request. The Company Law Board upheld the ground. In the light of decided case law, critically evaluate the correctness or otherwise of the decision of the Company Law Board.*
(10 marks)
- (b) *No special skills except a good knowledge of language is necessary for drafting a good legal document.*
(6 marks)

Answer 8(a)

The case is similar to that of *IFCI LTD. v. TFCI LTD.* [Del] CO.A (SB) 13/2011 & CO. APPLS. 538/2011, 564/2011, 764/2011

The decision of the Company Law Board is liable to be quashed.

Reason : The mere fact that RESPONDENT COMPANY did not reply to APPLICANT COMPANY's letter does not mean that any legal presumption can be drawn that the requisition was not authorised by the Board and/or the Company Secretary of RESPONDENT COMPANY did not have the authority to requisition the Extraordinary General Meeting. The fact is that the Board of RESPONDENT COMPANY has vide its resolution given specific authority to its Company Secretary to sign all legal documents.

Section 2(15) of the Act defines a document to include a requisition.

Consequently, if the RESPONDENT COMPANY's Board minutes are read in conjunction with Section 2(15), it is apparent that the Company Secretary of RESPONDENT COMPANY was authorised by its Board by a prior general authorisation to requisition an Extraordinary General Meeting. Also, during the course of hearing of the appeal, it was not controverted before the court that the minutes

of board meeting had been given to APPLICANT COMPANY as an annexure along with initial petition filed by the RESPONDENT COMPANY under Section 169 of the Act which was later dismissed as premature.

RESPONDENT COMPANY's subsequent board resolution passed in favour of its Company Secretary as a measure of abundant precaution did not prove that there was no prior authorisation in favour of RESPONDENT COMPANY's Company Secretary when requisition was issued.

As far as the finding of the CLB that the requisition was not signed as required under Section 169(3) of the Act is concerned, the law prescribes no particular form of the requisition.

In view of the aforesaid discussion, the reasoning given by the CLB in the impugned order is unsustainable.

Accordingly, the impugned order is ought to be set aside and the requisition as well as the Extraordinary General Meeting should be held to be legal and valid.

Answer 8(b)

The statement that, "No special skills except a good knowledge of language is necessary for drafting a good legal document" is incorrect.

Following skills are a pre-requisite for drafting legal documents, like agreements, contracts, deeds, notices, etc. between parties, clients, banks, financial institutions, employees and other constituents.

The knowledge of facts and law and analytical ability to record them in a systemized sequence to give a correct presentation of legal status, privileges, rights and liabilities and duties of the parties, terms and conditions breaches and remedies, etc. in a self contained and self explanatory form without any patent or latent ambiguity or doubtful constructions.

The draftsman should possess written communication skills to express concisely the intention of the parties clearly in technical language.

Important requirements of statute / law must be fulfilled while drafting an instrument on the subject. The draftsman should also keep his eye on the rules and case-law or the meaning of particular words and choose his phraseology to fit them. Documents are subject to interpretation when no clear meaning could be inferred by a simple reading of them. Hence, drafting must be legally perfect to avoid disputes.

GUIDELINE ANSWERS

PROFESSIONAL PROGRAMME

JUNE 2012

MODULE II



**THE INSTITUTE OF
Company Secretaries of India**
IN PURSUIT OF PROFESSIONAL EXCELLENCE
Statutory body under an Act of Parliament

GUIDELINE ANSWERS

PROFESSIONAL PROGRAMME

JUNE 2012

MODULE II



**THE INSTITUTE OF
Company Secretaries of India**

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

ICSI House, 22, Institutional Area, Lodi Road, New Delhi 110 003

Phones: 41504444, 45341000; Fax: 011-24626727

E-mail: info@icsi.edu; Website: www.icsi.edu

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

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

C O N T E N T S

Page

MODULE II

- | | |
|--|----|
| 1. Financial Treasury and Forex Management | 1 |
| 2. Corporate Restructuring and Insolvency | 20 |

(i)

NOTE: Guideline Answers of the last Six Sessions need to be updated in the light of changes and references given below:

PROFESSIONAL PROGRAMME

UPDATING SLIP

CORPORATE RESTRUCTURING AND INSOLVENCY

MODULE – II – PAPER 2

| <i>Examination Session</i> | <i>Question No.</i> | <i>Updating required in the answer</i> |
|----------------------------|---------------------|---|
| June 2009 to Dec. 2011 | — | SEBI (SAST) Regulations 1997 has been replaced by SEBI (SAST) Regulations 2011. |

PROFESSIONAL PROGRAMME EXAMINATION

JUNE 2012

FINANCIAL, TREASURY AND FOREX MANAGEMENT

Time allowed : 3 hours

Maximum marks : 100

- NOTE :** 1. Answer FIVE questions including Question No.1 which is compulsory. All working notes should be shown distinctly.
2. Tables showing the present value of ₹ 1 and the present value of an annuity of 1 for 15 years are annexed.

Question 1

Comment on **any four** of the following :

- (i) NPV decision rule does not hold true in the situation of capital rationing.
 - (ii) Risk is always associated with receivables.
 - (iii) The strategy for effective cash management in any firm has a core component of operating cycle.
 - (iv) Treasury function is supplemental and complementary to the finance function in a firm.
 - (v) Capital Asset Pricing Model (CAPM) is a tool to work out cost of equity.
- (5 marks each)

Answer 1(i)

The term capital rationing refers to the situation where the funds available to a firm are limited and a firm is not in the position to accept all positive NPV projects because of shortage of capital. Capital rationing is of two types - Hard and Soft, characterized by sources of capital expenditure constraints. Hard capital rationing occurs when constraints are externally imposed while soft rationing occurs, when constraints are imposed internally by management. As in the capital rationing NPV decision rule does not hold true, so it has to be modified. In single period rationing condition, the simple NPV decision rule is replaced by Feasibility set approach or Benefit cost ratio analysis and in multi-period capital rationing the optimal solution is obtained through linear programming.

Answer 1(ii)

Risk is always associated with receivables. The risk is related to bad debt losses and has a bearing on the profit margin, i.e., a company can bear more risk with great profit margin. Risk associated with receivables can be accounted for by adjusting either (a) the discount rate used to ascertain the present value of receivables – cost of capital or (b) the cash flow resulting from receivables. Standard deviation and co-efficient of variation are tools that may be used to determine the degree of risk associated with receivables.

Answer 1(iii)

The strategy for effective cash management in any firm has a core component

of ensuring uninterrupted supply of cash to the operating cycle. This cash is ideally generated from the cycle itself but under certain circumstances infusion of cash from outside the cycle also takes place. There are three essential elements of a successful cash management strategy:

- Realistic cash forecasting
- Speeding up collections
- Speeding out payments

Answer 1(iv)

The treasury function is supplemental and complementary to finance function. As a supplemental function, it reinforces the activities of the finance function by taking care of the finer points while the latter delineates the broad contours. As a complementary function, the treasury manager takes care of even those areas which the finance function does not touch. Looked at from this point of view, the treasury function integrates better with manufacturing and marketing functions than the finance function. This is because the treasury department of a firm is involved in more frequent interaction with other departments. For the purpose performing this role, the treasury manager operates in various financial markets including the inter-corporate market, money market, G-sec market, forex market etc.

Answer 1(v)

CAMP helps to work out required rate of return required by investors in the form of equity investment. It establishes a linear relationship between the required rate of return of a security and its β .

$$R_i = R_f + \beta (R_m - R_f)$$

= Beta of Security

$$R_f = \text{Risk free rate of return}$$

$$R_m = \text{Market rate of return}$$

The R_i calculated as above is the required rate of return of equity investors and it may be called as the cost of equity.

Question 2

- (a) During a 5 year period, the relevant results for the aggregate market are that the risk-free rate (r_f) is 8% and the return on market (r_m) is 14%. For that period, the results of five portfolio managers are as follows :

| Portfolio Manager | Actual Average Return (%) | Beta () |
|-------------------|---------------------------|----------|
| A | 13 | 0.80 |
| B | 14 | 1.05 |
| C | 17 | 1.25 |
| D | 13 | 0.90 |
| E | 15 | 0.95 |

Using CAPM model, you are required to —

- (i) Calculate the expected rate of return for each portfolio manager and compare the actual returns with the expected returns; and
- (ii) Based upon your calculations, select the portfolio manager with the best performance. (6 marks)

(b) You are given the following information :

| | |
|---|-------------|
| Spot rate (1 US \$) | = ₹ 48.0123 |
| 180 days forward rate (1 US \$) | = ₹ 48.8190 |
| Annualised interest rate for 6 months (₹) | = 12% |
| Annualised interest rate for 6 months (US \$) | = 8% |

Is there any arbitrage possibility ? If yes, how can an arbitrageur take advantage of the situation if he is willing to borrow ₹ 40,00,000 or US \$ 83,312 ? (4 marks)

(c) The following information is related to Sunrise Ltd. :

| | |
|-------------------------------|----------------------|
| | ₹ |
| Sales | 4,00,000 |
| Less : Variable expenses 35% | 1,40,000 |
| Contribution | <u>2,60,000</u> |
| Less : Fixed expenses | 1,80,000 |
| EBIT | <u>80,000</u> |
| Less: Interest Taxable income | 10,000 |
| | <u><u>70,000</u></u> |

You are required to submit the following to management of the company:

- (i) What percentage will taxable income increase, if the sales increase by 6% ? Use combined leverage. (2 marks)
 - (ii) What percentage will EBIT increase, if there is a 10% increase in sales? Use operating leverage. (1 mark)
 - (iii) What percentage will taxable income increase, if EBIT increases by 6%? Use financial leverage. (1 mark)
- (d) Priyanka Ltd. requires 2,000 units of an item annually. The cost of the item per unit is ₹ 20 and ordering cost is ₹ 50 per order. If the carrying cost is 25% of the cost of item, find the optimum lot size.

If the company purchases in lots of 1,000 or more units of the item, it gets a rebate of 3%. Should the company accept the offer ? (6 marks)

Answer 2(a)

(i) CAPM equation

$$R_i = R_f + \beta (R_m - R_f)$$

Where R_i = Expected rate of return

R_f = Risk free rate

R_m = Return on Market

β = Beta

The expected rates of return are as follows:

| Portfolio Manager | Expected Return (%) | Actual Average Return (%) | Difference between Actual & Expected Returns (%) |
|-------------------|--|---------------------------|--|
| A | $r_A = 8\% + 0.80 (14\% - 8\%) = 12.8$ | 13 | + 0.2 |
| B | $r_B = 8\% + 1.05 (14\% - 8\%) = 14.3$ | 14 | - 0.3 |
| C | $r_C = 8\% + 1.25 (14\% - 8\%) = 15.5$ | 17 | + 1.5 |
| D | $r_D = 8\% + 0.90 (14\% - 8\%) = 13.4$ | 13 | - 0.4 |
| E | $r_E = 8\% + 0.95 (14\% - 8\%) = 13.7$ | 15 | + 1.3 |

- (ii) Portfolio managers A, C and E did better than expected. A exceeded the expected return by 1.56 per cent ($0.2\% \div 12.8\%$), C exceeded the expected return by 9.68 per cent ($1.5\% \div 15.5\%$) and E bettered the expected return by 9.49 percent ($1.3\% \div 13.7\%$). Therefore, portfolio manager C showed the best performance.

Answer 2(b)

$$\text{Spot rate} = ₹ 40,00,000 / \$ 83,312 = ₹ 48.0123$$

Forward premium =

Annualized interest rate for 6 months (Rupee) = 12%

Annualized interest rate for 6 months (US\$) = 8%

Interest rate differential = 12% - 8% = 4%

Since the interest rate differential is negative in the U.S and is greater than forward premium, there is a possibility of arbitrage inflow into India.

The advantage by using Money Market arbitrage possibility can be analyzed as follows:

Step I

Borrow \$ 83,312 for 6 months

Amount repayable after 6 months along with interest

$$= \$ 83,312 + (\$ 83,312 \times 8/100 \times 6/12) = \$ 86,644.48$$

Step II

Convert \$ 83,312 into Rupees and get the principal amount of ₹ 40,00,000 deposited @12% for 6 months

Total amount at the end of 6 months = ₹ 40,00,000 + ₹ 2,40,000 = ₹42,40,000

Step III

Converting the total amount at forward rate and repay the \$ borrowing

$$= ₹ \frac{42,40,000}{48.8190}$$

$$= \$ 86,851.43$$

∴ Net gain

$$= (\$86,851.43 - \$ 86,644.48)$$

$$= \$206.95$$

Answer 2(c)

(i) The combined leverage on sales of ₹ 4,00,000 of Sunrise Ltd.

$$= 3.714$$

If sales increased by 6 per cent the taxable income will increase by $3.714 \times 0.06 = .22284 = 22.28\%$

(ii) The degree of operating leverage at sales level of ₹ 4,00,000

$$\frac{\text{Contribution}}{\text{Taxable Income}} = \frac{2,60,000}{70,000} \quad \frac{\text{Contribution}}{\text{Operating Income}} = \frac{2,60,000}{80,000} = 3.25$$

If sales increase by 10 per cent the EBIT will increase by $3.25 \times 0.10 = 0.325 = 32.5\%$

(iii) Degree of financial leverage

$$\frac{\text{EBIT}}{\text{Taxable Income}} = \frac{80,000}{70,000} = 1.143$$

If EBIT, increases by 6 percent taxable income will increase by $1.143 \times 0.06 = 0.686 = 6.86\%$.

Answer 2(d)

The following information of Priyanka Ltd is given:

A = Total annual requirement for the item – 2,000 units

B = Ordering cost per order of that item – ₹ 50

C = Carrying cost per unit per annum – ₹ 20 x .25 = ₹ 5

$$\text{EOQ} = \sqrt{\frac{2AB}{C}}$$

$$= \sqrt{\frac{2 \times 2,000 \times ₹ 50}{₹ 5}} = 200 \text{ units}$$

Company Opts for EOQ

$$\begin{aligned} \text{Total cost} &= \text{Purchase cost} + \text{Ordering cost} + \text{Carrying cost} \\ &= 2,000 \times ₹ 20 + 2,000/200 \times ₹ 50 + 200/2 \times ₹ 5 \\ &= ₹ 40,000 + ₹ 500 + ₹ 500 = ₹ 41,000 \end{aligned}$$

When company purchases in lot of 1,000 units

$$\begin{aligned} \text{Total cost} &= ₹ 2,000 \times ₹ 20 \times .97 + 2,000/1,000 \times ₹ 50 + 1000/2 \times ₹ 5 \times .97 \\ &= ₹ 38,800 + ₹ 100 + ₹ 2,425 = ₹ 41,325 \end{aligned}$$

Since the total cost in second case is higher than the cost when company purchases in economic lot size, the company should not accept the offer.

Question 3

- (a) *Maxwell Ltd. is operating in electronic equipments development and its sales and earnings before interest and taxes for the current year were ₹70,00,000 and ₹ 18,00,000 respectively. During the year, interest expense was ₹ 16,000 and preference dividend was ₹ 20,000. These fixed charges are expected to continue for the next year. The company is thinking to diversify its operations which will require ₹ 7,00,000 and is expected to increase EBIT by ₹ 4,00,000 to ₹ 22,00,000.*

The company has the following three financing alternatives under its consideration :

Alternative-1 : Issue 10,000 equity shares at ₹ 70 per share. The company has currently 80,000 shares of common stock outstanding.

Alternative-2 : Issue ₹ 7,00,000, 15 years 15% debentures. Sinking fund payments on these debentures will commence after 15 years.

Alternative-3 : Issue ₹ 7,00,000, 14% preference shares.

You are required to calculate —

- (i) The EPS at the expected earnings before interest and taxes level of ₹ 22,00,000 for each financing alternative.*
- (ii) The equivalency level of earnings before interest and taxes between the debt and common stock alternatives.*
- (iii) The equivalency level of earnings before interest and taxes between the preference shares and common stock alternatives.*

Assume 30% income-tax rate.

(12 marks)

- (b) *Identify the profit or loss (ignoring dealing cost and interest) in each of the following cases :*

- (i) A put option with exercise price of ₹ 250 is bought for a premium of ₹ 42. The price of underlying share is ₹ 189 at the expiry date.*

(ii) A put option with an exercise price of ₹ 300 is written for a premium of ₹ 57. The price of the underlying share is ₹ 314 at the expiry date. (4 marks)

(c) Sawan Ltd. currently has sales of ₹ 30,00,000 with an average collection period of two months. At present, no discounts are offered to the customers. The management of the company is thinking to allow a discount of 2% on cash sales which will result as under :

(i) The average collection period would reduce to one month.

(ii) 50% of customers would take advantage of 2% discount.

The company would normally require a 25% return on its investment. Advise the management whether to extend the discount on cash sales. (4 marks)

Answer 3(a)

(i) Determination of EPS at EBIT level of ₹ 22,00,000

Financing plan

| | (a) | (b) | (c) |
|--------------------------------------|-------------------|----------------|------------------|
| | Equity Shares (₹) | Debentures (₹) | Pref. Shares (₹) |
| EBIT | 22,00,000 | 22,00,000 | 22,00,000 |
| Less : Interest | 16,000 | 1,21,000 | 16,000 |
| Taxable Income | 21,84,000 | 20,79,000 | 21,84,000 |
| Less : Tax 30% | 6,55,200 | 6,23,700 | 6,55,200 |
| EAT | 15,28,800 | 14,55,300 | 15,28,800 |
| Less : Dividend on Pref. Shares | 20,000 | 20,000 | 1,18,000 |
| Earnings available for equity shares | 15,08,800 | 14,35,300 | 14,10,800 |
| Number of Equity Shares | 90,000 | 80,000 | 80,000 |
| EPS (₹) | 16.76 | 17.94 | 17.64 |

(ii) Equivalency level of Earnings between equity & debt

$$\frac{(X - I_1)(1 - t) - P_1}{N_1} = \frac{(X - I_1 - I_2)(1 - t) - P_1}{N_2}$$

$$\frac{(X - ₹ 16,000)(1 - .03) - ₹ 20,000}{90,000} = \frac{(X - ₹ 16,000 - ₹ 1,05,000)(1 - .03) - ₹ 20,000}{80,000}$$

$$\frac{0.7 X - ₹ 11,200 - ₹ 20,000}{90,000} = \frac{0.7 X - ₹ 11,200 - ₹ 73,500 - ₹ 20,000}{80,000}$$

$$\frac{0.7 X - ₹ 31,200}{90,000} = \frac{0.7 X - ₹ 1,04,700}{80,000}$$

$$8 (0.7 X - ₹ 31,200) = 9(0.7 X - ₹ 1,04,700)$$

$$5.6 X - ₹ 2,49,600 = 6.3 X - ₹ 9,42,300$$

$$5.6 X - 6.3 X = - ₹ 9,42,300 + ₹ 2,49,600$$

$$-.7X = - ₹ 6,92,700$$

$$X = ₹ \frac{6,92,700}{.7} = ₹ 9,89,571$$

(iii) Equivalency level between Preferred Stock and Common Stock

$$\frac{(X - I_1)(1 - t) - P_1 - P_2}{N_1} = \frac{(X - I_1)(1 - t) - P_1}{N_2}$$

$$\frac{(X - ₹ 16,000)(1 - .03) - ₹ 20,000 - ₹ 98,000}{80,000} = \frac{(X - ₹ 16,000)(1 - .03) - ₹ 20,000}{90,000}$$

$$\frac{0.7 X - ₹ 11,200 - ₹ 1,18,000}{90,000} = \frac{0.7 X - ₹ 11,200 - ₹ 20,000}{90,000}$$

$$\frac{0.7 x - ₹ 1,29,200}{80,000} = \frac{0.7 x - ₹ 31,200}{90,000}$$

$$9(0.7 X - ₹ 1,29,200) = 8(0.7 X - ₹ 31,200)$$

$$6.3 X - ₹ 11,62,800 = 5.6 X - ₹ 2,49,600$$

$$6.3 X - 5.6X = - ₹ 2,49,600 + ₹ 11,62,800$$

$$.7X = ₹ 9,13,200$$

$$X = ₹ \frac{9,13,200}{.7}$$

$$= ₹ 13,04,571$$

Answer 3(b)

| | | | |
|----------------------------------|-------------|--------|--------------|
| (i) Exercise price of Put Option | | ₹ 250 | |
| Less : | | | |
| Price of the Underlying | | | |
| Shares at the expiry date | ₹ 189 | | |
| Premium Paid | <u>₹ 42</u> | | <u>₹ 231</u> |
| | | Profit | ₹ 19 |

i.e. a profit of ₹ 19 per contract purchased.

- (ii) Exercise Price = ₹ 300, put option is written on exercise price for a premium of ₹ 57.

On the expiry date, the put option will not be exercised against the investor. Profit position would be equal to the amount of premium received i.e. ₹ 57

Answer 3(c)

Sales = ₹ 30,00,000

Average Collection Period = 2 months

Evaluation of Cash Discount Proposal of Sawan Ltd.

| | | |
|---|---|------------|
| Current Debtors (₹ 30,00,000 x 2/12) | = | ₹ 5,00,000 |
| Debtors under new proposal (₹ 30,00,000 x 1/12) | = | ₹ 2,50,000 |
| ∴ Reduction of Investment in Debtors | = | ₹ 2,50,000 |

Discount of 2% offered on Cash Sales and 50% customers would take advantage of the discount

Discount to be offered = ₹ 30,00,00 x 50/100 x 2/100 = ₹ 30,000

Increase in profit due to decrease in debtors or reduction in investment in debtors = ₹ 2,50,000 x 25/100 = ₹ 62,500

Net Increase in profit = Increase in profit – Discount Offered
= ₹ 62,500 – ₹ 30,000 = ₹ 32,500

Advise to management

It is advised to offer the 2% discount on cash sales which will result in increase in profit by ₹ 32,500.

Question 4

Distinguish between any four of the following :

- (i) 'Financial distress' and 'insolvency'.
- (ii) 'Open ended mutual funds' and 'close ended mutual funds'.
- (iii) 'Accounting exposure' and 'economic exposure'.

(iv) 'Semi-strong form of efficient market hypothesis' and 'strong form of efficient market hypothesis'.

(v) 'Factoring' and 'bill discounting'. (5 marks each)

Answer 4(i)

'Financial distress' and 'insolvency'

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

Answer 4(ii)

'Open Ended Mutual Funds' and 'Close Ended Mutual Funds'

| Open Ended Mutual Funds | Close Ended Mutual Funds |
|---|--|
| 1. Variable corpus due to on going purchase and redemption. | Fixed Corpus : No new units can be offered beyond the limit. |
| 2. No listing on exchange transactions done directly with the fund. | Listed on stock exchange for buying and selling or dealings |
| 3. Only NAV is available as one price. | Two values are available viz.: NAV and the market trading price. |
| 4. Highly liquid. | Mostly liquid. |

Answer 4(iii)

'Accounting Exposure' and Economic Exposure'

Accounting Exposure : Accounting exposure is also called Translation Exposure or balance sheet exposure. It is basically the exposure on the assets and liabilities shown in the balance sheet and which are not going to be liquidated in the near future. It refers to the probability of loss that the firm may have to face because of decrease in value of assets due to devaluation of a foreign currency despite the fact that there was no foreign exchange transaction during the year.

Economic Exposure : Economic exposure measures the probability that fluctuations in foreign exchange rate will affect the value of the firm. The intrinsic

value of a firm is calculated by discounting the expected future cash flows with appropriate discounting rate. The risk involved in economy exposure requires measurement of the effect of fluctuations in exchange rate on different future cash flows.

Answer 4(iv)

Semi strong Form of Efficient Market Hypothesis – This form says that the current market price is a reflection of historical information plus publicly available knowledge about the company. It maintains that as soon as the information becomes publicly available, it is absorbed and reflected in current prices. An analyst and an investor are similar placed in so far as making use the information is concerned. Thus an analyst can not obtain better returns than an ordinary investor.

Strong Form of Efficient Market Hypothesis – According to strong form, not only is the publicly available information useless to the analyst or the investor, but all information is useless. No information, whether public or inside information can be used to earn better return than the market.

Answer 4(v)

‘Factoring’ and ‘Bill Discounting’

- (a) Under a bill discounting arrangement, the drawer undertakes the responsibility of collecting the bills and remitting the proceeds to the financing agency. On the other hand, under factoring agreement, the factor collects client’s bills.
- (b) Bill discounting is always with recourse whereas factoring can be either with recourse or without recourse.
- (c) The finance house discounting bills does not offer any non-financial services unlike a factor which finances and manages the receivable of a client.

Question 5

- (a) Vivek is holding 1,000 shares of Right Choice Ltd. The current rate of dividend paid by the company is ₹ 5 per share and the share is being sold at ₹ 50 per share in the market. However, several factors are likely to change during the course of the year as indicated below :

| | Existing | Revised |
|----------------------|----------|---------|
| Risk free rate | 14% | 12% |
| Market risk premium | 8% | 6% |
| Beta () value | 1.42 | 1.27 |
| Expected growth rate | 6% | 10% |

In view of above factors, whether Vivek should buy, hold or sell the shares and why ? (6 marks)

- (b) Ruta Max Ltd. and Buta Max Ltd. operate in the same risk class and are identical in all respect except that Ruta Max Ltd. uses debt financing while Buta Max Ltd. does not opt for debt financing.

Ruta Max Ltd. has ₹ 25,00,000 debentures carrying coupon rate of 10%. Both the companies earn 20% profit before interest and taxes on their total assets of ₹ 50 lakh. Assume perfect capital markets and rational investors and so on. The capitalisation rate for an all equity company is 15%. The corporate tax rate is 30%.

You are required to compute the value of both companies according to net income (NI) and net operating income (NOI) approach. (8 marks)

- (c) Touch Wood Ltd. has a portfolio of capital projects which yield an average expected rate of return of 15% per annum. This return is subject to risk and this is estimated as a standard deviation of probabilities of expected returns of 2.5%. The risk free rate of interest is 6% per annum. Three projects have come up for consideration by Board of directors and these are designated as project A, B and C. Details of the estimates made for them appear below :

| | Project | | |
|---|---------|-------|-------|
| | A | B | C |
| Expected return (%) | 12 | 10 | 8 |
| Risk (standard deviation of probability distribution) | 1% | 1.4% | 2.4% |
| Co-efficient of correlation of project returns with portfolio returns | +0.58 | +0.94 | - 0.1 |

Determine in each case whether you would recommend acceptance of the project. Since all the three projects promise a yield less than the expected on the current portfolio, one member of Board of directors asks why they should be considered at all. How would you answer him ? (6 marks)

Answer 5(a)

The expected rate of return can be calculated by applying the CAPM as follows :

$$K_e = R_f + \beta (R_m - R_f)$$

$$\text{Existing Rate of Return} = 14\% + 1.42 (8\%) = 14\% + 11.36\% = 25.36\%$$

$$\text{Revised Rate of Return} = 12\% + 1.27 (6\%) = 12\% + 7.62\% = 19.62\%$$

$$\text{Original Share Price } P_o =$$

$$\text{Or } \frac{5 (1.06)}{.2536 - 0.06} = \frac{5.30}{.1936} = ₹ 27.38$$

$$\text{Revised Share Price } P_o = \frac{D(1+g)}{K_e - g} = \frac{5 (1+10\%)}{.1962 - .10}$$

$$\text{Or } \frac{5(1.10)}{.1962 - .10} = \frac{5.5}{.0962} = ₹ 57.17$$

Comment :

- (i) Under the growth rate of 6% the share price is expected to be ₹ 27.38 but the existing share price is ₹ 50 which is over priced. If the growth rate remains same at 6% under equilibrium process it is expected that share price will fall from ₹ 50 to ₹ 27.38. So sell the stock.
- (ii) Under the revised growth rate of 10% the expected share price is ₹ 57.17. The current market price is ₹ 50. So Mr. Vivek can hold the share for further price rise.

Answer 5(b)

(i) Value of firm under Net Income Approach

| | Ruta Max Ltd. (₹) (Levered firm) | Buta Max Ltd. (₹) (Unlevered firm) |
|--|-------------------------------------|---------------------------------------|
| EBIT (20% OF 50 Lakh) | 10,00,000 | 10,00,000 |
| Less : Interest | 2,50,000 | — |
| | <u>7,50,000</u> | <u>10,00,000</u> |
| Less : Taxes 30% | 2,25,000 | 3,00,000 |
| EAT or Profit available for shareholders | <u>5,25,000</u> | <u>7,00,000</u> |
| Equity Capitalization Rate | .15 | .15 |
| Market Value of Equity EAT/ K_e | 35,00,000 | 46,66,666 |
| Market Value of Debt (K_d) | 25,00,000 | — |
| Total Value of Firm | <u>60,00,000</u> | <u>46,66,666</u> |

(ii) Value of firm under Net Operating Income Approach

Value of Buta Max Ltd. (Unlevered firm)

$$= \frac{\text{EBIT}(1-t)}{K_e} = \frac{10,00,000(1-.30)}{.15} = ₹ 46,66,666$$

Value of Ruta Max Ltd. (Levered firm)

$$\begin{aligned} &= \text{Value of Unlevered firm} + D(t) \\ &= 46,66,666 + 25,00,000 (.3) \\ &= 46,66,666 + 7,50,000 = ₹ 54,16,666 \end{aligned}$$

Answer 5(c)

Determination of β for each project of Touch Wood Ltd. using formula

$\beta = \text{Corr}_{pi} \times S_i/S_p$ where Corr_{pi} = Coefficient of correlation of projects returns with portfolio return

S_i = S. D. of probability distribution

S_p = S.D of probabilities of expected return

| For A | For B | For C |
|---------------------------------|-----------------------------------|-----------------------------------|
| $\beta = 0.58 \times 1\%/2.5\%$ | $\beta = 0.94 \times 1.4\%/2.5\%$ | $\beta = -0.1 \times 2.4\%/2.5\%$ |
| $= 0.232$ | $= 0.526$ | $= -0.096$ |

Calculation of risk premium on present portfolio of Touch Wood Ltd

$$R_f + R_p = 15$$

$$R_p = 15\% - 6\% = 9\%$$

$$\text{For A} = R_f + \beta R_p = 6\% + (.232 \times 9\%) = 8.09\%$$

$$\text{For B} = R_f + \beta R_p = 6\% + (.526 \times 9\%) = 10.73\%$$

$$\text{For C} = R_f + \beta R_p = 6\% + (-.096 \times 9\%) = 5.14\%$$

| Project | Required rate of return (%) | Expected rate of return (%) | Decision |
|-------------------|-----------------------------|-----------------------------|---------------|
| A | 8.09 | 12 | Accept |
| B | 10.73 | 10 | Reject |
| C | 5.14 | 8 | Accept |
| | | <i>Risk</i> | <i>Return</i> |
| Current Portfolio | | 2.5% | 15% |
| Project A | | 1% | 12% |
| Project C | | 2.4% | 8% |

Risk and Return of current portfolio is 2.5% and 15% respectively. Project A is giving 12 % return with 1% risk. Project C is giving 8% return with the risk of 2.4% which is equivalent to current portfolio. As project A is giving higher return with lesser risk, it is recommended to consider project A, although considering the expected rate of return both Project A and C can be accepted.

Question 6

Ice Decor Ltd. sells goods at a uniform rate of gross profit of 20% on sales including depreciation as part of cost of production. Its annual figures for the current year are as under:

| | ₹ |
|---|-----------|
| <i>Sales (at 2 months' credit)</i> | 24,00,000 |
| <i>Materials consumed (suppliers' credit 2 months)</i> | 6,00,000 |
| <i>Wages paid (monthly at the beginning of the subsequent month)</i> | 4,80,000 |
| <i>Manufacturing expenses (cash expenses are paid — one month in arrear)</i> | 6,00,000 |
| <i>Administration expenses (cash expenses are paid — one month in arrear)</i> | 1,50,000 |
| <i>Sales promotion expenses (paid quarterly in advance)</i> | 75,000 |

The company keeps one month stock each of raw materials and finished goods. A minimum cash balance of ₹ 80,000 is always kept. The company wants to adopt a 10% safety margin in the maintenance of working capital. The company has no work-in-progress.

Find out the requirement of working capital of the company on cash cost basis. (20 marks)

Answer 6

Working Notes

| | | |
|--|----------|--------------------|
| (i) Total Manufacturing Expenses : | | ₹ |
| Sales | | 24,00,000 |
| Less : Gross profit (20%) | | <u>4,80,000</u> |
| Manufacturing Cost | | 19,20,000 |
| Less : Materials | 6,00,000 | |
| Wages | 4,80,000 | <u>10,80,000</u> |
| Manufacturing expenses | | = <u>8,40,000</u> |
| (ii) Cash manufacturing expenses | | ₹ 6,00,000 |
| (iii) Depreciation (₹ 8,40,000 – 6,00,000) | | ₹ 2,40,000 |
| (iv) Cost of Sales (cash expenses) | | |
| Manufacturing cost | | 19,20,000 |
| Less : Depreciation | | <u>2,40,000</u> |
| Cash cost of manufacture | | 16,80,000 |
| Add : Administration expenses | | 1,50,000 |
| Sales promotion expenses | | <u>75,000</u> |
| Total Cash cost | | = <u>19,05,000</u> |
| (v) Cash in Hand | | ₹ 80,000 |

Computation of Working Capital

| | | |
|---|-----|-----------------|
| Current Assets | | ₹ |
| Debtors (₹ 19,05,000/6) | | 3,17,500 |
| Sales promotion expenses prepaid (₹ 75,000/4) | | 18,750 |
| Raw Materials (₹ 6,00,000/12) | | 50,000 |
| Finished Goods (₹ 16,80,000/12) | | 1,40,000 |
| Cash in Hand | | <u>80,000</u> |
| | (A) | <u>6,06,250</u> |
| Current Liabilities | | ₹ |
| Sundry Creditors (₹ 6,00,000/6) | | 1,00,000 |
| Manufacturing Expenses (₹ 6,00,000/12) | | 50,000 |
| Administration Expenses (₹ 1,50,000/12) | | 12,500 |
| Wages Due (₹ 4,80,000/12) | | <u>40,000</u> |
| | (B) | <u>2,02,500</u> |

| | | |
|---|-----------|-----------------|
| <i>Working Capital :</i> | (A) – (B) | 4,03,750 |
| <i>Add : 10% for safety margin</i> | | <u>40,375</u> |
| <i>∴ Working Capital Requirement (on cash cast basis)</i> | = | <u>4,44,125</u> |

Question 7

Write notes on any four of the following :

- (i) External commercial borrowings*
 - (ii) Financial viability of a project*
 - (iii) Counter party risk*
 - (iv) Optimal capital structure*
 - (v) Zero coupon convertible notes.*
- (5 marks each)*

Answer 7(i)**External Commercial Borrowings (ECB)**

External Commercial Borrowing are one of the modes for sourcing of funds for corporates. External Commercial Borrowings (ECB) include commercial bank loans, buyer's credit, suppliers credit, securitized instruments such as floating rate notes and fixed rate bonds. ECB can be accessed under two routes, viz., (i) Automatic Route and (ii) Approval Route. ECB for investment in real sector-industrial sector, infrastructure sector-in India, and specific service sectors are under Automatic Route, i.e. do not require the Reserve Bank / Government of India approval. In case of doubt as regards eligibility to access the Automatic Route, applicants may take recourse to the Approval Route.

Answer 7(ii)**Financial viability of a project**

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

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

Answer 7(iii)**Counter Party Risk**

Counter Party risk means that there is an ever present risk of the other party not being able to honour its commitment. Counter party risk arises :

- (i) From the variation in the quantity of goods, place of delivery, price or*
- (ii) When one of the parties of forward contract goes bankrupt.*

There is a counterparty risk in forward transactions because these transactions

are bilateral and not exchange traded. Both the parties are subject to the risk of default by the other party.

Answer 7(iv)

Optimal Capital Structure

By the term optimal capital structure we mean a particular arrangement of various components of the structure (Debt and Equity) which is just in tune with the both the long term and short term objectives of the firm. A combination less or more than the optional combination would be less than satisfying. Hence a sub-optimal combination would affect the achievement of the goal of maximization of the shareholders' wealth. Optimal capital structure is an ideal situation which can function as the benchmark of performance for a firm. But this benchmark is invincible and the firm can expect to achieve moderated or toned down versions of this benchmark depending upon dynamics of each project.

Answer 7(v)

Zero Coupon Convertible Notes

These are debt securities convertible into equity shares of the issuer. If investors choose to convert, they get equity shares in the company. These convertibles are generally issued with put option to the investors. The advantage to the issuer is the raising of funds without immediate dilution of equity.

The investor gains in the event of appreciation in the value of the equity shares. Even if the appreciation does not materialize, the investor has the benefit of a steady stream of implied income. If the instrument is issued with put option, the investor can resell the securities to the issuer.

TABLE - 2 : PRESENT VALUE OF AN ANNUITY OF RUPEE ONE

| RATE | YEAR | YEAR | YEAR | YEAR | YEAR | YEAR | YEAR | YEAR | YEAR | YEAR | YEAR | YEAR | YEAR | YEAR | YEAR | YEAR | YEAR | YEAR | YEAR | YEAR |
|------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------|------|------|------|------|------|
| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 | | | | | |
| 5% | 0.9524 | 1.8594 | 2.7232 | 3.5460 | 4.3295 | 5.0757 | 5.7864 | 6.4632 | 7.1078 | 7.7217 | 8.3064 | 8.8633 | 9.3936 | 9.8986 | 10.3797 | | | | | |
| 6% | 0.9434 | 1.8334 | 2.6730 | 3.4651 | 4.2124 | 4.9173 | 5.5824 | 6.2098 | 6.8017 | 7.3601 | 7.8869 | 8.3838 | 8.8527 | 9.2950 | 9.7122 | | | | | |
| 7% | 0.9346 | 1.8080 | 2.6243 | 3.3872 | 4.1002 | 4.7665 | 5.3893 | 5.9713 | 6.5152 | 7.0236 | 7.4987 | 7.9427 | 8.3577 | 8.7455 | 9.1079 | | | | | |
| 8% | 0.9259 | 1.7833 | 2.5771 | 3.3121 | 3.9927 | 4.6229 | 5.2064 | 5.7466 | 6.2469 | 6.7101 | 7.1390 | 7.5361 | 7.9038 | 8.2442 | 8.5595 | | | | | |
| 9% | 0.9174 | 1.7591 | 2.5313 | 3.2397 | 3.8897 | 4.4859 | 5.0330 | 5.5348 | 5.9952 | 6.4177 | 6.8052 | 7.1607 | 7.4869 | 7.7862 | 8.0607 | | | | | |
| 10% | 0.9091 | 1.7355 | 2.4869 | 3.1699 | 3.7908 | 4.3553 | 4.8684 | 5.3349 | 5.7590 | 6.1446 | 6.4951 | 6.8137 | 7.1034 | 7.3667 | 7.6061 | | | | | |
| 11% | 0.9009 | 1.7125 | 2.4437 | 3.1024 | 3.6959 | 4.2305 | 4.7122 | 5.1461 | 5.5370 | 5.8892 | 6.2065 | 6.4924 | 6.7499 | 6.9819 | 7.1909 | | | | | |
| 12% | 0.8929 | 1.6901 | 2.4018 | 3.0373 | 3.6048 | 4.1114 | 4.5638 | 4.9676 | 5.3282 | 5.6502 | 5.9377 | 6.1944 | 6.4235 | 6.6282 | 6.8109 | | | | | |
| 13% | 0.8850 | 1.6681 | 2.3612 | 2.9745 | 3.5172 | 3.9975 | 4.4226 | 4.7988 | 5.1317 | 5.4262 | 5.6869 | 5.9176 | 6.1218 | 6.3025 | 6.4624 | | | | | |
| 14% | 0.8772 | 1.6467 | 2.3216 | 2.9137 | 3.4331 | 3.8887 | 4.2883 | 4.6389 | 4.9464 | 5.2161 | 5.4527 | 5.6603 | 5.8424 | 6.0021 | 6.1422 | | | | | |
| 15% | 0.8696 | 1.6257 | 2.2832 | 2.8550 | 3.3522 | 3.7845 | 4.1604 | 4.4873 | 4.7716 | 5.0188 | 5.2337 | 5.4206 | 5.5831 | 5.7245 | 5.8474 | | | | | |
| 16% | 0.8621 | 1.6052 | 2.2459 | 2.7982 | 3.2743 | 3.6847 | 4.0386 | 4.3436 | 4.6065 | 4.8332 | 5.0286 | 5.1971 | 5.3423 | 5.4675 | 5.5755 | | | | | |
| 17% | 0.8547 | 1.5852 | 2.2096 | 2.7432 | 3.1993 | 3.5892 | 3.9224 | 4.2072 | 4.4506 | 4.6586 | 4.8364 | 4.9884 | 5.1183 | 5.2293 | 5.3242 | | | | | |
| 18% | 0.8475 | 1.5656 | 2.1743 | 2.6901 | 3.1272 | 3.4976 | 3.8115 | 4.0776 | 4.3030 | 4.4941 | 4.6560 | 4.7932 | 4.9095 | 5.0081 | 5.0916 | | | | | |
| 19% | 0.8403 | 1.5465 | 2.1399 | 2.6386 | 3.0576 | 3.4098 | 3.7057 | 3.9544 | 4.1633 | 4.3389 | 4.4865 | 4.6105 | 4.7147 | 4.8023 | 4.8759 | | | | | |
| 20% | 0.8333 | 1.5278 | 2.1065 | 2.5887 | 2.9906 | 3.3255 | 3.6046 | 3.8372 | 4.0310 | 4.1925 | 4.3271 | 4.4392 | 4.5327 | 4.6106 | 4.6755 | | | | | |
| 21% | 0.8264 | 1.5095 | 2.0739 | 2.5404 | 2.9260 | 3.2446 | 3.5079 | 3.7256 | 3.9054 | 4.0541 | 4.1769 | 4.2784 | 4.3624 | 4.4317 | 4.4890 | | | | | |
| 22% | 0.8197 | 1.4915 | 2.0422 | 2.4936 | 2.8636 | 3.1669 | 3.4155 | 3.6193 | 3.7863 | 3.9232 | 4.0354 | 4.1274 | 4.2028 | 4.2646 | 4.3152 | | | | | |
| 23% | 0.8130 | 1.4740 | 2.0114 | 2.4483 | 2.8035 | 3.0923 | 3.3270 | 3.5179 | 3.6731 | 3.7993 | 3.9018 | 3.9852 | 4.0530 | 4.1082 | 4.1530 | | | | | |
| 24% | 0.8065 | 1.4568 | 1.9813 | 2.4043 | 2.7454 | 3.0205 | 3.2423 | 3.4212 | 3.5655 | 3.6819 | 3.7757 | 3.8514 | 3.9124 | 3.9616 | 4.0013 | | | | | |
| 25% | 0.8000 | 1.4400 | 1.9520 | 2.3616 | 2.6893 | 2.9514 | 3.1611 | 3.3289 | 3.4631 | 3.5705 | 3.6564 | 3.7251 | 3.7801 | 3.8241 | 3.8593 | | | | | |

CORPORATE RESTRUCTURING AND INSOLVENCY

Time allowed : 3 hours

Maximum marks : 100

NOTE : All references to sections relate to the Companies Act, 1956 unless stated otherwise.

PART A

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

Question 1

- (a) It is believed that 'strategy' is a tactical and flexible way of resolving routine and non-routine issues in the corporate world. In this connection, Henry Mintzberg has enunciated 5Ps of strategy. Briefly explain these 5Ps within a maximum limit of 20 words each. (5 marks)
- (b) What is meant by 'strategic alliance' and what are its features ? (5 marks)
- (c) "A conglomerate merger is neither a type of horizontal merger nor a vertical merger." Discuss. (5 marks)
- (d) State whether the following statements are true or false citing relevant provisions of the law :
- (i) Scheme of amalgamation which is not approved at a meeting by the requisite majority, but is subsequently approved by individual affidavits is deemed to be validly approved.
 - (ii) The resolution granting approval to the scheme of arrangement is passed by creditors with more than 3/4ths in value, but not by creditors majority in number. The scheme would be deemed to be disapproved and court can disapprove the scheme on this ground.
 - (iii) Court is not bound to order convening meeting of shareholders/creditors for their approval on scheme of amalgamation which prima facie looks to be illegal, contrary to the public policy and unfair in its opinion.
 - (iv) Court cannot sanction a scheme of amalgamation where order of winding-up has been made and a liquidator has been appointed.
 - (v) Any scheme of compromise or arrangement approved by the majority of creditors shall be binding on all the creditors even prior to the approval of the court and individual creditors shall not be entitled to file separate individual application. (2 marks each)

Answer 1(a)

'Strategy' is a tactical, flexible way of solving routine and non-routine issues, implementing the policy smoothly. 'Strategy' is the very soul of any action and therefore every executive and owner needs to be a 'strategist'. Famous strategy thinker, Henry Mintzberg has enunciated 5 Ps of strategy viz.—

- (i) Plan is strategy, a conscious course of action which a firm chooses to follow after careful deliberations on the various options available to it.

- (ii) Ploy is a specific manoeuvre which is intended to outwit an opponent or a competition. It is a device, a scheme to gain advantageous position.
- (iii) Pattern is not one decision and one action; it stands for a stream of decisions and actions to guide and tend the future course of the enterprise until it reaches its predetermined corporate objectives.
- (iv) Position is a means of locating the firm in an environment that helps in developing core competence analysis resulting in sustainable competitive advantage.
- (v) Perspective is an ingrained way of perceiving the world around the organisation and its business operations. It is greatly influenced by the mindset of people who especially form the dominant interest group and are involved in taking decisions affecting the future course that the firm takes.

Answer 1(b)

Any arrangement or agreement under which two or more parties co-operate in order to achieve certain commercial objectives while remaining independent organisations is called a strategic alliance. Thus, a strategic alliance is a partnership between firms whereby resources, capabilities and core competencies are combined to pursue mutual interests.

The following are the features of strategic alliances:

- Strategic alliances are often motivated by considerations such as reduction in cost, technology sharing, product development, market access to capital.
- Strategic alliances facilitate a market entry strategy, which maximises the potential for high return while mitigating economic risks and other exposures.
- Strategic alliance is gaining importance in infrastructure sectors, more particularly in areas of power, oil and gas.
- The basic idea is to pool resources and facilitate innovative ideas and techniques while implementing large projects, with the common objective of reduction of cost and time, and sharing the resultant benefits, in proportion to the contribution made by each party in achieving the targets.
- Strategy formulation is thus a sequential process which consists of strategic situation analysis and strategic choice analyses.
- Strategic situation analysis is self examination of the corporation's existing strategic posture, whereas strategic choice analysis is forward looking scenario building approach to the firm's future strategic posture.
- The strategic choice to be made by a firm will depend on its assessment of its competitive strengths and weaknesses and to match these against the opportunities and threats posed by the market forces.

Answer 1(c)

Conglomerate merger involves coming together of two or more companies engaged in different industries and/or services. Their businesses or services, are neither horizontally nor vertically related to each other. They lack any common features either

in their end product, or in the rendering of any specific type of service. This is the type of merger of companies which are neither competitors, nor complementaries nor suppliers nor consumers. In conglomerate merger, the merging companies operate in unrelated markets.

Answer 1(d)(i)

False

In the case of *SM Holdings Finance Pvt. Ltd. v. Mysore Machinery Mfrs. Ltd.* (1993) 78 Comp Case 432 (Ker), it was held that where a Scheme is not approved at a meeting, by the requisite majority, but is subsequently approved, by individual affidavits, the court may sanction the Scheme, as Section 391(2) is not mandatory but is merely directory and there should be substantial compliance thereof.

Answer 1(d)(ii)

True

In the case of *Kaveri Entertainment Ltd.*(2003) 17 Comp Cas 245 (Bom), the learned judge of Bombay High Court explained the requirement of Section 391(2) and stated that Sub section (2) of Section 391 of the Act requires that the resolution approving the Scheme of Arrangement should be passed by the majority in number representing 3/4th in value of the Creditors or class of creditors and / or members or class of members as the case may be. Hence, if a resolution is not approved by the majority in numbers shall be deemed to be disapproved and Court can disapprove the Scheme on this ground.

Answer 1(d)(iii)

True

The Court looks into the fairness of the Scheme before ordering a meeting because it would be no use putting before the meeting, a scheme containing illegal proposals which are not capable of implemented. At that stage, the Court may refuse to pass order for the convening of the meeting and dismiss the petition.

In *Union of India v. United Machine Co. Ltd.*,(1990) 3 Corp LA(Snr) 24(Cal), it was held that , where the court finds that the scheme is patently fraudulent or intended to be a cloak to cover the misdeeds of the directors, the court may reject the scheme at the outset without calling a meeting of creditors. The court does not function as a mere rubber stamp or post office and it is incumbent upon the court to be satisfied *prima facie* that the scheme is genuine, bonafide and in the interest of the creditors of the company.

Answer 1(d)(iv)

False

In the case of *Meghal Homes Private Ltd. v. Shreenivas Girmikk Samiti and others* (2007) 78 SCL 482 Supreme Court held that the company court could sanction a scheme even in the case of a company where an order of winding up has been made and a liquidator has been appointed. The essential factors to be seen by the Court are whether the scheme is bonafide and whether there is a genuine attempt to revive the company and such attempt is in public interest.

Answer 1(d)(v)**False**

As per Section 391(2), any compromise or arrangement approved by majority of creditors will be binding on all the creditors only if the said compromise or arrangement is sanctioned by the Court. Till the time sanction is not granted by the Court to the Scheme of arrangement, it cannot be said that the Scheme is binding on all the creditors or that the individual creditors are not entitled to file the individual application. [Ref: *Smt Promila v. DCM Financial Services Ltd.* (2001) 45 CLA 292 (Del)].

Question 2

- (a) *What types of disclosures are required to be published in the first financial statements following the amalgamation of the transferee company (both for pooling of interests method and purchase method) ? (7 marks)*
- (b) *Fitwell Ltd. is intending to make an initial public offer (IPO) of ₹50 crore through the book building process. Mention the provisions of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 relating to pricing in public issue. (8 marks)*

Answer to Question No. 2(a)

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

Disclosure Requirements

- (a) For amalgamations of every type, the following disclosures should be made in the first financial statements following the amalgamations:
- (i) names and general nature of business of the amalgamating companies;
 - (ii) effective date of amalgamation for accounting purposes;
 - (iii) the method accounting used to reflect the amalgamation; and
 - (iv) particulars of the scheme sanctioned under a statute.
- (b) In case of amalgamations accounted for under the pooling of interests method, the following additional disclosures are required to be made in the first financial statements following the amalgamation :
- (i) description and number of shares issued, together with the percentage of each company's equity shares exchanged to effect the amalgamation;
 - (ii) the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof.
- (c) In case of amalgamations accounted for under the purchase method the following additional disclosures are required to be made in the first financial statements following the amalgamations :
- (i) consideration for the amalgamation and a description of the consideration paid or contingently payable, and

- (ii) the amount of any difference between the consideration and the value of net identifiable assets acquired, and the treatment thereof including the period of amortization of any goodwill arising on amalgamation.

Answer 2(b)

Pricing in Public Issue as per SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009

Pricing

- (1) An issuer may determine the price of specified securities in consultation with the lead merchant banker or through the book building process.
- (2) An issuer may determine the coupon rate and conversion price of convertible debt instruments in consultation with the lead merchant banker or through the book building process.

Differential pricing

An issuer may offer specified securities at different prices, subject to the following:

- (a) retail individual investors or retail individual shareholders or employees entitled for reservation made under Regulation 42 making an application for specified securities of value not more than one lakh rupees, may be offered specified securities at a price lower than the price at which net offer is made to other categories of applicants:

Provided that such difference shall not be more than ten per cent of the price at which specified securities are offered to other categories of applicant;

- (b) in case of a book built issue, the price of the specified securities offered to an anchor investor shall not be lower than the price offered to other applicants;
- (c) in case of a composite issue, the price of the specified securities offered in the public issue may be different from the price offered in rights issue and justification for such price difference shall be given in the offer document.

- (d) In case the issuer opts for the alternate method of book building in terms of Part D of Schedule XI of SEBI (ICDR) Regulations, 2009, the issuer may offer specified securities to its employees at a price lower than the floor price:

Provided that the difference between the floor price and the price at which specified securities are offered to employees shall not be more than ten per cent of the floor price.

Price and price band

- (1) The issuer may mention a price or price band in the draft prospectus (in case of a fixed price issue) and floor price or price band in the red herring prospectus (in case of a book built issue) and determine the price at a later date before registering the prospectus with the Registrar of Companies:

Provided that the prospectus registered with the Registrar of Companies shall contain only one price or the specified coupon rate, as the case may be.

- (2) If the floor price or price band is not mentioned in the red herring prospectus, the issuer shall announce the floor price or price band at least two working days before the opening of the bid (in case of an initial public offer) and at least one working day before the opening of the bid (in case of a further public offer), in all the newspapers in which the pre issue advertisement was released.
- (3) The announcement shall contain relevant financial ratios computed for both upper and lower end of the price band and also a statement drawing attention of the investors to the section titled "basis of issue price" in the prospectus.
- (4) The cap on the price band shall be less than or equal to one hundred and twenty per cent of the floor price.
- (5) The floor price or the final price shall not be less than the face value of the specified securities.

Question 3

BM (India) Ltd. (BMIL) is a company registered in India. 99% of shareholding of BMIL is controlled by three companies namely, Van India Ltd. (VAN) (45%), Man India Ltd. (MAN) (45%) and Ran India Ltd. (RAN) (9%) which are the promoters of BMIL. The remaining 1% shareholding is in the control of 10 individual shareholders.

BMIL has filed a petition before the court for reduction of its share capital under sections 100 to 105 and stated that "only the shares of minority shareholding which at present is 1% of the total paid capital will be extinguished and reduced." The articles of association of BMIL contain provisions for the reduction of capital. 99.99% shareholders have approved the special resolution except one shareholder Gaurav who has 0.01% of shares of the company. Gaurav has raised objection on the proposed scheme of reduction of capital on the following grounds:

- *Proposed reduction of share capital by BMIL amounts to 'forcible acquisition' of shares of public shareholders as only their shares are being extinguished, whereas the shares of promoter group, i.e., VAN, MAN and RAN remain unaffected. According to Gaurav, the actual intent and reason for reduction of share capital is only to eliminate the minority shareholders as members of the company and is thus wholly unfair, discriminatory and malafide. Gaurav submits that reduction, if any, should be spread equally over all the different classes of shareholders of BMIL.*
- *Gaurav submits that the reduction of share capital proposed by BMIL is in fact a buy-back of the shares under section 77 A and accordingly reduction of share capital has - to be done on proportionate basis as mentioned in section 77A(5). Keeping in view the provisions of section 77A, sections 100 to 105 and also the objections of Gaurav, you, being the Company Secretary and Legal Advisor of BMIL, are asked to give your opinion on the following :*
 - (i) *Reduction of capital under section 100 gives liberty to the company to reduce its capital in 'any manner' other than what is illustrated in clause (a), (b) and (c) of section 100(1).*
 - (ii) *Section 77A should not be applicable in case where petition for reduction of capital is moved to the court pursuant to sections 100 to 105.*

Cite relevant case law in support of your answer.

(15 marks)

Answer 3

Section 100 of the Companies Act, 1956 expressly permits a company, if so authorised by its Article of Association, to reduce its share capital provided it has passed a Special Resolution for that purpose and the said resolution has been sanctioned by the Court. Clauses (a) (b) and (c) of Section 100(1) are mere illustrations and are not the only manner in which share capital of a company can be reduced. In fact, the power of reduction of capital is general and extend to any possible method of reduction subject to compliance of the applicable provisions. In *Bhimbhai v. Ishwar Das* (1984) ILR 18 Bom 152, the court has held that any arrangement concerning the company's capital which has the effect of reducing it is within the purview of this Section.

Hence the given statement is correct that reduction of capital can be done in any manner other than what is illustrated in clause (a) (b) and (c) of Section 100(1) of the Companies Act, 1956.

Section 77A of the Companies Act, 1956 is a facilitating provision which enables a company to buy back its shares without approaching to the Court under Section 100 to 105 of the Act. In fact, the provisions of Section 77A and 100 of the Act operate in different field. The Bombay High Court in the *Sterlite Industries (India) Limited (2003)* 113 Com cas 273/45 SCL 475 (Bom) has held that "Section 77A is merely an enabling provision and Court's power under Section 100 to 105 are not in any way affected. The conditions provided in Section 77A are applicable only to buy back of shares under Section 77A. The conditions applicable to Section 100 to 105 cannot be imported into or made applicable to a buy back under Section 77A. Similarly, the conditions for buy back under Section 77A cannot be applied to a Scheme under Section 100 to 105. The two operates in independent filed.

The facts of the case are similar to the case of *Chander Bhan Gandhi v. Reckitt Benckiser (India) Ltd.* [DEL] CO.APP. 1/2012, where Reckitt Benckiser (India) Ltd. (the respondent Company) being desirous of reducing its share capital by 1.55% by canceling and extinguishing 3,78,614 equity shares held by M/s. Lancaster Square Holdings SL., a subsidiary of promoter company and 28,531 shares held by the public, appointed Chartered Accountants to determine the fair value of its equity shares. The said Chartered Accountants recommended value of ₹ 836/- per share for payment to the shareholders whose shares were sought to be cancelled/ extinguished. However the Board of Directors of the respondent Company in the meeting while approving such reduction in the share capital, enhanced the payment from ₹ 836/- to ₹ 940/- per share. M/s Reckitt Benckiser Plc being the largest shareholder expressed intent to retain its shareholding. The Extraordinary General Meeting (EOGM) of the shareholders of the respondent Company by a special majority also approved such reduction.

The appellant voted against the said resolution. The respondent Company thereafter filed the petition for approval of its action of reduction of share capital. Initially 24 shareholders including the appellant filed objections. However upon the respondent Company offering to pay an amount of ₹ 1,500/- per share as against the amount of ₹ 940/- proposed by the Board of Directors and approved in the EOGM, 23 of the said objectors accepted the said offer and withdrew their objections leaving only the appellant in the fray.

The appellant objected to the scheme on various grounds including that it amounted

to "forcible acquisition" of shares of public shareholders in as much as the shares of the promoter group remained unaffected and that reduction was with the intent to "eliminate" the minority public shareholders and was thus wholly unfair, discriminatory and malafide., etc. The Appeal was dismissed.

In the light of the above decision, the contention of Mr. Gaurav regarding "forcible acquisition" would not hold good and BMIL would be successful in its proposal for reduction of capital.

Question 4

- (a) *A scheme of amalgamation was sanctioned by the High Court on 21st July, 2009 on the application made by Kshitija Garment Ltd. (KGL). KGL was directed to file a certified true copy of the order with the Registrar of Companies (ROC) within 30 days. However, due to inadvertence of the clerk of advocate on record, photostat signed copies of said order were obtained instead of certified copies. Thereafter, a fresh requisition was put in and on 25th November, 2009 (almost after a gap of three months), certified copy of the order was obtained. Since the period of 30 days from the date of the order had lapsed, ROC refused to accept the certified copies of the order.*

KGL moved an application before the Company Court for extension of time to file the certified copies of the sanctioned scheme with ROC beyond the permitted time. The Company Court dismissed the application holding that as applicant had not filed the certified true copy within the prescribed time of one month (30 days), a presumption arose that KGL had abandoned the scheme.

On appeal, KGL contended that Rule 7 of the Companies (Court) Rules, 1959 expressly empowers the courts to extend the time fixed by an order of the court for doing any act and with this rule, there cannot be a presumption that after expiry of 30 days it was to be deemed that the KGL had abandoned their right to file the certified copy.

KGL further stated that procedural law should not be allowed to overpower substantive rights and substantial cause for justice.

Keeping in view the above facts, give your opinion whether KGL would be successful in getting the extension of time for filing of certified copy of the order with the ROC. (7 marks)

- (b) *Discuss funding of a merger or takeover through financial institutions and banks.* (8 marks)

Answer 4(a)

From the given facts, it appears that KGL had duly appointed lawyer in the matter to take steps in terms of the rules framed and it appears that there is fault on the part of the advocate on record or his officer in taking steps in the matter in accordance with the provisions of law. Therefore, litigant should not suffer at the instance of his lawyer. It is also noticed that in the case of *Sambhaji v. Gangabai* (2008) 17 SCC 117, the Hon'ble Supreme Court has specifically stated that the "procedural law in certain systems tries to overpower substantive rights and substantial cause for justice. It is well known that

procedure should be the handmaid, not the mistress. The procedural law is not to be a tyrant (oppressor) but a servant, not an obstruction but an add to justice. The procedural prescriptions should be treated as lubricant and not a resistant in the administration of justice."

Applying the above principles in the instance case the application filed by the KGL Limited is to be allowed and extension is to be granted for filing the certified copy of the order sanctioning the scheme in question with the ROC with in a period as may be granted by the-Court.

The above facts are similar to the facts of HBR Sales (P) Ltd (2011) 110 SCL 481/15 Taxmann.com 339 (Calcutta). In this case, the Division Bench of the High Court has allowed the appeal setting aside the order of the Single Judge who rejected application of the appellant for enlargement of time. It was submitted that the single Judge has come to the conclusion that by not filing the certified copy of the order within one month from the date of receipt, a presumption arises that the applicants had abandoned its right to file the order with Registrar of Companies. The learned Judge has not stated under what law such presumption arises. On the other hand, Rule 7 of the Companies Court Rules expressly empowers the Court to enlarge the time fixed by an order of Court for doing any Act. With this Rule, there cannot be a presumption that after expiry of 30 days it is deemed that the applicants have abandoned their right to file the certified copy. Accordingly, KGL would be successful.

Answer 4(b)

Funding of a merger or takeover with the help of loans from financial institutions, banks etc, has its own merits and demerits.

Takeover of a company could be achieved in several ways and while deciding the takeover of a going concern, there are matters such as the capital gains tax, stamp duty on immovable properties and the facility for carrying forward of accumulated losses. With parameters playing a critical role, the takeover should be organized in such a way that best suits the facts and circumstances of the specific case and also it should meet the immediate needs and objectives of the management. While discussing modes of acquisition, certainly there would be a planning for organizing the necessary funding for the acquisition.

If borrowings from domestic banks and financial institutions have been identified as the inevitable choice, all the financial and managerial information must be placed before the banks and financial institutions for the purpose of getting the necessary resources.

The advantage of funding is that the period of such funds is definite which is fixed at the time of taking such loans. Therefore, the Board of the company is assured about continued availability of such funds for the pre-determined period. On the negative side, the interest burden on such loans, is quite high which must be kept in mind by the Board while deciding to use borrowed funds from financial institution. Such funding should be thought of and resorted to only when the Board is sure that the merged company or the target company will, give adequate returns i.e., timely payment of periodical interest on such loans and re-payment of the loans at the end of the term for which such loans have been taken.

However, in the developed markets, funding of merger or takeover is not a critical

issue. There are various sources of finance available to an acquirer. In the Indian market, it was not easy to obtain takeover finance from financial institutions and banks because they are not forthcoming to finance securities business. Takeover involves greater risk. There is no other organised sector to provide finance for takeover by a company.

Question 5

- (a) *What is meant by Indian depository receipts (IDRs) ? Why are such receipts issued ?* (5 marks)
- (b) *Where no mistake is found in valuation of exchange ratio worked out by a recognised firm of chartered accountants and the same has been accepted by the shareholders/creditors with overwhelming majority, court still has a right to substitute its own exchange ratio. Do you agree ? Discuss.* (5 marks)
- (c) *What is the meaning and importance of 'appointed date' particularly in case of demerger or spin-off ?* (5 marks)

Answer 5(a)

Indian Depository Receipt (IDR) means any instrument in the form of a depository receipt created by Domestic Depository in India against the underlying equity shares of issuing company which is located outside India. The IDR holders would thus indirectly own the equity shares of overseas issuer company. IDRs are to be listed and denominated in Indian Currency. An issuing company cannot raise funds in India by issuing IDRs unless it has obtained prior permission from SEBI.

Investment in Indian Depository Receipts (IDRs) is a good investment opportunity for the Indian Investors who are looking for investing their funds in foreign equity. Just like American Depository Receipts or Global Depository Receipts, which are instruments used by Indian Companies to raise money abroad, IDRs are meant for foreign companies looking to raise capital in India.

Answer 5(b)

It is well settled that the valuation of shares is a technical matter, requiring considerable skill and expertise. If the same has been worked out and arrived at by experts then the same should be accepted, more so, if the same has the approval of the shareholders. The court does not go into the matter of fixing of exchange ratio in great detail or to sit in appeal over the decision of the chartered accountant. If a chartered accountant of repute has given the exchange ratio as per valuation made by him and the same is accepted by the requisite majority of the shareholders, the court will only see whether there is any manifest unreasonableness or manifest fraud involved in the matter.

Answer 5(c)

Appointed date means the date for identification of assets and liabilities of existing company for transfer to new company. The 'appointed date' has been taken for identification and quantification of the assets and liabilities of the existing company and new company consequent upon proposed spin off. This identification is done on the basis of the audited balance sheet of the existing company for the financial year.

In the case of HCL Ltd., In re and HCL Hewlett-Packard Ltd., In re, the Central

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

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

PART B

(Answer ANY TWO questions from this part.)

Question 6

- (a) *ARC India Ltd. (ARCIL) filed winding-up petition of MF Ltd. (MFL) before the Company Court. ARCIL was having security interest in MFL and wanted to dispose of the assets for which it has requested the Company Court to give permission. Prior to the order of winding-up, an order was passed by the Company Judge declining permission to ARCIL (appellant) to sell the assets of MFL under section 13 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.*

Aggrieved by the order of Company Judge, ARCIL has filed an appeal before the division bench. The division bench has permitted ARCIL to sell the secured assets of MFL which is in liquidation in accordance with the provisions of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

On the basis of the valuation report of the registered valuer, the fair market value of the properties was fixed by the Sale Committee at ₹ 30 crore and distress market value was fixed at ₹ 15 crore. In auction, two bidders emerged at top, offering ₹ 40 crore and ₹ 41 crore. The Company Judge has refused to confirm the sale conducted by the Sale Committee on the ground that there was a huge gap between bid amount and fair market value. The Company Judge has not assigned any other reasons for not confirming the sale in favour of the highest bidder. Official Liquidator has made a statement that he was a party to the sale proceedings and he never objected to the proposal of the Sale Committee and today also he is not in a position to contend that the price quoted by the highest bidder is on the lower side or that the properties in question can be sold at a higher price.

In spite of the request of ARCIL and statement given by the Official Liquidator, the Company Judge set aside the proceedings of the sale and also directed refund of the security amount to all the bidders. The Company Judge further ordered to the Official Liquidator to get a fresh valuation report.

Keeping in view the above facts and circumstances, you are required to give your opinion as to —

- (i) Whether the Company Judge has committed an error in not approving the report submitted by the Sale Committee, without giving any reason ?
 - (ii) Whether ARCIL would be successful in getting favourable order from division bench ? (9 marks)
- (b) What do you understand by 'operating agency' and what are its functions ? (6 marks)

Answer 6(a)

Considering the given facts and in light of the law laid down by the Hon'ble Supreme Court in the matter of Asst. Commissioner, *Commercial Tax Department Works Contract & Leasing v. Shukla & Bros* (2010) 4 SCC 785, stated that "recording of reasons is an essential feature of dispensation of justice. A litigant who approaches the Court with any grievance in accordance with law is entitled to know the reasons for grant or rejection of his prayer. Reasons are soul of the orders. Non recording of reason could lead to dual infirmities. Firstly, it may cause prejudice to the affected party and secondly more particularly hamper the proper administration of justice. The orders of the Court must reflect what weighed with the Court in granting or declining the relief claimed by the applicant.

In the case of *Kayjay Industries (P) Ltd. v. Asnew Drums (P) Ltd.* (1974) 2 SCC 213, held that Company Judge has committed an error in not approving the report submitted by the Sale Committee. Moreover, in the interest of justice it was expected from the Company Judge to give speaking reason of not accepting the proposal of Sale Committee in spite of the statement given by the Official Liquidator in favour of the Sale Committee.

Considering the above, it can be said that Company Judge had committed an error in not approving the report submitted by the Sale Committee. In a similar matter of *ARCIL v. Maikaal Fibres Ltd. (In liquidation)* 2011 110 SCL 746/16 Taxmann.com 248 (Madhya Pradesh), Division Bench has reversed the order of Company Judge and confirm the sale of assets of the company in favour of highest bidder.

As stated above, the ARCIL will be successful in getting the favourable order in its favour.

Answer 6(b)

Under SICA [Section 3(1)(i)]

"Operating agency" means any public financial institution, State level institution, scheduled bank or any other person as may be specified by general or special order as its agency by the Board for Industrial and Financial Reconstruction (BIFR).

Under the Companies Act 1956 [Section 2(31AA)]

"Operating agency" means any group of experts consisting of persons having special knowledge of business or industry in which the sick industrial company is engaged and includes public financial institutions, State level institution, scheduled bank or any other person as may be specified as the operating agency by the Tribunal.

The functions of Operating Agency includes:

1. Conduct of inquiry on reference received
2. Preparation of scheme of rehabilitation
3. Apply to Tribunal for review of its order
4. Recommended to the Tribunal on the various steps to be taken to implement the scheme and remove the difficulties therein
5. Implementation of Rehabilitation scheme ordered by Tribunal
6. Appointment as liquidator in case of winding up of Industrial company
7. Preparation of detailed inventory etc.,

Question 7

- (a) *GCL Ltd. is a company engaged in the business of accepting deposits from the general public and lending the same to the needy at a higher rate of interest and thereby earning profits. Over a period of time, GCL Ltd. started incurring losses and did not pay back to their depositors. Ranjan, one of the deposit holders of GCL Ltd. issued statutory notice to GCL Ltd. asking for repayment of amount due to him. In spite of the lapse of 21 days, the GCL Ltd. neither paid the amount to Ranjan nor replied to the statutory notice served to it.*

Ranjan, aggrieved by the conduct of the GCL Ltd., filed petition for winding-up of GCL Ltd. before the High Court under section 433(e) and (f). In response to the said petition, GCL Ltd. stated that if the loans and advances made by it were recovered, GCL Ltd. would have been able to repay the amount due to the deposit holders. However, due to the financial crises and the globalisation of markets, GCL Ltd. was unable to repay the amount. GCL Ltd. has submitted profit and loss account and balance sheet according to which the liability of the company was more than its assets.

Considering the above facts, give your comments as to whether Ranjan would be successful in getting the winding-up order against GCL Ltd. (7 marks)

- (b) *On what grounds is RBI entitled to exercise its power under section 4 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 to cancel the 'certificate of registration' issued by it to any asset reconstruction company? What formalities have to be undertaken by RBI before cancellation of certificate of registration? (4 marks)*
- (c) *Explain the term 'cross border insolvency'. (4 marks)*

Answer 7(a)

According to Section 433(e) and (f) of the Companies Act, 1956, a company may be wound up by the Court if the company is unable to pay its debt and if the Court is of the opinion that it is just and equitable that the company should be wound up.

In the instant case, it is evident from the facts that company's source of earning is the difference of interest earned and paid. From the Profit & Loss Account and Balance Sheet it is evident that liabilities of the GCL are more than its assets. The company

accepted that due to the financial crises and the globalization of markets it was not able to meet its commitment. The company has not responded to Mr. Ranjan and also did not pay outstanding amount due to him.

Therefore, it can be said that company is unable to pay its debt and its assets are not sufficient to meet its liabilities and there is no another source of earning of the company. Hence court may on the ground of just and equitable be able to order for winding up of GCL Limited. Mr. Ranjan would be successful in getting the order in his favour.

The above fact is similar to the *Ashok Gowda v. Gopika Credit & Investment Co.* Comp Petition No 126/2006 (2012]111 SCL 792/18 taxman.com 165(Karnataka Jan 17, 2012).

Answer 7(b)

Reserve Bank of India has the power under Section 4 of the SARFESI Act, 2002 to cancel the Certificate of Registration issued by it to any Asset Reconstruction Company, If the Company

- (i) ceases to receive or hold any investment from qualified institutional buyer or
- (ii) ceases to carry on asset reconstruction business or
- (iii) it fails to comply with the conditions of registration
- (iv) Fails to fulfill the conditions of Section 3(3)
- (v) Fails to comply with the directions of RBI
- (vi) Fails to maintain accounts
- (vii) Fails to submit documents on inspection by RBI
- (viii) Obtains approval from RBI for any substantial change in its management.

Before canceling registration, Reserve Bank shall give an opportunity to such company on such terms as the Reserve Bank may specify for taking necessary steps to comply with such provisions or fulfillment of such conditions.

Answer 7(c)

Cross Border insolvency

Cross Border Insolvency includes cases where the insolvent debtor has assets in more than one State or where some of the creditors of the debtor are not from the State where the insolvency proceeding is taking place. United Nations Commission on International Trade Law approved the text of the UNCITRAL Model law on Cross-Border Insolvency (the Model Law) in May 1997. The Model Law is designed to assist States to equip their insolvency laws with a modern, harmonized and fair framework to address more effectively instances of cross-border insolvency. The Model Law respects the differences among national procedural laws and does not attempt a substantive unification of insolvency law. It offers solutions that help in several significant ways, including : foreign assistance for an insolvency proceeding taking place in the enacting State; foreign representative's access to courts of the enacting State; recognition of foreign proceedings; cross-border cooperation; and coordination of concurrent proceedings etc.

Question 8

- (a) "Under some circumstances including the completion of basic objective of incorporation of a company, the company may be wound-up by knocking the door of a court of law." You are required to explain —
- (i) Circumstances under which a company may be wound-up. (4 marks)
 - (ii) The procedure to be followed for winding-up of a company. (4 marks)
 - (iii) Why, in your view, the provisions of voluntary winding-up are contained in the Companies Act, 1956 ? (2 marks)
- (b) In the context of UNCITRAL Model Law, what do you mean by the following :
- (i) State
 - (ii) Establishment
 - (iii) Foreign main proceeding
 - (iv) Foreign Court
 - (v) Foreign representative. (1 mark each)

Answer 8(a)(i)

Section 484 specifies the circumstances in which the company may wound up voluntarily, which are as follows :

- (a) When the period fixed for the duration of the company by the articles has expired; or
- (b) the event, if any has occurred, on the on the occurrence of which the articles provide that the company is to be dissolved, and the company in general meeting passes a resolution requiring the company to be would up voluntarily; and
- (c) if the company passes a special resolution that the company be wound up voluntarily.

Answer 8(a)(ii)**Procedure to be followed for Voluntary winding up of a company**

A company may be wound up voluntarily on the expiry of the term fixed for duration of the company or on the occurrence of the event as provided in its articles. In these two cases only an ordinary resolution may be passed in the general meeting of the company. Apart from these two cases, a company may be voluntarily wound up for any other reason as well for which a company has to pass a special resolution. A proper notice required for the respective meetings must be given to all the members and in the latter case the text of the special resolution to be passed together with the reason to wind up voluntarily must be mentioned therein.

The resolution (whether ordinary or special), when passed, must be advertised within 14 days of the passing of the resolution in the Official Gazette and also in some newspaper circulating in the district where the registered office of the company is situated. A liquidator of the company is deemed to an officer of the company for the purposes of the above requirements.

A voluntary winding up commences from the date of the passing of the resolution for voluntary winding up. This is so even when after passing a resolution for voluntary winding up, a petition is presented for winding up by the Court.

Answer 8(a)(iii)

Voluntary winding up enables members or creditors, as the case may be, to initiate the winding up process. The companies are usually wound up voluntarily as it is an easier process of winding up. It is altogether different from a compulsory winding up. In voluntary winding up the company and its creditors are left to settle their affairs without going to a Court, although they may apply to the Court for directions or orders, as and when necessary.

Answer 8(b)(i)

"State"

The word "State", as used in the preamble and throughout the UNCITRAL Model Law, refers to the country that enacts the Law (the "enacting State"). The term should not be understood as referring, for example, to a state in a country with a federal system.

Answer 8(b)(ii)

"Establishment"

"Establishment" means any place of operations where the debtor carries out a non-transitory economic activity with human means and goods or services.

Answer 8(b)(iii)

"Foreign main proceeding"

"Foreign main proceeding" means a foreign proceeding taking place in the State where the debtor has the centre of its main interests.

Answer 8(b)(iv)

"Foreign Court"

"Foreign court" means a judicial or other authority competent to control or supervise a foreign proceeding.

Answer 8(b)(v)

"Foreign representative"

"Foreign representative" means a person or body, including one appointed on an interim basis, authorized in a foreign proceeding to administer the reorganization or the liquidation of the debtor's assets or affairs or to act as a representative of the foreign proceeding.

GUIDELINE ANSWERS

PROFESSIONAL PROGRAMME

JUNE 2012

MODULE III



**THE INSTITUTE OF
Company Secretaries of India**
IN PURSUIT OF PROFESSIONAL EXCELLENCE
Statutory body under an Act of Parliament

GUIDELINE ANSWERS

PROFESSIONAL PROGRAMME

JUNE 2012

MODULE III



**THE INSTITUTE OF
Company Secretaries of India**

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

ICSI House, 22, Institutional Area, Lodi Road, New Delhi 110 003

Phones: 41504444, 45341000; Fax: 011-24626727

E-mail: info@icsi.edu; Website: www.icsi.edu

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

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

C O N T E N T S

Page

MODULE III

- | | |
|--|----|
| 1. Strategic Management, Alliances and International Trade | 1 |
| 2. Advanced Tax Laws and Practice | 22 |

(i)

NOTE : Guideline Answers of the last Six Sessions need to be updated in the light of changes and references given below :

PROFESSIONAL PROGRAMME
UPDATING SLIP
**STRATEGIC MANAGEMENT, ALLIANCES
AND INTERNATIONAL TRADE**

MODULE – III – PAPER 1

| <i>Examination Session</i> | <i>Question No.</i> | <i>Updating required in the answer</i> |
|--------------------------------|---------------------|---|
| June 2009 to Dec. 2011 | | Foreign Direct Investment Policy issued by DIPP effective from 1 st October, 2011. |

(ii)

NOTE : Guideline Answers of the last Six Sessions need to be updated in the light of changes & references given below :

ADVANCED TAX LAWS AND PRACTICE

MODULE – III – PAPER 2

| <i>Examination Session</i> | <i>Question No.</i> | <i>Updating required in the answer</i> |
|----------------------------|---------------------|---|
| June 2009 & December 2011 | All questions | <p>The Income Tax, Central Excise and Customs Laws are subject to changes by the Annual Finance Acts. In order to update all the answers, the students are advised to refer to the latest law keeping in mind the following amendments/changes, for December 2012 examination.</p> <ul style="list-style-type: none">(i) All changes made by the Finance Act, 2011 relevant to Assessment Year 2012-13 or before for Direct Taxes and all changes made by Finance Act, 2012 for Indirect Taxes.(ii) All the circulars, clarifications/ notifications issued by the CBDT/ CBEC/Central Government which became effective on or before six months prior to the date of the respective examination.(iii) The levy of Gift Tax has been suspended w.e.f. 1st October, 1998 by insertion of clause (3) to Section 3 of Gift Tax Act, 1958 by Finance (No.2) Act, 1998. Therefore, Gift Tax Act has been excluded from the scope of examination unless otherwise informed. <p>The questions based on case laws, in conflict with the latest law be treated as of academic interest only.</p> |

PROFESSIONAL PROGRAMME EXAMINATION
JUNE 2012
**STRATEGIC MANAGEMENT, ALLIANCES AND
INTERNATIONAL TRADE**

Time allowed : 3 hours

Maximum marks : 100

PART A

(Answer ANY TWO questions from this part.)

Question 1

- (a) *Explain the various phases of 'strategic management process'.*
(8 marks)
- (b) *"Weaknesses must be compared with strengths for internal analysis." Explain the statement giving a suitable example.*
(8 marks)
- (c) *"Strategic planning is different from operational planning." Discuss.*
(4 marks)

Answer 1(a)

Strategic management process

Strategic management process can be described as a set of managerial decisions and actions which determines the long run direction and performance of the organization.

Various phases of Strategic management process are as follows:

1. *Setting organizational mission and objectives* : Organisations are deliberate creations having a definite mission towards which all efforts, energies and resources are directed. In strategic management, this includes strategic intent which consists of vision, mission, values and objectives of an organisation.
2. *Environmental analysis* : A key premise of strategic management is that plans must be made on the basis of what has happened, is happening, and will happen in the world outside the organization with a focus on the threats and opportunities these external changes present to the organization. Thus it can be said that it is the process by which organizations comprehends various environmental factors and determines the opportunities and threats that are provided by these factors.
3. *Organizational assessment* : Why the organization has succeeded in the past, what it will take to succeed in the future, and how it must change to acquire the necessary capabilities to succeed in the future are issues to be analysed in this stage.
4. *Identification of strategic alternative* : Interactions of organization with its

environment in the light of its strengths and weaknesses will result in various strategic alternatives. This process may result in large number of alternatives through which an organization can relate itself to environment. In fact, all alternatives can not be chosen even if all of them produce the same results.

5. *Choice of appropriate strategy* : It is the stage of strategic decision process. It consists of identifying the various alternatives and choosing the most appropriate and acceptable one. Once the alternatives are available the next step is to choose the right strategy to tackle the situation. Strategy formulation is the result of making strategic decisions that determine a given strategy.
6. *Implementation of strategy* : Strategy implementation is the step which leads to achievement of organizational objectives. Implementation of strategy is the real use of the formulated strategy. To implement a strategy, it needs to be translated into a more understandable form. The strategy must be understood at the functional level to be successful. Thus it can be said that it is the process by which strategies and policies are put into action through the developments of programs, budgets and procedures.
7. *Performance evaluation and control* : It is the comparison between actual results and desired results. The evaluation and control of performance completes the strategic management process. Although performance evaluation and control is the final major step in strategic management process, it can also pin point weakness in previously implemented strategic plans and thus stimulate the entire process to begin again.

Answer 1(b)

"Weaknesses must be compared with strengths for internal analysis" means that what may represent strengths with respect to one objective may be weakness for another objective. Therefore internal factors may be viewed as strengths and weaknesses depending upon their impact on the organization's objectives.

Let's take an example of a case study which is based on Hindustan pro sports: Thinking strategically. This is a case of determining long-term objectives for a sports bicycle manufacturing company on the basis of internal and external information. Some tools may be used to identify strategies that the company may use to achieve its long-term objectives. Consequently, it becomes possible to ascertain more strategic alternatives.

Chairman's Views & CEO's Views

The Chairman wants the company to emerge as the number 1 specialty bike retailer in India in terms of revenue and in terms of number of stores within the next 5 years whereas the CEO has a focus on profitability rather than the competitive portion. He wants the company to achieve an increase in its profitability from 28% to 35% and to become the lowest cost producer of racing bikes in the whole of India by bringing down manufacturing cost per bike to ₹3,000.

Environment Scanning

Firstly, a long-term objective has to be recommended which would require the collection of critical internal and external information. The internal information is readily available and the external information will require some expenses to be made. The company's strategy analyst has suggested the undertaking of Specialty Bicycle Consumer Study for India for its statistical significance and the Indian Bicycle Retailing Industry Analysis for its detail. Both these studies would help in trend analysis, statistical data and information specific to sports bicycle retailers. Both these studies were done at a stipulated budget of ₹3,00,000

Analysis of Strengths and Weaknesses:

- (i) Strengths of the company include cash position sale of the bike branded "Anti-Gravity" through dealers and service network.
- (ii) Weaknesses of the company are: low presence in areas witnessing sharp growth, male-oriented brand image, low brand recall among 12-24 age groups.

Therefore, it can be seen that the focus has to be shifted from middle aged consumers to woman consumers. There should be creation of brand recall among women consumers by creating a range of bikes appealing to women consumers and increasing women sales staff.

Answer 1(c)

The difference between Strategic planning and Operational planning can be viewed from the following points given herein below:

1. Strategic planning refers to the process of developing and analyzing the organization's mission, overall goals, general strategies, and allocating resources whereas operational planning refers to the process of deciding the most effective use of the resources already allocated and to develop a control mechanism to assure effective implementation of the actions so that organizational objectives are achieved.
2. Strategic planning takes into account the external environment and tries to relate the organization with it, whereas operational planning focuses on internal organizational environment so as to make the effective use of given resources.
3. Strategic planning is usually conducted by top level management and other specified planning staff in the organization whereas, operational planning is usually spread over a wide range within the organization and is generally performed by operating managers with the help of the subordinate staff.
4. Strategic planning precedes the operational planning as the latter is primarily the implementation of the former.

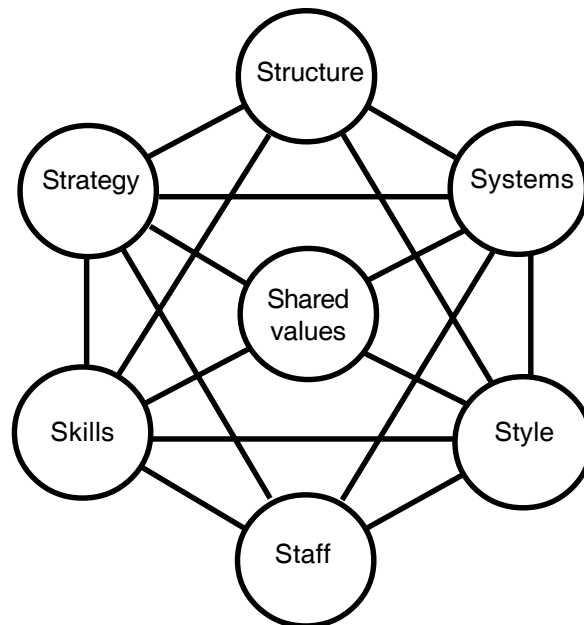
Question 2

- (a) "McKinsey framework shows that there is a multiplicity of factors that influence an organisation's ability to change." Discuss. (10 marks)
- (b) What are the different responsibility centres evolved for measuring divisional performance ? Elaborate. (10 marks)

Answer 2(a)

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

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

**McKinsey 7-S Framework**

According to the framework, there is a multiplicity of factors which influence an organization's ability to change and understand as to how the 7-S model mechanism works. In general terms, the proposition of the 7-S model suggests that there are multiple factors which influence an organization's ability to change

and its proper mode of change. Since the variables are interconnected, significant progress cannot be made in one area unless corresponding progress is made in other areas too. It is imperative to know what each 'S' means and what is its implication. The 3S's across the top of the model are described as Hard S's and 4S's across the bottom of the model are less tangible, more cultural in nature and some time neglected in major change efforts and mergers and were termed as soft Ss by McKinsey.

Answer 2(b)

Measuring Divisional Performance

Responsibility centers are used to isolate a unit so that it can be evaluated separately from the rest of the corporation. Each responsibility centre has its own budget and is evaluated on its use of budgeted resources. A firm may use different divisional formats like cost centre, revenue centre, profit centre, investment centre, expense centre, etc., for the purpose of the performance measurement of various divisions and can use different evaluation criteria suitable for a particular divisional format.

The responsibility centres are of various types which are discussed as under:

- (i) *Standard Cost Centers* : Cost centres are divisions which add to the cost of the organization, but only indirectly add to the profit of the company. It is primarily used in manufacturing organization. Standard cost is computed for each operation on the basis of historical data in evaluating the center's performance. Standard cost for each unit when multiplied by the number of units produced result in the expected cost of production which is compared with actual cost.
- (ii) *Profit Centers* : Performance is measured in terms of difference between revenue and expenditures. A profit centre is established when an organization unit has control over both its resources and its products or services. By having a profit centre, a company can be organized in divisions or separate product lines. Profit Centers are part of an organization which directly adds to its profit. Managers are held accountable for both revenues, and costs (expenses), and therefore, profits. Different profit centers are separated for accounting purposes so that the management can follow how much profit each center makes and compare their relative efficiency and profit. Examples of typical profit centers are a store, a sales organization and a consulting organization.
- (iii) *Revenue Centers* : Revenue Centers are the logical complement to a cost center. The performance measure in such centers is total revenue and they have many of the same features as cost centers.
- (iv) *Investment Centres* : Investment center is a unit within an enterprise, the performance of which is measured against use of its capital, as opposed to a cost or profit center, which are measured against raw costs or profits.

An investment centre performance is measured in terms of difference between its resources and its product or services. The most widely used measure of investment centre performances is return on investment. Investment centers are a variation on the profit center structure in which the manager is evaluated on the relation between profits and the assets used to generate them.

- (v) *Expense Centres* : Resources are measured in terms of rupees without consideration for product or service cost. The budgets have been prepared for those costs that can be calculated and can be estimated. This division generally produces services for the rest of the organization. The provision of internal administrative services such as, human resources, patent and public relations services, administrative service, and research facilities, are commonly organized as expense centers.

Question 3

- (a) *Explain the various strategies followed at various stages of product life cycle.*
(5 marks)
- (b) *Explain benchmarking process with an example.*
(5 marks)
- (c) *Discuss in detail the reasons that prompt the companies for doing business globally.*
(5 marks)
- (d) *Explain how a GAP analysis guides the choice of an appropriate strategy.*
(5 marks)

Answer 3(a)

Various Strategies followed at various stages of product life cycle are :

- (i) *Introduction Stage Strategies* : Here the marketing strategy should focus on correcting product problems in design, features, and positioning. The personnel strategy could focus on planning and recruiting for new product. Financial strategy would be likely to address primarily sources of funds.
- (ii) *Growth Stage Strategies* : Here marketing strategy is concerned with quickly carving out a niche for the product or firm and for its distribution capabilities. Communication strategy is directed towards establishing brand preference and personnel strategy may focus on developing loyalty, commitment, and expertise.
- (iii) *Maturity-Stage Strategy* : Here marketing efforts concentrate on maintaining customer loyalty. Production strategy concentrates on efficiency and, at the same time, sharpens the ability to meet delivery schedules and minimize defective products. Personnel strategy may focus on various incentive systems to produce manufacturing efficiency.
- (iv) *Decline-Stage Strategies*: Some of the strategies adopted are: (1) concentration on a small market segment and reduction of the firm's asset base to the minimum levels needed for survival (2) acquisition of several similar firms so as to raise sales to a substantial percent of the leaders' sales; (3) selling

out to a buyer with sufficient cash resources and the willingness to use them to effect a turnaround; and (4) liquidation.

Answer 3(b)

Benchmarking Process

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

Example of Xerox Company embarking benchmarking process

Xerox pioneered the case of benchmarking when Japanese manufacturers began selling midsize copiers in the United States at less than the Xerox production cost. To handle this problem, Xerox sent a team of line managers to Japan to study competitor's business processes and cost. It sought the help of Fuji-Xerox who was its joint venture partner. Investigations revealed that Xerox costs were excessive due to gross inefficiencies in manufacturing processes and business practices. It lead Xerox to embark on a long term programme to benchmark its key work processes against best practices, pursued by its competitors in Japan. Over the year Xerox extended benchmarking to almost every activity connected with its business.

Similar benchmarking strategy was adopted by Southwest Airlines to reduce the turnaround time of its aircraft at each scheduled stop pit crews on the auto racing circuit.

Benchmarking has been found to produce best results in companies which are already well managed.

Answer 3(c)

Reasons for doing business globally

The reasons are as follows:

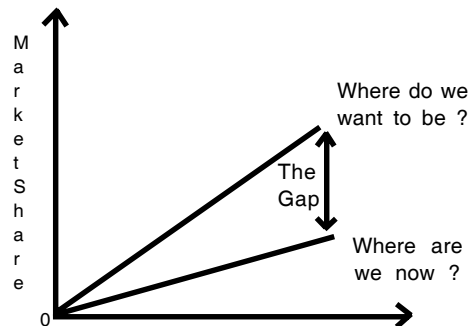
- (i) *Market saturation* : It is the immediate threat to the successful operation of the firms engaged in manufacturing unlike underdeveloped or developing countries where population grows faster than anything else-leave aside production of goods and services.
- (ii) *Foreign competition* : The international competition improves quality, reduces costs and increases the consumer choice and satisfaction.
- (iii) *Trade deficit* : It is a common feature of all under developed countries, though it is a rare phenomenon in case of developed nations.
- (iv) *New markets* : For developed countries, the developing and the underdeveloped countries and in case of developing countries the less developed or under-developed countries constitute a major market for their products and services.

- (v) *Savings in Costs* : Among the elements of costs, labour is very predominant, as much as it represents almost 50 per cent of the total cost. Profits can be easily increased where the labour costs are the minimum. That is why many advanced nations expanded their foreign operations in underdeveloped or developing countries where skilled labour is comparatively very cheap.
- (vi) *Business adversities* : Business is a game and is having the cycle of economic tide-waves of ups and downs. International business provides a safety net or a cushion during business adversities.
- (vii) *Utilise full capacity* : The need for fuller utilization of capacity makes the unit to go international.
- (viii) *Avail product technology, raw-materials, etc.* : A country that is exposed to global business conditions is geared to have increased access to advances in technology, world-wide raw-materials and diverse international economic groups.
- (ix) *Developing and Testing New Products* : Many business firms prefer to develop and test their products in countries than in the home country. This is to avoid exposure to home competition and keep the development information as a secret till the product is taken up on commercial basis. The foreign markets provide the best opportunities of test marketing or target marketing.

Answer 3(d)

GAP Analysis

Gap analysis is the process of identifying the gap between the optimized allocation and integration of the inputs and the current level of allocation. This helps company provide insight into areas that have room for improvement. The gap analysis process involves determining, documenting and approving the variance between business requirements and current capabilities. Once the general expectation of performance in the industry is understood, it is possible to compare that expectation with the level of performance at which the company currently functions. This comparison becomes the gap analysis.



GAP Analysis

Under Gap Analysis attention is first focused on the gaps between the actual or anticipated values that certain variables take on and the values that are most desirable. Once the gaps are properly identified, attention shifts to devising ways to close them. This is how the choice of an appropriate strategy is devised. Gap analysis has been advocated for strategic choice decisions within the following four primary contexts: (1) Environmental analysis, (2) Functional-level policy analysis, (3) Business-level strategy analysis, and (4) Corporate-level strategy analysis.

Each type of gap may be closed through its own set of strategic or tactical moves. They correspond to business-level goals and action plans or marketing strategy, depending upon the level of their organization.

PART B

(Answer ANY ONE question from this part.)

Question 4

In an inter-dependent world, every company is required to work in co-operation with others if it wants to compete in the global market. Alliance between companies has become a crucial weapon in the battle for competitive advantage. In this context, briefly describe the following :

- (i) Characteristics of strategic alliances.*
- (ii) Need for alliances.*
- (iii) Advantages of alliances.*
- (iv) Types of strategic alliances.*
- (v) Cross-cultural alliances.*

(4 marks each)

Answer 4(i)

Characteristics of Strategic alliance are as follows

- (i) the two or more firms that unite to pursue a set of agreed goals remain independent subsequent to the formation of an alliance.
- (ii) the partner firms share the benefits of the alliance and control over the performance of assigned tasks.
- (iii) the partner firms contribute on a continuing basis in one or more key strategic areas e.g. technology, products and so forth.

Answer 4(ii)

Need of Alliances

Most firms enter into alliances out of need. With alliances, we can do more for less. Whatever the needs driving alliance formation, managements must take the time to analyse why an alliance is the best strategy. The record suggests that ten main strategic factors reduce the whys in most alliance equations are as follows:

- Satisfy customer demands

- Share R & D costs
- Fill knowledge gaps
- Make scale economies
- Make scope economies:
- Jump market barriers
- Speed product introduction
- Pre-empt competitive threats
- Use excess capacity
- Cut exit costs

Answer 4(iii)**Advantages of Alliances**

Alliances are the quickest way to grow a company, particularly in times of change. Without implementing difficult and time-consuming internal changes, they allow a company to:

- Rapidly move to decisively seize opportunities before they disappear.
- Respond more quickly to change.
- Adapt with greater flexibility.
- Increase a company's market share.
- Gain access to a new market or beat others to that market.
- Quickly shore up internal weaknesses.
- Gain a new skill or area of competence.

Answer 4(iv)**Types of Strategic Alliance are as under**

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

Answer 4(v)**Cross Cultural Alliances**

In a global economy with shifting labour markets, work migrates to wherever quality, cost and efficiency can be managed so as to derive a better return on capital and time invested. When an organization decides to enter the international market place, there are certain strategic management capabilities that must be modified and introduced into the corporate culture for the venture to be successful. The most important of these are flexible organizational culture, political risk awareness, decentralized strategic planning, multifaceted management structures and share authority/responsibility. Cross cultural joint ventures can thus reap enormous benefits, for companies.

Thus, important difference in developing a plan for a cross-cultural alliance is that the 'key skill' of the managers involved in building such alliances must be the ability to work in ambiguous, unfamiliar, cross-functional and trans-cultural relationships. Understanding the issue of cultural differences in the way information is communicated and applying these understandings is critical to the success of such alliances. As most alliances are cross organizational and cross-cultural, so, it is a challenge as to how to create and deal with such alliances.

Question 5

- (a) *Discuss the factors that should be kept in mind while drafting a foreign collaboration agreement.* (10 marks)
- (b) *Enumerate the methods of funding for investment in an overseas joint venture/wholly owned subsidiary.* (10 marks)

Answer 5(a)

While drafting a foreign collaboration agreement, the following factors should be kept in mind:

- Capability of the collaborator and the requirements of the party are clearly indicated.
- Clear definitions of technical terms are given.
- Specify if the product shall be manufactured/sold on exclusive or non-exclusive basis.
- Terms and conditions regarding nature of technical know-how, disclosure of drawings, specifications and other documents, furnishing of technical information in respect of processes with flow charts etc., plant outlay list of equipment, machinery and tool with specification have to be provided.
- Provisions for making available the engineers and/or skilled workers of the collaborator on payment of expenses relating to their stay per diem etc. are given.

- Details regarding specification and quality of the product to be manufactured are given.
- Quality control and trademarks to be used are also specified.
- Responsibility of the collaborator in establishing or maintaining assembly plants should be clearly determined and provided for.
- If sub-contracting of the work is involved, clarify if there would be any restrictions.
- The rate of royalty, mode of calculation and payment etc. Also, make provision as to who will bear the taxes/cess on such payments.
- Use of information and industrial property rights should also be provided for in the agreement.
- A clause on force majeure should be included.
- A clause that the collaborating company has to train the personnel of Indian company within a specified period should be incorporated. The clause should also specify the terms and conditions of such assistance, place of training, period of training and fees payable.
- A comprehensive clause on arbitration containing a clear provision as to the kind of arbitrator and place of arbitration should be included.
- There should be provision in the agreement for payment of interest on delayed payments.

Answer 5(b)**Investment in an Overseas Joint Venture /Wholly Owned Subsidiary may be funded out of one or more of the following sources**

1. Drawl of foreign exchange from an Authorised Dealer Bank in India;
2. Capitalization of exports;
3. Swap of shares;
4. Utilizations of proceeds of External Commercial Borrowings (ECBs)/Foreign Currency Convertible Bonds (FCCBs);
5. In exchange of American Depository Receipts/Global Depository Receipts issued in accordance with the scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (through Depository Receipt Mechanism) Scheme, 1993, and the guidelines issued there under from time to time by the Central Government;
6. Balances held in Exchange Earner Foreign Currency account of the Indian party; and
7. Utilization of proceeds of foreign currency funds raised through ADR/GDR issues.

PART C

(Answer ANY TWO questions from this part.)

Question 6

- (a) Explain the theory of comparative advantage. (5 marks)
- (b) State the major outcome of WTO Doha Ministerial Conference. (5 marks)
- (c) Discuss the salient features of Singapore Ministerial Declaration on trade in information technology products. (5 marks)
- (d) What do you mean by the term 'dumping' ? Explain various types of dumping. (5 marks)

Answer 6(a)

The classical economists writing in the first quarter of the nineteenth century reinforced the case for free trade. The theory of comparative advantage emerged during this period and strengthened the understanding of the nature of trade and its benefits. David Ricardo has received most of the credit for developing this important theory, although James Mill and Robert Torrens had similar ideas around the same time.

The theory of comparative advantage suggests that a country should export goods in the country in which its relative cost advantage, and not the absolute cost advantage, is greatest in comparison to other countries. Suppose that the United States can produce both shirts and automobiles more efficiently than Mexico. But if it can produce shirts twice as efficiently as Mexico and can produce automobiles three times more efficiently than Mexico, the United States has an absolute productive advantage over Mexico in both the goods but a relative advantage in producing automobiles. In this case, the United States might export automobiles in exchange for imports of shirts—even though it can produce shirts more efficiently than Mexico. The practical import of the doctrine is that a country may export a good even if a foreign country could produce it more efficiently if that is where its relative advantage lies; similarly, a country may import a good even if it could produce that good more efficiently than the country from which it is importing the good. From Mexico's standpoint, it lacks an absolute productive advantage in either commodity, but has a relative advantage in producing shirts (where its relative disadvantage is least). This trade is beneficial for both the United States and Mexico.

The comparative advantage proposition is incredibly counterintuitive. It states that a less developed country that lacks an absolute advantage in any goods can still engage in mutually beneficial trade, and that an advanced country whose domestic industries are more efficient than those in any other country can still benefit from trade even as some of its industries face intense import competition.

Answer 6(b)**The WTO Doha ministerial conference produced three key documents**

- (i) *Declaration on TRIPS Agreement and Public Health* – This declaration

represents some weakening of the TRIPS agreement in so far as access to medicines is concerned. Article 39 of the TRIPS Agreement allows member countries to authorize third parties to produce a patented product through 'compulsory licences' to satisfy local needs. This authorization must however be preceded by efforts by the third party to obtain authorization from the patent holder on reasonable commercial terms. This requirement can be waived only in 'national emergency or other circumstances of extreme urgency'.

The Doha declaration on TRIPS weakens the condition under which the member states can issue compulsory licenses. Each member has a right to grant compulsory licenses and the freedom to determine the grounds upon which such licenses are issued. Each member also has been given the right to determine what constitute national emergency or other extreme urgency, it being understood that AIDS, malaria, and other epidemics or national health crisis could constitute national emergency. But countries that do not have domestic capability for such production will effectively be unable to benefit from this flexibility.

- (ii) *Decision on Implementation-related issues and concerns* – Developing countries have had a series of complaints about the manner in which the various WTO agreements have been implemented in practice. The problem with these issues is that virtually no issue involved herein warrants sufficient ground for invoking the Dispute Settlement Body investigations. All of them involve either implementation of non-binding, best endeavour clauses in the agreement or new concessions. But the Doha Decision on these issues and concerns have landed on future negotiating agenda of the Doha Ministerial Declaration with developed countries mainly offering 'best endeavour', 'good faith effort' clauses in the Decision.
- (iii) *Doha Ministerial Declaration* – The Doha Work Programme, launched by Doha Ministerial Declaration can be divided into three parts :
 - Agenda with clear negotiating mandate : For seven items: implementation, agriculture, services, market access for non-agriculture products, trade and environment, WTO rules, TRIPS and Dispute Settlement.
 - Singapore Issues : with ambiguous negotiating mandate. These are MAI, competition policy, trade facilitation, and transparency in government procurement.
 - Study programme : On trade and investment, trade and competition policy, trade and environment, intellectual property, e-commerce, small economies, trade, debt and finance etc.

Answer 6(c)

Singapore Ministerial Declaration on Trade in Information Technology Products

Ministers, representing Members of the WTO and States or separate customs territories in the process of acceding to the WTO, which have agreed in Singapore

on the expansion of world trade in information technology products and which account for well over 80 per cent of world trade in these products ("parties") declared that each party's trade regime should evolve in a manner that enhances market access opportunities for information technology products, each party shall bind and eliminate customs duties and other duties and charges of any kind, within the meaning of Article II:1(b) of the General Agreement on Tariffs and Trade 1994, with respect to the following:

- (a) All products classified (or classifiable) with Harmonized System (1996) ("HS") headings listed in Attachment A to the Annex to the Declaration; and
- (b) All products specified in Attachment B to the Annex to the Declaration, whether or not they are included in Attachment A;

through equal rate reductions of customs duties beginning in 1997 and concluding in 2000, recognizing that extended staging of reductions and, before implementation, expansion of product coverage may be necessary in limited circumstances.

Ministers expressed satisfaction about the large product coverage and instructed their respective officials to make good faith efforts to finalize plurilateral technical discussions in Geneva on the basis of these modalities, and to complete this work by January 31, 1997, so as to ensure the implementation of this Declaration by the largest number of participants.

Ministers also invited the Ministers of other Members of the WTO, and States or separate customs territories in the process of acceding to the WTO, to provide similar instructions to their respective officials, so that they may participate in the technical discussions and participate fully in the expansion of world trade in information technology products.

Answer 6(d)

Dumping is broadly defined as exporting at prices below those charged in the domestic market or at prices insufficient to cover the cost the goods sold. The definition is only a prima facie description of phenomenon, which is in fact, far more complex. It does, however, identify the key element, which makes it a distorting instrument in international trade. The primary effect of dumping is a greater or lesser disturbance, depending upon the case, of a given economic sector of the import market. The ultimate result is that the exporting firm gains advantage overall other producers, foreign or national, trading on the import market. The opportunities for profit from dumping depend upon the inter-section of three variables: the demand for the firm's production its own country and abroad, the barriers to re-entry into the exporting market, and the nature of the firms, cost structure.

Types of Dumping

Dumping can be also characterized as international price discrimination, as predatory pricing or as intermittent dumping.

- (i) Price discrimination implies charging of significantly different product prices

to two or more customers when there are no significant differences between the costs to the sellers for supplying to those customers. There are two arguments for prohibiting price discrimination. Since price discrimination involves some degree of monopoly or market dominance it can lead to decrease in output and thus impose welfare losses on the society.

- (ii) Predatory pricing is the second characterization of dumping that gives rise to an economic rationale for antidumping laws. It consists of systematically pricing below cost with a view to intimidating and eliminating rivals in an effort to bring about a market price higher than otherwise would prevail. Antidumping laws penalize predatory pricing in addition to international price discrimination by authorizing the constructed cost method of calculating the normal value.
- (iii) The final characterization of dumping that gives rise to an economic rationale for antidumping laws is intermittent dumping. A situation in which this occurs is oversupply of perishable goods. Agricultural producers often make planning decisions long before selling their produce.

Question 7

(a) *The Dispute Settlement Understanding (DSU) is often seen as one of the most important achievements in the World Trade Organisation (WTO) agreement. Match the following with the approximate target period for each stage of dispute settlement procedure :*

- | | |
|---|---------------------|
| (i) <i>Panel set-up and panelists appointment</i> | (a) <i>60 Days</i> |
| (ii) <i>Final panel report to WTO members</i> | (b) <i>45 Days</i> |
| (iii) <i>Consultations, mediation, etc.</i> | (c) <i>6 Months</i> |
| (iv) <i>Final panel report to parties</i> | (d) <i>3 Weeks</i> |
| (v) <i>Dispute settlement body adopts appeals report (if no appeal)</i> | (e) <i>60 Days.</i> |
- (1 mark each)

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

- (i) _____ duties have been described as 'a curious hybrid of tariff ideas and price discrimination theories of anti-tariff laws'.
- (ii) _____ is broadly defined as exporting at price below those charged in the domestic market or at a price insufficient to cover the cost of goods sold.
- (iii) _____ means placing home and foreign producers on an equal level with regard to artificial conditions of production caused by foreign bounties, but not interfering with natural comparative advantage.

- (iv) _____ is the comparable price at which the goods under complaint are sold, in ordinary course of trade, in the domestic market of the exporting country or territory.
- (v) _____ refers to the difference between normal value of the like article and export price of the product under consideration.
(1 mark each)
- (c) State, with reasons in brief, whether the following statements are true or false :
- (i) Mercantilist writers argued that a key objective of trade should be to promote a favourable balance of trade.
- (ii) According to Adam Smith, division of labour was not limited by the extent of market.
- (iii) Comparative advantage states that a less developed country that lacks an absolute advantage in any good can still engage in mutually beneficial trade.
- (iv) The Association of South East Asian Nations (ASEAN) was established on 8th August, 1967 in Bangkok by six original members.
- (v) The Uruguay Round was largest trade negotiation ever and most probably the largest negotiation of any kind in international trade history,
(1 mark each)
- (d) Write a note on institutional arrangement in India for anti-dumping, anti-subsidy and safeguard against unfair trade practices. (5 marks)

Answer 7(a)

- (i) Panel set up and panelists appointment = (b) 45 days
- (ii) Final panel report to WTO members = (d) 3 weeks
- (iii) Consultations, mediation, etc. = (a) 60 days
- (iv) Final panel report to parties = (c) 6 months
- (v) Dispute Settlement Body adopts appeals report (if no appeal) = (e) 60 days

Answer 7(b)

- (i) **Antidumping** duties have been described as 'a curious hybrid of tariff ideas and price discrimination theories of anti-tariff laws'.
- (ii) **Dumping** is broadly defined as exporting at price below those charged in the domestic market or at a price insufficient to cover the cost of goods sold.
- (iii) **Fair trade** means placing home and foreign producers on an equal level with regard to artificial conditions of production caused by foreign bounties, but not interfering with natural comparative advantage.

- (iv) **Normal value** is the comparable price at which the goods under complaint are sold, in ordinary course of trade, in the domestic market of the exporting country or territory.
- (v) **Margin of dumping** refers to the difference between normal value of the like article and export price of the product under consideration.

Answer 7(c)(i)**True**

Mercantilist writers argued that a key objective of trade should be to promote a favourable balance of trade. A favourable balance of trade is one in which the value of domestic goods exported exceeds the value of foreign goods imported.

Answer 7(c)(ii)**False**

According to Smith, the division of labour was limited by the extent of the market; in other words, small markets would not be able to support a great deal of specialization, whereas larger markets could.

Answer 7(c)(iii)**True**

Comparative advantage states that a less developed country that lacks an absolute advantage in any goods can still engage in mutually beneficial trade. Those countries whose domestic industries are more efficient than those in any other country can still benefit from trade by exporting goods that have more efficiency compared to other goods in the country.

Answer 7(c)(iv)**False**

The Association of South-East Asian Nations (ASEAN) was established on 8 August, 1967 in Bangkok by the five original Member Countries, namely, Indonesia, Malaysia, Philippines, Singapore, and Thailand.

Answer 7(c)(v)**True**

Uruguay Round was the largest trade negotiation ever, and most probably the largest negotiation of any kind in international trade history. It took seven and a half years, almost twice the original schedule. By the end, 123 countries were taking part. It covered almost all trade, from toothbrushes to pleasure boats, from banking to telecommunications, from the genes of wild rice to AIDS treatments.

Answer 7(d)**Institutional arrangement in India for anti dumping, anti-subsidy and safeguard action against unfair trade practices**

Anti dumping and anti subsidies & countervailing measures in India are

administered by the Directorate General of Anti dumping and Allied Duties (DGAD) functioning in the Dept. of Commerce in the Ministry of Commerce and Industry and the same is headed by the "Designated Authority".

The Designated Authority's function, however, is only to conduct the anti dumping/anti subsidy & countervailing duty investigation and make recommendation to the Government for imposition of anti dumping or anti subsidy measures. Such duty is finally imposed/levied by a Notification of the Ministry of Finance. Thus, while the Department of Commerce recommends the Anti-dumping duty, it is the Ministry of Finance, which levies such duty.

Safeguard measures, on the other hand, are administered by another Authority namely, Director General (Safeguard), which functions under the Dept. of Revenue, Ministry of Finance. The Standing Board of Safeguards (chaired by the Commerce Secretary) considers the recommendations of the DG (Safeguards) and then recommends the impositions of the Safeguard Duty as it deems fit, to the Ministry of Finance which levies the duty.

Question 8

- (a) Explain the process of 'dumping investigation'. (5 marks)
- (b) Describe the types of 'specificity' that comes within the ambit of SCM? agreement. Give examples to substantiate your answer. (5 marks)
- (c) Explain the circumstances under which anti-dumping duties can be levied retrospectively. (5 marks)
- (d) What are 'rules of origin' and why are they considered to be an essential part of trade rules ? (5 marks)

Answer 8(a)

A dumping investigation can normally be initiated only upon receipt of a written application by or on behalf of the "Domestic Industry". Designated Authority, receiving the application proceeds expeditiously with the conduct of the investigation and, in appropriate cases; make a preliminary finding containing the detailed information on the main reasons behind it.

Provisional Duty

A provisional duty not exceeding the margin of dumping may be imposed by the Central Government on the basis of the preliminary finding recorded by the Designated Authority. The provisional duty can be imposed only after the expiry of 60 days from the date of initiation of investigation.

Oral Evidence

Interested parties who participate in the investigations can request the Designated Authority for an opportunity to present the relevant information orally.

Final Determination

The final determination is normally made within 150 days of the date of Preliminary determination.

Disclosure of Information

The Designated Authority will inform all interested parties of the essential facts, which form the basis for its decision before the final finding is made.

Time-limit for Investigation Process

The normal time allowed by the statute for conclusion of investigation and submission of final findings is one year from the date of initiation of the investigation. The above period may be extended by the Central Government by 6 months.

Termination

The Designated Authority may suspend or terminate the investigation in the following cases :

- (i) if there is a request in writing from the domestic industry at whose instance the investigation was initiated.
- (ii) when there is no sufficient evidence of dumping or injury.
- (iii) injury is negligible.

Answer 8(b)

There are four types of "specificity" within the meaning of the SCM Agreement:

- *Enterprise-specificity* : A government targets a particular company or companies for subsidization.
- *Industry-specificity* : A government targets a particular sector or sectors for subsidization.
- *Regional specificity* : A government targets producers in specified parts of its territory for subsidization.
- *Prohibited subsidies* : A government targets export goods or goods using domestic inputs for subsidization.

Assuming that a measure is a subsidy within the meaning of the SCM Agreement, it nevertheless is not subject to the SCM Agreement unless it has been specifically provided to an enterprise or industry or group of enterprises or industries. The basic principle is that a subsidy that distorts the allocation of resources within an economy should be subject to discipline. Where a subsidy is widely available within an economy, such a distortion in the allocation of resources is presumed not to occur. Thus, only "specific" subsidies are subject to the SCM Agreement disciplines.

Answer 8(c)

Anti-dumping duties can be levied retrospectively, where-

- (i) there is a history of dumping which caused the injury or that the importer

was, or, should have been aware that the exporter practices dumping and that such dumping would cause injury, and

- (ii) The injury is caused by massive dumping, in a relatively short time, so as to seriously undermine the remedial effect of anti-dumping duty. Such retrospective application will not go beyond 90 days of the date of imposition of provisional duty. Further, no retrospective application prior to the date of initiation of investigation is possible.

Answer 8(d)

“Rules of origin” are the criteria used to define where a product was made. They are an essential part of trade rules because a number of policies discriminate between exporting countries: quotas, preferential tariffs, anti-dumping actions, countervailing duty, and more. Rules of origin are also used to compile trade statistics, and for “made in” labels that are attached to products. This first-ever agreement on the subject requires WTO members to ensure that their rules of origin are transparent; that they do not have restricting, distorting or disruptive effects on international trade; that they are administered in a consistent, uniform, impartial and reasonable manner; and that they are based on a positive standard. For the longer term, the agreement aims for common rules of origin among all WTO members, except in some kinds of preferential trade.

ADVANCED TAX LAWS AND PRACTICE

Time allowed : 3 hours

Maximum marks : 100

NOTE : All the references to sections mentioned in Part-A and Part-C of the Question Paper relate to the Income-tax Act, 1961 and relevant Assessment Year 2012-13, unless stated otherwise.

PART A

(Answer ANY TWO Questions from this part)

Question 1

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

- (i) The minimum penalty for failure to get accounts audited under section 44AB or furnish audit reports along with return of income is ₹1 lakh and is imposed by the assessing officer.
 - (ii) The, minimum penalty for failure to deduct tax at source or failure to pay wholly or partly the tax-under section 115-O(2) or second proviso to section 194-B is a sum equal to the amount of tax failed, to be deducted or paid.
 - (iii) A non-resident company's tax liability arises in India when the resident company credit the royalty payable for the amount due before making payments to it outside India based on the contract which was signed and executed outside India.
 - (iv) It is mandatory for a corporate assessee to file a return in electronic form even if there is a loss or nil income as per section 139(1) read with section 139D.
 - (v) The law declared by the Supreme Court upon a judgment of a High Court is binding on that High Court only. (2 marks each)
- (b) "Assets which are included in the definition of 'intangible assets' under section 32(1)(ii) include, along with other things, any other business or commercial rights of similar nature; goodwill, when appositely understood, does convey a positive reputation built by a person / company/business concern over a period of time and hence, it is an asset, eligible to depreciation."

Critically 'examine the proposition stated in the above para. Support your answer with relevant case law. (5 marks)

Answer 1(a)(i)

False : The minimum penalty for failure to get accounts audited under Section 44AB or furnish audit reports along with Return of Income is ₹ 1,50,000/- or one-half percent of total sales and is imposed by Assessing Officer.

Answer 1(a)(ii)

True : The minimum penalty for failure to deduct tax at source or failure to

pay wholly or partly the tax under section 115-O (2) or second proviso to Section 194B is a sum equal to the amount of tax omitted to be deducted or paid.

Answer 1(a)(iii)

True : A non-resident company's tax liability depends upon the accounting entry passed by the resident company in India. The Hon'ble Supreme Court in case of *Standard Triumph Motor Company Ltd. v. CIT* (1993) 201 ITR 391 held that when an Indian resident company passes an entry crediting a non-resident company with an amount of royalty payable, it tantamount to receiving income in India and hence, falls into the Indian tax net.

Answer 1(a)(iv)

True : Section 139(1) of Income-tax Act, 1961, provides that in case of a corporate assessee, it is mandatory to file its return of income even if there is loss or nil income. Section 139 further provides that a corporate assessee has to file its return of income by e-filing only with digital signature.

Answer 1(a)(v)

False : Where the judgment of a High Court is changed or reversed in an appeal by the Supreme Court, it is binding on all courts within the territory of India under Article 141 of the Constitution.

Answer 1(b)

The proposition contained in the question is based on the judgment in the case of *CIT v. Hindustan Coca Cola Beverages Pvt. Ltd.* (DEL).

The scope of Section 32 has been widened by the Finance (No.2) Act, 1998 whereby depreciation is now allowed on intangible assets acquired on or after 1st April, 1998. As per Section 32(1)(ii), depreciation is allowable in respect of know-how, patent, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature being intangible assets. Scanning the anatomy of this section, it can safely be stated that the provision allows depreciation on both tangible and intangible assets and clause (ii) enumerates the intangible assets on which depreciation is allowable. The assets which are included in the definition of 'intangible assets' under Section 32(1)(ii) includes, along with other things, any other business or commercial rights of similar nature.

To effectively understand what would constitute an intangible asset, certain aspects, like the nature of goodwill involved, how the goodwill has been generated, how it has been valued, agreement under which it has been acquired, what intangible asset it represents, namely, trademark, right, patent, etc. and further whether, it would come within the clause, namely, 'any other business or commercial rights which are of similar nature are to be borne in mind.

The depreciation was claimed on goodwill by the assessee on account of payment made for the marketing and trading reputation, trade style and name, marketing and distribution, territorial know-how, including information or consumption patterns and habits of consumers in the territory and the difference between the consideration paid for business and value of tangible assets. The Tribunal had treated the same to be valuable commercial asset similar to other intangibles

mentioned in the definition of the block of assets and, hence, eligible to depreciation. It has also been noted by the Tribunal that the said facts were stated by the assessee in the audit report and assessing officer had examined the audit report and also made queries and accepted the explanation preferred by the assessee. The acceptance of the claim of the assessee by the assessing officer would come in the compartment of taking a plausible view in as much as basically intangible assets are identifiable non-monetary assets that cannot be seen or touched or physical measures which are created through time and/or effort and that are identifiable as a separate asset. They can be in the form of copyrights, patents, trademarks, goodwill, trade secrets, customer lists, marketing rights, franchises etc. which either arise on acquisition or are internally generated.

Question 2

- (a) *Lucent Ltd. purchased a machinery on 1st April, 2011 for ₹ 10 crore by availing 70% loan facility from bank. The machine was put to use into effective production on 1st February, 2012. The interest on loan works out to 12% per annum. Advise Lucent Ltd. on the treatment of interest payment made on this loan and depreciation allowable for the previous year 2011-12. You may assume that this is the only machine in its block.*
(5 marks)
- (b) *Various houses owned by the assessee-company were allotted for the residential purposes to its employees having salaries less than ₹ 5 lakh per annum. The company claimed wealth-tax exemption in respect of the said houses (including the land appurtenant comprising of garden, pathway, tennis court etc.). The department has denied such exemption. Examine whether the action of the department is tenable in law? Cite relevant case law.*
(5 marks)
- (c) *Can the Appellate Tribunal rectify the mistake in the following separate cases—*
- if a different interpretation of law is available.*
 - if a retrospective amendment is made to the provision.*
 - if a subsequent decision of the Supreme Court is available on the subject after the Appellate Tribunal's order.*
 - if a ruling cited before the Appellate Tribunal is not considered.*
 - if fresh grounds are raised before the Appellate Tribunal.*
- (1 mark each)

Answer 2(a)

Total Interest for the Year 2011-12

$$\text{₹ 10 crore} \times 12\% \text{ per annum} \times 70\% = \text{₹ 84 lakh}$$

$$\begin{array}{l} \text{Interest to be capitalized with cost of asset as per proviso} \\ \text{to Section 36(1)(iii) ₹ 84 lakh} \times 10 \text{ months}/12 \text{ months} \end{array} = \text{₹ 70 lakh}$$

$$\text{Interest to be claimed as deduction under section 36(1)(iii)} = \underline{\text{₹ 14 lakh}}$$

Note : Interest is capitalized for pre-commencement period, i.e., from 1.4.2011 to 31.1.2012 (10 months)

Calculation of Depreciation Allowance

Actual cost of Machine for the purpose of depreciation =

$$\text{₹ 10 crore} + \text{₹ 70 lakh} = \text{₹ 10.7 crore}$$

Normal Depreciation allowed under section 32

$$\text{₹ 10.7 crore} \times 15\% \times 50\% = \text{₹ 0.80 crore}$$

Additional Depreciation under section 32(1)(iia)

$$\text{₹ 10.7 crore} \times 20\% \times 50\% = \text{₹ 1.07 crore}$$

Total Depreciation allowable

$$= \underline{\text{₹ 1.87 crore}}$$

Note : Depreciation is restricted to 50% of the depreciation allowable, if asset is acquired during the previous year and put to use for less than 180 days.

Answer 2(b)

The facts of the case are similar to *Binny Ltd. v. Asstt. CIT* (2010) 324 ITR 34 (Mad.), wherein it was held that, if the building together with the land is treated as an indivisible unit and enjoyed as such by the persons occupying the building, the entire extent of land is appurtenant to the building. The various amenities, such as, roads, garden, play area etc., as long as they are used solely for residence and benefit of those grounds is confined to the residents of the house and their visitors, such grounds would qualify to be land appurtenant to the building. Hence, the company was entitled to exemption in respect of the gardens, pathway, tennis court, etc. which were appurtenant to land under section 2(ea)(i) of the Wealth Tax Act, 1957.

Answer 2(c)

Any mistake in the order passed by the Tribunal, which is apparent from the record, may be rectified by the Tribunal under section 254(2). Rectification under different cases may be examined as under:

- (i) No, Possibility of a different view of law does not justify the Tribunal to recall appellate order in exercise of the power under section 254(2).
- (ii) No, If the order passed was correct in law at the time when it was passed, it does not cease to be correct merely because of the retrospective amendment made to the provision.
- (iii) No, A subsequent decision of the Supreme Court cannot result in rectification, if at the time, the order was passed, it was consistent with law.
- (iv) Yes, Non-consideration by the Tribunal of a judgment cited before the Tribunal constitutes a mistake apparent from record within the meaning of Section 254(2).
- (v) No, An assessee cannot apply for rectification of the Tribunal's order by raising fresh grounds which were not raised earlier.

Question 3

What is the difference between 'minimum alternate tax' under section 115JAA and 'alternate minimum tax' under section 115JC? Who is subject to these taxes? Also discuss the implication of these taxes in the case of an overseas entity having a permanent establishment (PE) in India. (15 marks)

Answer 3**Difference between Minimum Alternate Tax (MAT) and Alternate Minimum Tax (AMT)**1. *Applicability*

As per section 115JB of the Income Tax Act, 1961, MAT is applicable only on companies. As per Section 115JC, AMT is applicable on Limited Liability Partnerships (LLPs).

2. *When liability arises*

Company needs to pay the Minimum Alternate Tax, if the income-tax payable by a Company, on the total income as computed under this Act in respect of any previous year relevant to the assessment year commencing on or after the 1st day of April, 2011, is less than 18.5% of its book profit, than

- such book profit shall be deemed to be the total income of the Company, and
- the tax payable by the Company on such total income shall be the amount of income-tax at the rate of 18.5% of the book profit.

Where the regular income-tax payable for a previous year by a limited liability partnership is less than the alternate minimum tax payable for such previous year, the adjusted total income shall be deemed to be the total income of the limited liability partnership for such previous year and it shall be liable to pay income-tax on such total income at the rate of eighteen and one-half per cent.

3. *Book Profits and Adjusted Total Income*

Book profit means the net profit arrived after making the specified adjustments. The net profit shall be increased by the following amounts, where any of these is debited to profits and loss account:

- (a) the amount of income-tax paid or payable, and the provision therefor; or
- (b) the amounts carried to any reserves, by whatever name called, other than a reserve specified under section 33AC; or
- (c) the amount or amounts set aside to provisions made for meeting liabilities, other than ascertained liabilities; or
- (d) the amount by way of provision for losses of subsidiary companies; or

- (e) the amount or amounts of dividends paid or proposed; or
- (f) the amount or amounts of expenditure relatable to any income to which section 10 [other than expenditure relating to income referred in clause (38)] or section 11 or section 12 apply; or
- (g) the amount of depreciation,
- (h) the amount of deferred tax and the provision therefor,
- (i) the amount or amounts set aside as provision for diminution in the value of any asset,

Further, the net profits shall be reduced by the following:

- (i) the amount withdrawn from any reserve or provision, if any such amount is credited to the profit and loss account:
- (ii) the amount of income to which any of the provisions of section 10 (other than income referred in clause (38) thereof) or section 11 or section 12 apply, if any such amount is credited to the profit and loss account; or
- (iia) the amount of depreciation debited to the profit and loss account (excluding the depreciation on account of revaluation of assets); or
- (iib) the amount withdrawn from revaluation reserve and credited to the profit and loss account, to the extent it does not exceed the amount of depreciation on account of revaluation of assets referred to in clause (iia); or
- (iii) the amount of loss brought forward or unabsorbed depreciation, whichever is less as per books of account;
- (iv) the amount of profits of sick industrial company for the assessment year commencing on and from the assessment year relevant to the previous year in which the said company has become a sick industrial company under sub-section (1) of section 17 of the Sick Industrial Companies (Special Provisions) Act, 1985 (1 of 1986) and ending with the assessment year during which the entire net worth of such company becomes equal to or exceeds the accumulated losses;
- (vi) the amount of deferred tax, if any such amount is credited to the profit and loss account;

Adjusted total income referred to in sub-section (1) shall be the total income before giving effect to this Chapter as increased by—

- (i) deductions claimed, if any, under any section included in Chapter VI-A under the heading "C- Deduction in respect of certain incomes", and
- (ii) deduction claimed, if any, under section 10AA.

4. *Audit Report*

Every company, to which this section applies, shall furnish a report in Form 29B from a Chartered Accountant as defined in the Explanation below section 288(2), certifying that the book profit has been computed in

accordance with the provisions of this section along with return of income filed under section 139(1).

Every limited liability partnership to which this section applies shall obtain a report, in Form No. 29C, from an accountant certifying that the adjusted total income and the alternate minimum tax have been computed in accordance with the provisions of this Chapter and furnish such report on or before the due date of filing of return under sub-section (1) of section 139.

5. *Tax Credit*

Under MAT provisions, the amount of tax credit shall be the excess of MAT paid over the tax payable on the total income. Whereas, under AMT provisions, the tax credit shall be the excess of AMT paid over the regular income-tax payable of that year. The amount of tax credit in both the cases can be carry forward and set off up to 10 assessment years.

Implication of MAT and AMT on overseas entity having a permanent establishment in India:

As per advance ruling in case of The Timken Company (AAR), Section 115JB is not designed to be applicable to a foreign company, who has no presence or PE in India. Therefore, the provisions of MAT shall be applicable on an overseas entity (in the form of company) having a permanent establishment (PE) in India.

As per section 2(23) of the Income Tax Act, firm shall have the meaning assigned to it in the Indian Partnership Act, 1932 and shall include a Limited Liability Partnership as defined in LLP Act, 2008. As per section 2(n) of the LLP Act, 2008, LLP means a partnership formed and registered under the LLP Act.

Since, an overseas business entity having a permanent establishment in India, is not to be treated as LLP as per the LLP Act, 2008. Therefore, the provisions of AMT may not be applicable to such type of entity.

PART B

(Answer Question No. 4 which is 'compulsory and any two of the rest from this part.)

Question 4

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

(i) What is the source of power of levying VAT under the Constitution of India -

- (a) Entry 84 of List I
- (b) Entry 97 of List I
- (c) Entry 52 of List II
- (d) Entry 54 of List II.

- (ii) National Calamity Contingent Duty of customs is not imposed on -
- Mobile phones
 - Pan masala
 - Chewing tobacco
 - Cigarettes.
- (iii) What is the amount of prescribed fees which should be accompanied with an application to settlement commission -
- ₹ 500
 - ₹ 1,000
 - ₹ 2,500
 - ₹ 5,000.
- (iv) Section 114 of the Customs Act, 1962 provides for levy of penalty in case of goods in respect of which any prohibition is in force not exceeding —
- One time of the value of the goods
 - Three times of the value of the goods
 - Two times of the value of the goods
 - Four times of the value of the goods.
- (v) Credit, balance as on 31st January, 2012 is ₹ 75,000 and on 5th February, 2012 it is ₹ 87,000. Duty payable for January, 2012 is ₹ 90,000. How much credit can the assessee utilise from the CENVAT credit account—
- ₹ 87,000
 - ₹ 75,000
 - ₹ 37,500
 - ₹ 43,500. (1 mark each)
- (b) Re-write the following sentences after filling-in the blank spaces with appropriate word(s)/figure(s) :
- Service tax is a _____ based consumption tax on commercial activities.
 - Residual penalty for violation of CENVAT Credit Rules can be imposed _____ under Rule 15A of CENVAT Credit Rules, 2004.
 - Refund of export duty under section 26 of the Customs Act, 1962 is _____ provisions of unjust enrichment.
 - Promissory estoppel plea fails where _____ intervenes.
 - _____ means the value of imported goods determined in accordance with Rule 8 of Customs Valuation (Determination of Price of Imported Goods) Rules, 2007. (1 mark each)
- (c) State whether the following goods are 'input' as per Rule 2(k) of the CENVAT Credit Rules, 2004 :
- All goods used for generation of electricity for captive use

- (ii) *Light diesel oil*
 - (iii) *Motor vehicles*
 - (iv) *Goods used for making of structures for support of capital goods*
 - (v) *Goods used for providing free warranty for final products.*
- (d) *Pradhan imported a consignment valuing ₹ 8 lakh vide a bill of entry presented before the proper officer on 25th April, 2011 on which date the rate of customs duty was 10%. On Pradhan's failing to produce requisite documents for the purpose of assessment, the goods were provisionally assessed at a value of ₹ 8 lakh and the duty was paid accordingly on the same date. The goods were finally assessed at ₹ 12 lakh on 9th June, 2011 and the differential duty was paid on 12th June, 2011.*
- Compute the amount of interest, if any, under section 18 of the Customs Act, 1962.* (5 marks)

Answer 4(a)(i)

- (d) Entry 54 of List II

Answer 4(a)(ii)

- (a) Mobile Phones

Answer 4(a)(iii)

- (b) ₹ 1,000

Answer 4(a)(iv)

- (b) Three times of the value of the goods

Answer 4(a)(v)

- (b) ₹ 75,000

Answer 4(b)

- (i) Service tax is a **destination** based consumption tax on commercial activities.
- (ii) Residual penalty for violation of CENVAT Credit Rules can be imposed **Upto ₹ 5,000** under Rule 15A of CENVAT Credit Rules, 2004.
- (iii) Refund of export duty under section 26 of the Customs Act, 1962 is **not subject to** provisions of unjust enrichment.
- (iv) Promissory estoppel plea fails where **Public Interest** intervenes.
- (v) **Computed Value** means the value of imported goods determined in accordance with Rule 8 of Customs Valuation (Determination of Price of Imported Goods) Rules, 2007.

Answer 4(c)

- (i) Yes

- (ii) No
- (iii) No
- (iv) No
- (v) Yes

Answer 4(d)

The importer shall be liable to pay interest on any differential amount payable after final assessment, from the first day of the month in which duty is provisionally assessed till date of payment. Present interest rate is 18% w.e.f. 1.4.2011.

The amount of interest in present case shall be arrived as under :

- (i) The amount of differential duty payable by Mr. Pradhan = (₹ 12 lakh – ₹ 8 lakh) x 10.3% = ₹ 41,200.
- (ii) No. of days for which interest is payable = 01.04.2011 to 12.06.2011 = 73 days.
- (iii) Amount of interest payable by Mr. Pradhan = ₹ 41,200 x 18% x 73 days/ 365 days = ₹ 1,483.20 = ₹ 1,483 (rounded off).

Question 5

- (a) *Avon Plastic Ltd. is a company manufacturing plastic goods. It has two factories one at Jaipur and another at Noida. Following information in respect of the two factories is available for the financial year 2011-12 :*

| Particulars | (₹ in lakhs) | |
|--|-------------------|------------------|
| | Jaipur Factory | Noida Factory |
| (i) Goods cleared with own brand name | 75 | 100 |
| (ii) Clearances of plastic containers bearing brand name of Jolly Jams (to pack jam by them) | 45 | 70 |
| (iii) Goods cleared to 100% EOU against Form CT-3 | 90 | 80 |
| (iv) Export to Bhutan | 50 | 60 |
| (v) Job work under Notification No. 214/86-CE dated 25.03.1986 | 65 | 55 |
| (vi) Job work under Notification No. 84/94-CE dated 11.04.1994 | 85 | 95 |

On the basis of above information, you are required to ascertain whether Avon Plastic Ltd. is eligible for the benefit of small scale exemption under Notification No. 8/2003-CE dated 1st March, 2003 during the financial year 2011-12.

(6 marks)

- (b) *From the following information, compute the amount of basic customs duty*

and additional duty of customs payable under section 3(1) of the Customs Tariff Act, 1975 in respect of import of readymade garments :

- Assessable value under customs : ₹ 1,50,000;
- Tariff value notified under central excise for levy of excise duty : 45% of the retail sale price;
- Retail sale price : ₹ 4,00,000 (readymade garments are not notified under section 4A of the Central Excise Act, 1944);
- Basic customs duty : 10%;
- Central excise duty : 10%; and
- Education cess : as applicable. (5 marks)

(c) Vishal has made an unauthorised import of 1,000 pieces of a product. Other particulars are as under :

| | | |
|----------------------------|---|-------------------|
| Total assessable value | : | ₹ 5,00,000 |
| Total customs duty payable | : | ₹ 1,20,000 |
| Market price in India | : | ₹ 1,000 per piece |

Customs authorities have confiscated the said goods and importer has been given an option to get the said goods released on payment of a fine equal to margin of profit.

Compute - (i) amount of fine payable; and (ii) maximum amount of fine under section 125 of the Customs Act, 1962. (4 marks)

Answer 5(a)

Computation for the purpose of limit of ₹ 400 lakh

| | (₹ in lakhs) | |
|--|------------------|------------|
| | Jaipur | Noida |
| (i) Goods cleared with own brand name | 75 | 100 |
| (ii) Clearance of plastic containers with brand name of Jolly Names (packing material) | 45 | 70 |
| (iii) Goods cleared to 100% EOU (Deemed export) | (Not includible) | |
| (iv) Export to Bhutan | 50 | 60 |
| (v) Job work under Notification No. 214/86 | (Not includible) | |
| (vi) Job work under Notification No. 84/94 | (Not includible) | |
| Total Turnover | <u>170</u> | <u>230</u> |

If the same manufacturer has more than one factory, the turnover of all factories has to be clubbed together for calculating the SSI exemption limit of ₹ 400 lakh.

Since the aggregate value of clearances during the preceding financial year does not exceed ₹ 400 lakh (₹ 170 lakh + ₹ 230 lakh = ₹ 400 lakh), the company is eligible for SSI exemption in the Financial Year 2011-12.

Answer 5(b)**Computation of Customs duty payable**

| | ₹ |
|---|---------------|
| (i) Basic Customs duty @ 10% of ₹ 1,50,000 | 15,000 |
| (ii) Additional duty of customs (CVD) @ 10.3% of Tariff value i.e. 45% of ₹ 4,00,000 | <u>18,540</u> |
| Total (BCD + CVD) | 33,540 |
| (iii) Education Cess @ 3% of ₹ 33,540 | <u>1,006</u> |
| Total Customs duty payable | <u>34,546</u> |

Note : In case of goods liable to excise duty based on tariff value, additional duty of customs will be computed on tariff value.

Answer 5(c)**Calculation of Amount of Fine**

| | ₹ |
|---|------------------|
| Total Assessable Value of goods | 5,00,000 |
| <i>Add</i> : Total Customs duty payable | <u>1,20,000</u> |
| Total cost to importer | 6,20,000 |
| Market price in India ₹ 1,000 x 1,000 | <u>10,00,000</u> |
| Margin of profit | <u>3,80,000</u> |
| (i) Amount of fine equal to margin of profit | <u>3,80,000</u> |
| (ii) Maximum fine imposable under Section 125 = Market Price – Total Customs duty = ₹ 10,00,000 – 1,20,000 = ₹ 8,80,000 | |

Question 6

(a) *Menz Car Co. is manufacturing cars and discharging duty liability thereon by including cost of mandatory one year warranty in the transaction value of cars. An option was given to customers to obtain extended warranty for a further period of two years against payment of separate charges. This extended warranty was introduced by assessee and administered through dealers for which dealers were allowed commission. Such extended warranty charges were not included in assessable value.*

The department contended that the same were includible in assessable value of manufactured cars. Discuss, in the light of decided case law, if any, whether contention of the department is tenable in law. (5 marks)

(b) *Explain the validity of the following statements with reference to Chapter IX of the Customs Act, 1962 containing the provisions relating to warehousing:*

(i) *Owner of any warehoused goods cannot carry on any manufacturing process or other operations in relation to warehoused goods.*

- (ii) *Warehoused goods may be transferred from one warehouse to another warehouse.*
- (iii) *The importer must execute a bond equal to the amount of duty assessed with necessary surety or security. (2 marks each)*
- (c) *Briefly discuss whether the following powers vest with the Commissioner (Appeals) under the Central Excise Act, 1944/Customs Act, 1962 :*
 - (i) *Remanding the case back to the adjudicating authority; and*
 - (ii) *Condoning the delay in filing appeal before him. (2 marks each)*

Answer 6(a)

The facts of the case are similar to that in *CC Ex. v. Ford India Pvt. Ltd.* (2010) 255 ELT A14 (SC). In this case, it was held that only the first sale transaction is relevant for the purpose of valuation of manufactured goods. The extended warranty was optional; it was not a condition of sale. The sale of car and sale of extended warranty are two different businesses, which had no direct or proximate connection.

The definition of transaction value in section 4 of the Central Excise Act, 1944 makes it clear that only payments made by the buyers of the goods are includible in transaction value. In this case, optional extended warranty charges are paid by final customers and not by dealers.

Hence, contention of the Department is not tenable in law and Menz Car Company is not required to include these charges in the assessable value of cars.

Answer 6(b)

- (i) **False** : Section 65 provides that owner of any warehoused goods may carry on any manufacturing process or other operations in relation to warehoused goods with the sanction of AC/DC and subject to prescribed conditions on payment of prescribed fees.
- (ii) **True** : According to Section 67, the owner of any warehoused goods may be removed from one warehouse to another, with the permission of proper officer and subject to such conditions as may be prescribed.
- (iii) **False** : As per Section 59, the importer must execute a bond for twice the amount of duty assessed with necessary surety or security.

Answer 6(c)

- (i) **No**, Commissioner (Appeals) does not have power to remand the case back to the adjudicating authority for fresh adjudication — *MIL India Ltd. v. CC Ex/(2007) 210 ELT 188 (SC)* and CBEC F. No.275/34/2006-CX.8A, dated 18.2.2010.
- (ii) **Yes**, Commissioner (Appeals) can condone the delay in filing the appeal before him for a further period of 30 days — Section 35 of the Central Excise Act and Section 128 of the Customs Act.

Question 7

- (a) *What are the goods notified under section 3A of the Central Excise Act, 1944 liable to duty based on annual capacity of production? Whether declaration of retail sale price is mandatory in case of such notified goods?*
(5 marks)
- (b) *Briefly explain with reference to section 11AC of the Central Excise Act, 1944 the circumstances under which penalty has to be imposed mandatorily. State whether it can be reduced statutorily.*
(5 marks)
- (c) *Discuss the provisions of the Customs Act, 1962 relating to the determination of duty where imported goods consist of articles liable to different rates of duty.*
(5 marks)

Answer 7(a)

On following goods, excise duty is payable on basis of annual capacity under section 3A of Central Excise Act, 1944 :

- (i) Pan masala containing more than 15% betel nut;
- (ii) Pan masala containing tobacco, i.e., gutkha;
- (iii) Unmanufactured tobacco, bearing a brand name;
- (iv) Chewing tobacco; and
- (v) Jarda scented tobacco Manufactured with the aid of packing machine and packed in pouches.

Yes, the declaration of retail sale price is mandatory in case of such notified goods. The duty is fixed per month per packing machine based on retail sale price of pouches.

Answer 7(b)

As per section 11AC (1)(a), a mandatory penalty equal to the duty short paid or not paid or erroneously refunded is payable if such non-payment or short-payment or erroneous refund was due to fraud, collusion, willful mis-statement or suppression of facts, or contravention of any of the provisions of the Act or rules with intent to evade payment of duty.

There is no discretion to adjudicating authority to impose penalty less than or more than the amount of duty evaded. However, in case the duty, interest and the penalty all are deposited within 30 days from the date of communication of the order, then, the assessee will be liable to pay penalty equal to 25% of the duty payable.

Answer 7(c)**Determination of Duty where imported goods consists of articles liable to different rates of duty, (Section 19)**

Where goods consist of a set of articles, duty shall be calculated as follows:

- (i) Articles liable to duty with reference to quantity shall be chargeable to that duty.

- (ii) Articles liable to duty with reference to value shall, if they are liable to duty at the same rate, be chargeable to duty at that rate, and if they are liable to duty at different rates, be chargeable to the highest of such rates;
- (iii) Articles not liable to duty shall be chargeable to duty at the rate at which articles liable to duty at the highest of the rates specified in (ii) above.

However, if the importer produces to the satisfaction of the proper officer documents regarding the value of any articles liable to different rates of duty. Such article shall be chargeable to duty separately at the rate applicable to it.

Further, accessories of and spare parts or maintenance and repairing implements for, any article which satisfy the conditions specified in the rules made in this behalf shall be chargeable to different rates of duty, such article shall be chargeable at the same rate of duty as that article.

PART C

Question 8

Attempt any two of the following :

- (i) *You are a tax consultant to an overseas manufacturing company which is going to start a permanent establishment in India with manufacturing facility in Madurai District of Tamilnadu. Prepare a report for the Chairman of the company highlighting latest transfer pricing provisions applicable in India. (10 marks)*
- (ii) *Explain the provisions relating to 'advance ruling' in the Income-tax Act, 1961. (10 marks)*
- (iii) *How foreign institutional investors are taxed on their income and capital gains arising from the transfer of securities ? (10 marks)*

Answer 8(i)

Report on applicability of Transfer Pricing provisions in India

To
The Chairman
XYZ & Co., UK

This is with reference to your enquiry regarding the applicability of transfer pricing provisions to your overseas manufacturing company which is going to start a permanent establishment in India with new manufacturing unit in Madurai district. As per transfer pricing provisions permanent establishment is considered as associated enterprise thus, understanding of these provisions is essential to avoid any tax disputes/litigation. The highlights of transfer pricing provisions applicable in India are as follows:

Transfer Pricing Regulations ("TPR") are applicable to the all enterprises that entered into an 'International Transaction' with an 'Associated Enterprise'. Therefore, generally it applies to all cross border transactions entered into between associated enterprises. These regulations relates to:

1. *Computation of income from international transactions having regard to the*

Arm's length price : any income arising from an international transaction shall be computed having regard to ALP.

ALP means a price which is applied in a transaction between persons other than associated enterprise in uncontrolled conditions. As per section 92C (1), ALP in relation to an international transaction shall be determined by any of the following method being the most appropriate method:

- (a) comparable uncontrolled price method;
- (b) resale price method;
- (c) cost plus method;
- (d) profit split method;
- (e) transactional net margin method;
- (f) such other method as may be prescribed by the Board.

2. *Associated Enterprise* : "associated enterprise", in relation to another enterprise, means an enterprise:

- (a) which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or
- (b) in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

"Enterprise" means a person (including a permanent establishment of such person) who is, or has been, or is proposed to be, engaged in any activity, relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights, or the provision of services of any kind, [or in carrying out any work in pursuance of a contract,] or in investment, or providing loan or in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate, whether such activity or business is carried on, directly or through one or more of its units or divisions or subsidiaries, or whether such unit or division or subsidiary is located at the same place where the enterprise is located or at a different place or places;

"Permanent establishment", includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

3. *"International transaction"* shall include —

- (a) the purchase, sale, transfer, lease or use of tangible property including building, transportation vehicle, machinery, equipment, tools, plant, furniture, commodity or any other article, product or thing;

- (b) the purchase, sale, transfer, lease or use of intangible property, including the transfer of ownership or the provision of use of rights regarding land use, copyrights, patents, trademarks, licences, franchises, customer list, marketing channel, brand, commercial secret, know-how, industrial property right, exterior design or practical and new design or any other business or commercial rights of similar nature;
 - (c) capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business;
 - (d) provision of services, including provision of market research, market development, marketing management, administration, technical service, repairs, design, consultation, agency, scientific research, legal or accounting service;
 - (e) a transaction of business restructuring or reorganisation, entered into by an enterprise with an associated enterprise, irrespective of the fact that it has bearing on the profit, income, losses or assets of such enterprises at the time of the transaction or at any future date;
4. *Keeping and maintain of information and document by a person entering into international transaction* : As per Rule 10D(1), every person who has entered into an international transaction shall keep and maintain documents relating to international transaction.
5. *Furnishing of report from an Accountant by a person entering into such transaction* : Every person who has entered into an international transaction during a previous year shall obtain a report from an accountant and furnish such report on or before the specified date in the prescribed form duly signed and verified in the prescribed manner by such accountant and setting forth such particulars as may be prescribed.

Hence, company is advised to keep the above provision in mind before taking any sort of initiative regarding above subject matter.

Answer 8(ii)

“Advance ruling” means,

- (i) a determination by the Authority in relation to a transaction which has been undertaken or is proposed to be undertaken by a non-resident applicant;
or
- (ii) a determination by the Authority in relation to the tax liability of a non-resident arising out of a transaction which has been undertaken or is proposed to be undertaken by a resident applicant with such non-resident,
- (iii) a determination or decision by the Authority in respect of an issue relating to computation of total income which is pending before any income-tax authority or the Appellate Tribunal.

Who can seek Advance Ruling

As per Section 245N(b) of the Income Tax Act, the advance ruling under the income-tax act could be sought by :

- (a) A non-resident;
- (b) Resident having transactions with non-residents.
- (c) Specified categories of residents.

Application for advance ruling

An applicant shall make an application in such form and in such manner as may be prescribed, stating the question on which the advance ruling is sought. The application shall be made in quadruplicate and be accompanied by a fee of two thousand five hundred rupees. An applicant may withdraw an application within thirty days from the date of the application. The application may be withdrawn within 30 days from the date of the application.

The application shall be submit in the following forms:

34C Applicable for a non-resident applicant.

34D Applicable for a resident having transactions with a non-resident.

34E Applicable for the notified residents.

Procedure on receipt of Application

On receipt of an application, the Authority shall forward one copy of the application to the Commissioner having jurisdiction over the case of the applicant and, if considered necessary by the Authority, relevant records can also be obtained from the Commissioner.

Section 254R(2) of the Income Tax Act provides that the Authority may, after examining the application and the records called for, either 'allow' or 'reject' the application. The word 'allow' has been used synonymously with 'admit'. In other words, after examining the records, the Authority either admits or rejects the application. In case Authority has admitted the application, it is empowered to collect or received additional material and it will examine all the material thus available to it at the time of hearing and pronouncing a ruling on the application. In case the application has been rejected then an opportunity of being heard must be given to the assessee.

The authority shall pass the ruling in writing within six months of the receipt of application and the copy of the order thereof, shall be sent to the commissioner and assessee.

Powers of Authority

Sub-section (1) of section 245U, provides that for the purpose of exercising its powers, the Authority shall have all the powers of a Civil Court under the Code of Civil Procedure, 1908 (5 of 1908) as are referred to in Section 131 of the Income-tax Act, when trying a suit in respect of the following matters, namely :

- (a) Discovery and inspection;

- (b) Enforcing the attendance of any person, including any officer of a banking company and examining him on oath;
- (c) Compelling the production of books of account and other documents; and
- (d) Issuing commissions.

Applicability of Advance Ruling

The advance ruling pronounced by the Authority under Section 245R shall be binding only:

- (a) On the applicant who had sought it;
- (b) In respect of the transactions in relation to which the ruling had been sought; and
- (c) On the Commissioner, and the income-tax authorities subordinate to him, in respect of the applicant and the said transaction.

Answer 8(iii)

Tax on income of Foreign Institutional Investors from securities or capital gains arising from their transfer

- (1) Where the total income of a Foreign Institutional Investor includes
 - (a) income other than income by way of dividends referred to in section 115-O, received in respect of securities (other than units referred to in section 115AB); or
 - (b) income by way of short-term or long-term capital gains arising from the transfer of such securities, the income-tax payable shall be the aggregate of
 - (i) the amount of income-tax calculated on the income in respect of securities referred to in clause (a), if any, included in the total income, at the rate of twenty per cent;
 - (ii) the amount of income-tax calculated on the income by way of short-term capital gains referred to in clause (b), if any, included in the total income, at the rate of thirty per cent :
 Provided that the amount of income-tax calculated on the income by way of short-term capital gains referred to in section 111A shall be at the rate of fifteen per cent;
 - (iii) the amount of income-tax calculated on the income by way of long-term capital gains referred to in clause (b), if any, included in the total income, at the rate of ten per cent; and
 - (iv) the amount of income-tax with which the Foreign Institutional Investor would have been chargeable had its total income been reduced by the amount of income referred to in clause (a) and clause (b).
- (2) Where the gross total income of the Foreign Institutional Investor—
 - (a) consists only of income in respect of securities referred to in clause (a) of sub-section (1), no deduction shall be allowed to it under

sections 28 to 44C or clause (i) or clause (iii) of section 57 or under Chapter VI-A;

- (b) includes any income referred to in clause (a) or clause (b) of sub-section (1), the gross total income shall be reduced by the amount of such income and the deduction under Chapter VI-A shall be allowed as if the gross total income as so reduced, were the gross total income of the Foreign Institutional Investor.
 - (3) Nothing contained in the first and second provisos to section 48 shall apply for the computation of capital gains arising out of the transfer of securities referred to in clause (b) of sub-section (1).
-

GUIDELINE ANSWERS

PROFESSIONAL PROGRAMME

JUNE 2012

MODULE IV



**THE INSTITUTE OF
Company Secretaries of India**
IN PURSUIT OF PROFESSIONAL EXCELLENCE
Statutory body under an Act of Parliament

GUIDELINE ANSWERS

PROFESSIONAL PROGRAMME

JUNE 2012

MODULE IV



**THE INSTITUTE OF
Company Secretaries of India**

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

ICSI House, 22, Institutional Area, Lodi Road, New Delhi 110 003

Phones: 41504444, 45341000; Fax: 011-24626727

E-mail: info@icsi.edu; Website: www.icsi.edu

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

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

C O N T E N T S

Page

MODULE IV

- | | |
|--|----|
| 1. Due Diligence and Corporate Compliance Management | 1 |
| 2. Governance, Business Ethics and Sustainability | 19 |

(i)

NOTE: Guideline Answers of the last Six Sessions need to be updated in the light of changes and references given below::

PROFESSIONAL PROGRAMME

UPDATING SLIP

DUE DILIGENCE AND CORPORATE COMPLIANCE

MODULE – IV – PAPER 1

| <i>Examination Session</i> | <i>Question No.</i> | <i>Updating required in the answer</i> |
|----------------------------|---------------------|---|
| June 2009 to Dec. 2011 | — | (1) Unlisted Public Companies (Preferential Allotment) Amendment Rules, 2011. (2) SEBI (SAST) Regulations 1997 has been replaced by SEBI (SAST) Regulations, 2011. |

PROFESSIONAL PROGRAMME EXAMINATION

JUNE 2012

**DUE DILIGENCE AND CORPORATE
COMPLIANCE MANAGEMENT**

Time allowed : 3 hours

Maximum marks : 100

NOTE : Answer SIX questions including Question No. 1 which is **COMPULSORY**.

Question 1

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

- (i) *Due diligence is concerned with historical financial statements and provides an opinion as to whether the financial statements represent a 'true and fair' view of the company's operations.*
- (ii) *As per the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, any person aggrieved by an order of SEBI may prefer an appeal to the High Court.*
- (iii) *Neeraj holds 1.95% of the share capital of Sunrise Ltd. If he wishes to enter into a contract with Sunrise Ltd., he will be required to comply with section 299 of the Companies Act, 1956.*
- (iv) *Rajesh, a shareholder of Rosa Ltd. requested for copies of the register under section 301 of the Companies Act, 1956. His request was turned down stating that as the register contains details about interest of directors and contracts in which they are interested, it is confidential and copies cannot be given.*
- (v) *Where the validity period of an instrument of transfer of shares has expired, the holder may make an application to the prescribed authority for extension of its validity. (2 marks each)*

(b) *Critically examine and comment on the following :*

- (i) *The scope of a search report depends upon the requirements of the bank or financial institution concerned.*
- (ii) *Dematerialisation is a process of conversion of physical certificates into electronic balances. Before the process of dematerialisation is set in motion some essential pre-requisites need to be considered. (5 marks each)*

Answer 1(a)(i)

False

Reason : "Due diligence" is an analysis and risk assessment of an impending business transaction. It is the careful and methodological investigation of a business or persons, or the performance of an act with a certain standard of care to ensure that information is accurate, and to uncover information that may affect the outcome of the transaction. As such, it spans investigation into all relevant aspects of the past, present, and predictable future of the business of a target company.

Answer 1(a)(ii)**False**

Reason: As per SEBI Act, any person aggrieved by an order of SEBI may prefer an appeal to the Securities Appellate Tribunal.

Answer 1(a)(iii)**Alternate Answer 1****If Neeraj is a director,****True**

Reason: Section 299 of the Companies Act 1956, requires directors of the company who in any way are interested in a contract of the company, to disclose the nature of his interest.

Note: As per section 299(6), this section does not apply to any contract or arrangement entered into or to be entered into between two companies where any of the directors of one company or two or more of them together holds or hold not more than 2% of the paid up capital in the other company. In the spirit of law neeraj being a director is holding 1.95% of shares of the company in which he is a director, he is required to make disclosure under Section 299.

Alternate Answer 2**If Neeraj is only a shareholder****False**

Reason: Since, Neeraj in the underlying question is only a shareholder; he will not be required to comply with Section 299.

Answer 1(a)(iv)**False**

Reason: Rosa Ltd cannot refuse the member, the copies of register of contracts, companies, firms in which directors are interested as they are entitled to obtain the same, pursuant to Section 301(5) to the same extent, in the same manner and on the same fee as in the case of register of members of the company.

Answer 1(a)(v)**True**

Reason: The validity period of the instrument of transfer of shares may be extended by making an application to the ROC in FORM 7C.

Answer 1(b)(i)

The scope of a Search report depends upon the requirements of the Bank or Financial Institution concerned. A Search report prepared by the Company Secretary in Practice

enables the Bank/Financial Institution to evaluate the extent upto which the company has already borrowed moneys and created charges on the security of its movable and/or immovable properties. The Search report acts as an important source of information enabling the lending Bank/Institution to take an informed and speedy decision, and also assures it about the credit-worthiness or otherwise of the borrowing company.

Answer 1(b)(ii)

Dematerialisation is a process of conversion of physical certificates into electronic balances. Before the process of dematerialisation is set in motion some essential prerequisites need to be considered as under:

- (a) An investor must open an Account with a DP.
- (b) Only the securities eligible for demat can be dematerialized.
- (c) The securities must be in the name of the account holder and owned by him.
- (d) A separate demat requisition form (DRF) is required for each issuer.
- (e) A separate DRF is required for lock-in and lock free securities.
- (f) The DRF form must be signed by all the joint holders.

Question 2

- (a) *Write the most appropriate answer from the given options in respect of the following :*
 - (i) *As per the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009, for raising of funds through public issues, the responsibility of ensuring that the basis of allotment is fair and proper lies with —*
 - (a) *Bankers to the issue*
 - (b) *SEBI*
 - (c) *Executive director or managing director of the designated stock exchange*
 - (d) *Brokers to the issue.*
 - (ii) *American Depository Receipts (ADRs) that do not qualify or are not intended to be listed on stock exchanges are referred to as —*
 - (a) *Level 1 ADRs*
 - (b) *Level 2 ADRs*
 - (c) *Level 3 ADRs*
 - (d) *Both (b) and (c) above.*
 - (iii) *The compensation committee with respect to Employee Stock Option Scheme (ESOS) shall frame suitable policies and systems to ensure that there is no violation of —*
 - (a) *SEBI (Merchant Bankers) Regulations, 1992*
 - (b) *SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011*

- (c) SEBI (Prohibition of Insider Trading) Regulations, 1992
 (d) None of the above.
- (iv) Mergers and acquisitions in unrelated industries are called —
 (a) Horizontal mergers
 (b) Vertical mergers
 (c) Conglomerate mergers
 (d) Cogeneric mergers.
- (v) As per clause 35 of the listing agreement, a company is required to file the share holding pattern with the stock exchange on —
 (a) Monthly basis
 (b) Quarterly basis
 (c) Half-yearly basis
 (d) Annual basis.
- (vi) If the articles of association of the company do not have provision for capitalisation of reserves, then required resolution should be passed in a general meeting for making the provision and the same is to be filed with the Registrar of Companies in —
 (a) e-Form 2
 (b) e-Form 5
 (c) e-Form 23
 (d) e-Form 32. (1 mark each)
- (b) Distinguish between the following :
 (i) 'Derived instruments' and 'benchmarked instruments'.
 (ii) 'Rights issue' and 'private placement'. (5 marks each)

Answer 2(a)

- (i) (c) Executive director or managing director of the designated stock exchange
 (ii) (a) Level 1 ADRs
 (iii) (c) SEBI (prohibition of Insider Trading) Regulations, 1992
 (iv) (c) Conglomerate mergers
 (v) (b) Quarterly basis
 (vi) (c) e-Form 23

Answer 2(b)(i)**'Derived Instruments' and 'Benchmarked Instruments'**

Derived instruments are the instruments that derive their value from other debt instruments. These are not direct debt instruments. For instance:

- Mortgage Bonds

- Pass Through Certificates (PTCs)
- Participation Certificates (PCs)

Debt instruments wherein the fixed income earned is based on some benchmark rate are called Benchmarked Instruments. For instance: the Floating Interest rate Bonds are benchmarked to either the LIBOR, MIBOR etc.

Answer 2(b)(ii)

'Right Issue' and 'Private Placement'

Rights Issue is when a listed company which proposes to issue fresh securities to its existing shareholders as on a record date. The rights are normally offered in a particular ratio to the number of securities held prior to the issue. This route is best suited for companies who would like to raise capital without diluting stake of its existing shareholders unless they do not intend to subscribe to their entitlements.

A private placement is an issue of shares by a company to a select group of persons under Section 81 of the Companies Act, 1956 which is neither a rights issue nor a public issue. This is a faster way for a company to raise equity capital. A private placement of shares or of convertible securities by a listed company is generally known by name of preferential allotment.

Question 3

- (a) *Sun Ltd. and its group company Moon Ltd. acquired shares of Oasis Ltd. (the target company) over a period of time. On 29th October, 2011, Sun Ltd. and Moon Ltd. were holding 14.85% and 2.56% shares respectively of the target company. Both these companies want to further acquire shares in the target company. Can these companies freely acquire further shares in the target company as per the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ? Elaborate. (6 marks)*
- (b) *Ashok purchased 4,000 shares of Uttam Sugar Mills Ltd. from Birendra on the faith of a share certificate held in his name. Ashok tenders to the company a transfer deed, duly executed, along with Birendra's share certificate for transferring the shares in his name. The company discovers that the certificate in the name of Birendra is forged one and, hence, refused to register the transfer. As a Practising Company Secretary, what course of action would you suggest to Ashok ? (5 marks)*
- (c) *Ajoy Ltd. owns 38% shares of Bijoy Ltd. On 26th November, 2010, Ajoy Ltd. sent the requisition to Bijoy Ltd. for convening an extra-ordinary general meeting (EGM) with the objective of appointing two new directors and removal and replacement of one director on the Board of Bijoy Ltd. Bijoy Ltd. questioned the validity of requisition on the ground that though it was signed by the Company Secretary of Ajoy Ltd., but -specific authorisation by Board resolution to file such requisition had not been annexed, so it requested Ajoy Ltd. to send the Board resolution. Ajoy Ltd. sent a copy of resolution passed earlier on 29th November, 2006 under which specific authority was given to its Company Secretary to sign all legal documents.*

However, Bijoy Ltd. decided for not convening the EGM as the required Board resolution was not received by it and informed Ajoy Ltd. accordingly. Ajoy Ltd. in turn initiated the process under section 169(6) of the Companies Act, 1956 for convening EGM on its own on 17th January, 2011.

Decide the validity of the requisition dated 26th November, 2010 and calling of EGM on 17th January, 2011 by Ajoy Ltd. citing relevant provisions of law.

(5 marks)

Answer 3(a)

As per Regulation 3 of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011, an acquirer, who (along with Persons Acting in Concerts (PAC), if any) holds less than 25% shares or voting rights in a target company and agrees to acquire or acquires shares/voting rights along with PAC's that would entitle him to exercise 25% or more of voting rights in a target company, needs to make an open offer before acquiring such additional shares.

The holdings by Sun Ltd., and Moon Ltd. on 28th October 2011 was 17.41% (i.e. 14.85%+ 2.56%). Accordingly, if Moon Ltd. and Sun Ltd. along with any other person acting in concert, want to acquire additional shares that would result in 25% or more shares or voting rights in Oasis Ltd., (including the current holding of 17.41%), then, it will have to make open offer before acquiring such additional shares that would entitle them to exercise 25% or more of voting rights of Oasis Ltd.

Answer 3(b)

This is a dispute relating to transfer of shares on the basis of forged share certificates. A forgery is a nullity. Thus the action of the Company in refusing the transfer is justified. Mr. Ashok can take legal action against Mr. Birendra for transferring forged share certificates.

In *Kaushalya Devi v. National Insulated Cable Company of India Ltd.*, 1977 Tax LR 1928(Del) it was held that when shares were transferred by means of a forged instrument of transfer deed, the transferee did not get any right in respect of the shares. The fact that he was a bonafide purchaser for value would not make any difference.

Answer 3(c)

The facts of this case is similar to *IFCI LTD . v. TFCI LTD.* [Del] CO.A (SB) 13/2011 & CO. APPLS. 538/2011, 564/2011, 764/2011 Manmohan, J. [Decided on 16/05/2011], where the appellant company (hereinafter referred to as "IFCI") owns 37.85% of shares of respondent-company (hereinafter referred to as "TFCI"). On 26th November, 2010 IFCI sent a requisition to TFCI for convening an Extra-Ordinary General Meeting (for short "EOGM") with the objective of appointing four new directors and removal and replacement of one director on the Board of TFCI. However, TFCI vide letter dated 2nd December, 2010 questioned the validity of the requisition on the ground that though it was signed by the Company Secretary of IFCI, but specific authorisation/board resolution to file such requisition had not been annexed and it requested IFCI to send the said board resolution within a period of one week. Subsequently, on not getting the said information, TFCI through its board meeting held on 14th December, 2010 decided not to convene EOGM of TFCI. On receiving this information, IFCI on 15th December, 2010

initiated the process under Section 169(6) of the Act for convening an EOGM on 17th January, 2011. IFCI then filed the Company Petition No. 124(ND) of 2010 under Sections 398 and 402 of the Act on the same day before the CLB. The CLB vide its order dated 12.1.2011 deferred the holding of the EOGM and this order was impugned before the High Court, wherein the High Court allowed the EOGM to be held as scheduled on 17th January, 2011 but directed that the decisions taken by EOGM would not be given effect to till the CLB decides the petition finally. CLB's order quashed.

Question 4

- (a) *Satya Infotech Ltd. established under the Companies Act, 1956 is planning to raise funds from Euro market through issue of GDRs. The Board of directors of the company seek your advice about the steps involved in the process of GDR issue. Advise. (6 marks)*
- (b) *Shruti Cement Ltd., a listed company declared 10% dividend in the annual general meeting held on 30th September, 2011 for the year 2010-11. Indicate the time limit for payment of the dividend. Also state the circumstances when a company will not be deemed to have committed any default even if it does not pay the amount of dividend within the prescribed period. (5 marks)*
- (c) *Describe the role of a Practising Company Secretary in securities management and compliances with respect to the Securities and Exchange Board of India Act, 1992. (5 marks)*

Answer 4(a)

Process involved in the issue of GDRs

Following are the broad steps involved in GDR issue –

1. Indian company would issue rupee denominated shares to a depository outside India, where the GDRs 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 GDRs to foreign investors.
5. Listing of GDRs in American and European Stock Exchanges would take place.
6. Indian company has to comply with various requirements of EU directives and SEC requirements.

Answer 4(b)

The time limit for payment of the dividend to the registered shareholders under the Companies Act 1956 is within 30 days of its' declaration.

As per section 207 of the said act, the circumstances when a company will not be deemed to have committed any default even if it does not pay the amount of dividend in prescribed period are as follows –

- (a) where the dividend could not be paid by reason of the operation of any law;
- (b) where a shareholder has given directions to the company regarding the payment of the dividend and those directions cannot be complied with;

- (c) where there is a dispute regarding the right to receive the dividend;
- (d) where the dividend has been lawfully adjusted by the company against any sum due to it from the shareholder; or
- (e) where, for any other reason, the failure to pay the dividend or to post the warrant within the period aforesaid was not due to any default on the part of the company.

Answer 4(c)

Role of Practicing Company Secretary (PCS) in Securities Management and Compliances with respect to the Securities and Exchange Board of India Act, 1992

1. SEBI has authorized the practicing company secretary to appear before the Securities Appellate Tribunal as an authorized representative of an appellant
2. Practicing Company Secretary can, certify non-promoter holdings as per clause 35 of Listing Agreement in demat mode in case of the companies which have established connectivity with both the depositories.
3. PCS is authorized to issue certificate of compliance of conditions of corporate governance for companies who have listed their equity shares, debt instruments and Indian Depositories in stock exchanges. .
4. PCS can issue certificate regarding maintenance of adequate security cover in respect of listed debentures every quarter.
5. PCS can conduct Internal Audit of Portfolio Managers/brokers and sub-brokers.
6. PCS can issue a certificate to listed companies to the effect that all refund orders/certificates to allottee of the previous issues were dispatched within prescribed time and manner and securities were listed on the stock exchanges specified in the offer document.

Question 5

- (a) *Radha Cable Manufacturing Ltd. intends to issue shares under Employee Stock Option Scheme (ESOS). The following details have been extracted from the records of the Company*

| | |
|-----------------------------|-----------------|
| <i>Face value of shares</i> | : ₹ 1 |
| <i>Exercise price</i> | : ₹ 150 |
| <i>Option exercisable</i> | : After 3 years |
| <i>Current market price</i> | : ₹ 360 |

On the basis of above information —

- (i) *Determine the intrinsic value of the option.*
- (ii) *Calculate the change, if any, in the intrinsic value of the option, if the exercise price is ₹ 360 instead of ₹ 150.*
- (iii) *How is the intrinsic value to be treated in company's accounts ?*
- (iv) *Calculate the value of perquisite of the option under section 17(2)(iii) of the Income-tax Act, 1961.*

(6 marks)

- (b) *Surya Roshni Ltd. held its annual general meeting for the year 2010-11 on 30th September, 2011. However, as the accounts were not ready, the meeting transacted all other businesses except accounts and adjourned the meeting to 16th December, 2011 for consideration of accounts. The Registrar of Companies issued show cause notice to the company for violation of section 210 of the Companies Act, 1956. Advise the company. (5 marks)*
- (c) *The Board of directors of a company decides to pay 2.5% of the issue price of the debentures as underwriting commission to the underwriters. On the other hand, the articles of association of the company permits only 2% commission. The Board of directors further decides to pay the commission out of the proceeds of the debentures. Advise the company. (5 marks)*

Answer 5(a)

- (i) According to Regulation 2.1 (9a) of SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines 1999, “intrinsic value” means the excess of the market price of the share under ESOS over the exercise price of the option (including up-front payment, if any).
- In the given case, this implies that the Intrinsic Value of option = Current Market Price - Exercise Price
- $$= ₹ 360 - ₹ 150$$
- $$= ₹ 210.$$
- (ii) If the Exercise price is Rs. 360, then, Intrinsic Value = Current Market Price - Exercise Price
- $$= ₹ 360 - ₹ 360$$
- $$= ₹ 00$$
- (iii) Accounting treatment for Intrinsic Value –
- As per Schedule 1 of the SEBI(ESOP&ESPS) Guidelines 1999,
- The accounting value of options shall be equal to the aggregate, over all employee stock options granted during the accounting period, of the intrinsic value of the option or, if the company so chooses, the fair value of the option. The required disclosure in this regard has to be made in the directors’ report.
- (iv) For the purpose of Section 17(2)(iii) of the Income Tax Act 1961, the perquisites include the value of any specified security allotted or transferred, directly or indirectly, by any person free of cost or at concessional rate, to an individual who is or has been in employment of that person. These shall be taxable perquisite in the hands of the assessee. Further, it is also provided that the value of such specified security shall be fair market value or sweat equity share on the date of exercising the option as reduced by the amount already paid in respect of the shares/ securities. Accordingly, the value of perquisite on the date of exercising the option will be ₹ 360 less ₹ 150, amounting to ₹ 210.

Answer 5(b)

Section 210(3) prescribes that, the profit and loss account should relate to a period beginning with the day immediately after the period for which the account was last

submitted and ending with a day, which shall not precede the day of the meeting by more than six months. Where the Registrar has granted extension of time for holding the AGM under Section 166, such interval should not exceed six months and the extended period.

As per the proviso to subsection 1 of section 166 of the Companies Act, 1956, the Registrar may for any special reason extend the time within which any annual general meeting (not being the first annual general meeting) shall be held, by a period not exceeding three months. It has been clarified by the Ministry of Corporate Affairs that delay in completion of annual accounts of the company does not ordinarily constitute a special reason justifying the extension of time for holding annual general meeting.

In the given case

- I. The annual general meeting of the company was held within statutory time and the company has adjourned the Annual General Meeting as the accounts were not ready.
- II. The company has not obtained extension from the registrar of companies.

The action of Registrar of Companies in issuing show cause notice to the company for violation of Section 210 of the companies act is justified as the company has not laid down the accounts before the Annual general meeting within six months from the closure of the financial year.

Answer 5(c)

Under Section 76 of the Companies Act 1956, a company may pay underwriting commission to any person if:

- the payment of the commission is authorized by the articles;
- the commission paid or agreed to be paid does not exceed in the case of debentures, two and a half percent of the price at which the debentures are issued or the amount or rate authorized by the articles, whichever is less.

Thus, the decision of the board in paying 2.5% of the issue price of the debenture as underwriting commission is not a valid one since the rate authorized by the articles is lesser.

The percentage commission of 5 per cent of the price in the case of shares, and 2½ per cent of the price in the case of debentures, fixed by the section only indicates the quantum, and not the source from which it is to be paid, which may be out of capital or profits. Thus the action of the Board in payment of commission out of proceeds of debentures is justified.

Question 6

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

- (i) *'Deal makers' are those reports wherein the diligence team has not been able to come across any violation leading them to submit what is called a '_____ report'.*

- (ii) A _____ is an issue of shares or of convertible securities by a company to a select group of persons under section 81 of the Companies Act, 1956 which is neither a rights issue nor a public issue. This is a faster way for a company to raise equity capital.
- (iii) As per listing agreement, a company has to close its transfer books at least once in a year at the time of _____ if they have not been otherwise closed at any time during the year.
- (iv) A depository participant is required to preserve its records and documents for a minimum period of _____ .
- (v) _____ is the process of conversion of existing assets or future cash flows into marketable securities.
- (vi) The minimum fee for compliance certification for a company having a paid-up share capital of ₹ 75,00,000 shall ordinarily not be less than ₹ _____.
(1 mark each)
- (b) Narrate the procedure for investment for acquisition of a foreign company through bidding or tender procedure. (5 marks)
- (c) Prepare a check-list for compliance certificate regarding transfer of unpaid amounts to the Investor Education and Protection Fund. (5 marks)

Answer 6(a)

- (i) 'Deal makers' are those reports wherein the diligence team has not been able to come across any violation leading them to submit what is called a '**clean** report'.
- (ii) A **private placement** is an issue of shares or of convertible securities by a company to a select group of persons under section 81 of the Companies Act, 1956 which is neither a rights issue nor a public issue. This is a faster way for a company to raise equity capital.
- (iii) As per listing agreement, a company has to close its transfer books at least once in a year at the time of **Annual General Meeting** if they have not been otherwise closed at any time during the year.
- (iv) A depository participant is required to preserve its records and documents for a minimum period of **5 years** .
- (v) **Securitization** is the process of conversion of existing assets or future cash flows into marketable securities.
- (vi) The minimum fee for compliance certification for a company having a paid-up share capital of ₹ 75,00,000 shall ordinarily not be less than ₹ **7,500**.

Answer 6(b)

Acquisition of a Foreign Company through Bidding or Tender Procedure

An Indian party may remit earnest money deposit or issue a bid bond guarantee for acquisition of a foreign company through bidding and tender procedure and also make subsequent remittances through an Authorised Dealer Category - I bank, in accordance

with the provisions of Regulation 14 of Foreign Exchange Management (Transfer or issue of any foreign security) Regulations, 2000.

In terms of the said Regulation 14, Authorised Dealer Category – I (AD) banks may, on being approached by an eligible Indian party and subject to the limits, allow remittance towards Earnest Money Deposit (EMD) to the extent eligible after obtaining Form A2 duly filled in or may issue bid bond guarantee on their behalf for participation in bidding or tender procedure for acquisition of a company incorporated outside India. On winning the bid, AD banks may remit the acquisition value after obtaining Form A2 duly filled in and report such remittance (including the amount initially remitted towards EMD) to the Chief General Manager, Foreign Exchange Department, Central Office, Overseas Investment Division, Amar Building, 5th floor, Mumbai 400 001 in form ODI. AD Category– I banks, while permitting remittance towards EMD should advise the Indian party that in case they are not successful in the bid, they should ensure that the amount remitted is repatriated in accordance with Foreign Exchange Management (Realisation, Repatriation & Surrender of Foreign Exchange) Regulations, 2000.

In cases where an Indian party, after being successful in the bid / tender decides not to proceed further with the investment, AD banks should submit full details of remittance allowed towards EMD / invoked bid bond guarantee, to the Chief General Manager, Foreign Exchange Department, Central Office, Overseas Investment Division, Amar Building, 5th floor, Mumbai 400 001.

In case the Indian party is successful in the bid, but the terms and conditions of acquisition of a company outside India are not in conformity with the provisions of Regulations, or different from those for which specific approval has already been obtained from RBI, the Indian entity should again obtain approval from the Reserve Bank by submitting form ODI.

Answer 6(c)

Checklist for compliance certificate regarding transfer of unpaid amounts to the Investor Education and Protection Fund

- (i) Check whether the company has duly transferred the following amounts to the Investor Education and Protection Fund:
 - (a) amounts in the unpaid dividend accounts of the company;
 - (b) the application money received by the company for allotment of any securities and due for refund;
 - (c) matured deposits with the company;
 - (d) matured debentures with the company;
 - (e) interest accrued on the amounts referred to in clauses (a) to (d) above;if such amounts have remained unclaimed and unpaid for a period of seven years from the date they became due for payment and filed a copy of challan evidencing such deposit with the Registrar.
- (ii) whether company has filed Form I of Investor Education and Protection Fund (Awareness and Protection of Investors) Rules, 2001 duly certified.

- (iii) whether the other provisions of Investor Education and Protection Fund Rules, 2001, as far as applicable were complied with.

Question 7

- (a) Explain the compliances required with regard to any two of the following :
- (i) Cost audit and appointment of cost auditor.
 - (ii) Forfeiture and re-issue of shares.
 - (iii) Significance of corporate compliance management. (4 marks each)
- (b) Write notes on any two of the following :
- (i) Disqualification for appointment as Practising Company Secretary
 - (ii) Risks on trading in debt securities
 - (iii) Inspection of register of members/debentureholders. (4 marks each)

Answer 7(a)(i)

Compliances with regard to Cost Audit and Appointment of Cost Auditor requires to check whether –

Check whether

- (i) there was an order of the central government ordering audit of cost accounts of the company.
- (ii) Board resolution was passed for appointing a person as cost auditor and whether he was qualified to act as such;
- (iii) approval of the Central Government was obtained for the appointment of the cost auditor and the cost auditor was issued appointment order;
- (iv) a copy of the cost audit report was received from the cost auditor;
- (v) full information and explanations were furnished to the Central Government for any reservations or qualifications contained in the cost audit report;
- (vi) any directions were received from the Central Government for circulation of the cost audit report to the members along with the notice of the annual general meeting and, if so, whether the same has been complied with.

Answer 7(a)(ii)

Compliances with regard to Forfeiture and Re-issue of Shares requires to check whether –

- (i) the company has forfeited shares during the year in accordance with provisions contained in the Articles;
- (ii) necessary noting/recording has been done in the Register of members and other registers;
- (iii) the company has reissued the forfeited shares and if so, the re- issue has been done in accordance with the provisions contained in the Articles;

- (iv) the aggregate of the amount received on forfeited shares and amount received on the reissue of those forfeited shares was not below the issue price of the original shares which were duly forfeited;
- (v) share certificates have been issued to the allottee(s) and necessary entries made in the Register of members.

Answer 7(a)(iii)**Significance of Corporate Compliance Management includes**

1. Better compliance of the law
2. Real time status of legal/statutory compliances
3. Safety valve against unintended non compliances/ prosecutions, etc.
4. Real time status on the progress of pending litigation before the judicial/quasi-judicial fora
5. Cost savings by avoiding penalties/fines and minimizing litigation
6. Better brand image and positioning of the company in the market
7. Enhanced credibility/creditworthiness that only a law abiding company can command
8. Goodwill among the shareholders, investors, and stakeholders.

Answer 7(b)(i)**Disqualifications of secretary in whole-time practice-Recommended by the Guidance note on Compliance Certificate published by ICSI**

With a view to ensure that Practicing Company Secretary shows utmost integrity and independence of judgment in the performance of his duties, it is desirable that, a person referred to in Sub-section (3) or Sub-section (4) of Section 226 of the Companies Act, not to be eligible for appointment or reappointment for giving Compliance Certificate to a company.

Accordingly, the following persons are not to be qualified for appointment as Practicing Company Secretary of a company :

- (a) a body corporate;
- (b) an officer or employee of the company;
- (c) a person who is a partner, or who is in the employment, of an officer or employee of the company;
- (d) a person who is indebted to the company for an amount exceeding one thousand rupees, or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the company for an amount exceeding one thousand rupees;
- (e) a person holding any security of that company which carries voting rights.

Answer 7(b)(ii)**Risks on Trading in Debt Securities**

1. Default Risk is the risk that an issuer of a bond may be unable to make timely payment of interest or principal on a debt security.
2. Interest Rate Risk is the risk emerging from an adverse change in the interest rate prevalent in the market so as to affect the yield on the existing instruments.
3. Reinvestment Rate Risk is the probability of a fall in the interest rate resulting in a lack of options to invest the interest received at regular intervals at higher rates at comparable rates in the market.
4. Counter Party Risk refers to the failure or inability of the opposite party to the contract to deliver either the promised security or the sale-value at the time of settlement.
5. Price Risk refers to the possibility of not being able to receive the expected price on any order due to an adverse movement in the prices.

Answer 7(b)(iii)**Inspection of Register of Members/Debenture Holders**

Section 163 of the Companies Act, 1956 requires that the register of members commencing from the date of registration of the company, the index of members, the register and index of debenture holders, and copies of all annual returns prepared under Section 159 and 160, together with the copies of certificates and documents required to be annexed thereto, shall be kept at the registered office of the company. Further the said registers shall except when the register of members or debenture holders is closed under the provisions of this Act, be open during business hours, subject to reasonable restrictions, as the company may impose, so that not less than two hours in each day are allowed for inspection:

- (a) of any member or debenture holders, without fee; and
- (b) of any other person, on payment of a prescribed fee for each inspection.

Question 8

Critically examine and comment on any four of the following :

- (i) *Compliance solution providers adopt systematic approach for creating or enhancing an ethics and compliance program for companies in this age of information technology and outsourcing.*
- (ii) *A key step in any due diligence exercise is to develop an understanding of the purpose for the transaction.*
- (iii) *As per the SEBI (Issue and Listing of Debt Securities) Regulations, 2008, the debt issued can be rolled over subject to certain conditions (compliances with respect to non- convertible debt instruments).*
- (iv) *Issue of preferential allotments by unlisted companies is mainly governed by the Unlisted Public Companies (Preferential Allotment) Rules, 2003.*

- (v) *In the context of corporate governance, ethics is the intent to observe the spirit of law — in other words, it is the expressed intent to do what is right.*

(4 marks each)

Answer 8(i)

Compliance solution providers adopts following approaches for creating or enhancing an ethics and compliance program for companies—

Risk/Cultural Assessment : Through employee surveys, interviews, and document reviews, a company's culture of ethics and compliance at all levels of the organization is validated.

Program Design/Update : In this phase, compliance solution providers help company in creating guideline documents that outline the reporting structure, communications methods, and other key components of the code of ethics and compliance program.

Policies and Procedures : In this phase compliance solution providers help company to develop or enhance the detailed policies of the program, including issues of financial reporting, antitrust, conflicts of interest, gifts and entertainment, records accuracy and retention, employment, the environment, global business, fraud, political activities, securities, and sexual harassment, among others.

Communication, Training, and Implementation : Even the best policies and procedures are useless if they are not institutionalized— they must become part of the fabric of the organization. Compliance solution providers help company to clearly articulate, communicate, and reinforce not only the specifics of the program, but also the philosophy behind it, and the day-to-day realities of it.

Ongoing self-Assessment, Monitoring, and Reporting : The cultural assessment, mechanisms, and processes put in place including employee surveys, internal controls, and monitoring and auditing programs, help organisations achieve sustained success.

Answer 8(ii)

A key step in any due diligence exercise is to develop an understanding of the purpose for the transaction. The goal of due diligence is to provide the party proposing the transaction with sufficient information to make a reasoned decision as to whether or not to complete the transaction as proposed. It should provide a basis for determining or validating the appropriate terms and price for the transaction incorporating consideration of the risks inherent in the proposed transaction. The following factors may be kept in mind in this regard:

- Be clear about your expectations in terms of revenues, profits and the probability of the target company to provide you the same.
- Consider whether you have resources to make the business succeed and whether you are willing to put in all the hard work, which is required for any new venture.
- Consider whether the business gives you the opportunity to put your skills and experience to good use.
- Learn as much as you can about the industry you are interested in from media reports, journals and people in the industry.

Answer 8(iii)**SEBI (Issue and Listing of Debt Securities) Regulations, 2008 (compliances with respect to non-convertible debt instruments)**

The debt securities issued can be rolled over subject to the following conditions:

- (a) The roll-over is approved by a special resolution passed by the holders of debt securities through postal ballot having the consent of not less than 75% of the holders by value of such debt securities;
- (b) Atleast one rating is obtained from a credit rating agency within a period of six months prior to the due date of redemption and is disclosed in the notice;
- (c) Fresh trust deed shall be executed at the time of such roll –over or the existing trust deed may be continued if the trust deed provides for such continuation;
- (d) Adequate security shall be created or maintained in respect of such debt securities to be rolled-over.

Answer 8(iv)

Issue of preferential allotment by unlisted company is mainly governed by the Unlisted Public Companies (Preferential Allotment), 2003. The Ministry of Corporate Affairs (MCA) has issued Unlisted Public Companies (Preferential Allotment) Amendment Rules, 2011, to specifically include allotment of convertible instrument including hybrid instruments convertible into shares. Following are the highlights of the said rules in the light of amendments.

- Requirement of special resolution is made specifically applicable to issue of convertible instrument including hybrid instruments convertible into shares.
- The offer for preferential allotment cannot be made to more than 49 persons.
- Any offer or invitation not in compliance with provisions of Section 81(1A) read with section 67(3) of the Companies Act, 1956 (the Act) would be treated as public offer and provisions of the SCRA, 1956 and SEBI Act, 1992 will need to be complied with.
- The money payable on subscription should be paid only by way of Cheque or DD or other banking channels but not by cash.
- Allotment of securities should be completed within 60 days from the receipt of application money. If not so allotted, the company should repay application money within 15 days thereafter, failing which it should be repaid along with an interest @ 12percent p.a.
- The application money should be kept in a separate bank account and should not be utilized prior to allotment.
- Company offering securities can not release any public advertisements or utilize any media, marketing or distribution channels or agents to inform the public at large about the offer.
- Details of proposed allottee should be included in the Special Resolution.

Answer 8(v)

In the context of corporate governance, compliance means obeying the law. Ethics is the intent to observe the spirit of the law, in other words, it is the expressed intent to do what is right. In the wake of recent corporate scams, a governance practice that strongly emphasizes both ethics and compliance is good business.

Various institutions and regulatory authorities have been realizing the need for ethical behavior and effective corporate compliance programs. Companies and their leadership that adhere both to the letter and the spirit of the law can achieve substantial benefits.

An ethical compliance management programme ensures that the mechanisms are in place to provide early warning of deviations from guidelines and regulations. It is essential to create or expand a culture of trust, enthusiasm, and integrity - critical attributes that can produce measurable results in terms of productivity, employee satisfaction, customer satisfaction and ultimately, brand equity.

GOVERNANCE, BUSINESS ETHICS AND SUSTAINABILITY

Time allowed : 3 hours

Maximum marks : 100

PART A

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

Question 1

- (a) "Corporate governance extends beyond corporate law. Its fundamental objective is not mere fulfilment of the requirements of law, but in ensuring commitment of the Board of directors in managing the company in a transparent manner for maximising stakeholders' value." In the light of this statement, discuss the various factors which add greater value through good governance. (10 marks)
- (b) State, with reasons in brief, whether the following statements are true or false :
- (i) As per clause 49 of the listing agreement, the Chairman of the audit committee shall be an independent director.
 - (ii) Global Corporate Governance Forum was founded by the World Bank.
 - (iii) A company is required to file the shareholding pattern with the stock exchange on a quarterly basis.
 - (iv) Filing of CSR e-form is mandatory for all the listed companies.
 - (v) Mutual funds are institutional investors. (2 marks each)

Answer 1(a)

The statement is true that Corporate Governance extends beyond corporate law. Its fundamental objective is not mere fulfillment of the requirements of law but in ensuring commitment of the Board of Directors in managing the company in a transparent manner for maximising stakeholder value. The various factors which add greater value through good governance are:

Corporate Performance : Improved governance structures and processes help ensure quality decision-making, encourage effective succession planning for senior management and enhance the long-term prosperity of companies, independent of the type of company and its sources of finance. This can be linked with improved corporate performance—either in terms of share price or profitability.

Enhanced Investor Trust : Investors consider corporate Governance as important as financial performance when evaluating companies for investment. Investors who are provided with high levels of disclosure & transparency are likely to invest openly in those companies. The consulting firm McKinsey surveyed and determined that global institutional investors are prepared to pay a premium of upto 40 percent for shares in companies with superior corporate governance practices.

Better Access to Global Market : Good corporate governance system attracts investment from global investors, which subsequently leads to greater efficiencies in the financial sector.

Combating Corruption : Companies that are transparent, and have sound system that provide full disclosure of accounting and auditing procedures, allow transparency in all business transactions, provide environment where corruption will certainly fade out. Corporate Governance enables a corporation to compete more efficiently and prevent fraud and malpractices within the organization.

Easy Finance From Institutions : Several structural changes like increased role of financial intermediaries and institutional investors, size of the enterprises, investment choices available to investors, increased competition, and increased risk exposure have made monitoring the use of capital more complex thereby increasing the need of Good Corporate Governance. Evidence indicates that well-governed companies receive higher market valuations. The credit worthiness of a company can be trusted on the basis of corporate governance practiced in the company.

Enhancing Enterprise Valuation : Improved management accountability and operational transparency fulfill investors' expectations and confidence on management and corporations, and return, increase the value of corporations.

Reduced Risk of Corporate Crisis and Scandals : Effective Corporate Governance ensures efficient risk mitigation system in place. The transparent and accountable system that Corporate Governance makes the Board of a company aware of all the risks involved in particular strategy, thereby, placing various control systems to monitor the related issues.

Accountability : Investor relations' is essential part of good corporate governance. Investors have directly/ indirectly entrusted management of the company for the creating enhanced value for their investment. The company is hence obliged to make timely disclosures on regular basis to all its shareholders in order to maintain good investor's relation. Good Corporate Governance practices create the environment where Boards cannot ignore their accountability to these stakeholders.

Answer 1(b)(i)

True

As per clause 49(II) (A) (iii) of the listing agreement the Chairman of the Audit Committee shall be an independent director.

Answer 1(b)(ii)

False

The Global Corporate Governance Forum was not founded by World Bank alone. It was co founded by the World Bank and the Organisation for Economic Cooperation and Development (OECD) following the financial crises in Asia and Russia.

Answer 1(b)(iii)

True

As per clause 35 of the Listing Agreement, the Company is required to file the shareholding pattern with the exchange on a quarterly basis, within 21 days from the end of each quarter in the format specified.

Answer 1(b)(iv)**False**

Filing of CSR e-form is not mandatory for any company. The companies adopting and pursuing CSR activities may report the same on voluntary basis.

Answer 1(b)(v)**True**

Mutual Funds are covered under the definition of Institutional Investors.

Question 2

(a) Write short notes on any three of the following :

- (i) Price sensitive information
- (ii) Corporate governance in public sector undertakings
- (iii) Corporate Communication Officers (CCOs)
- (iv) National Foundation for Corporate Governance. (3 marks each)

(b) "Companies are not entirely free to decide on how they shall handle their risks."
Discuss this statement in the light of clause 49 of the listing agreement.
(6 marks)

Answer 2(a)(i)**Price Sensitive Information**

Information that, if made public, would be likely to have a significant effect on the price of company's securities. Such information must, in connection with a listed company, be released to the market in a fashion that is fair to all investors. Any person who uses price sensitive information to make a profit either for themselves or a third party in the shares of a company is in breach of insider trading laws.

Price Sensitive information means any information which relates directly or indirectly to a company and which if published is likely to materially affect the price of securities of company and includes:

- Periodical financial results of a company
- Intended declaration of dividend
- Issue or buy back of securities
- Any major expansion plans or execution of new projects, amalgamation, merger, takeovers, disposal of the whole or substantial part of the undertaking and any other significant changes in policies, plans or operations of the company

Answer 2(a)(ii)**Corporate Governance in public sector undertakings**

The Ministry of Heavy Industries and Public Enterprises, Department of Public Enterprises has issued Guidelines on Corporate Governance for Central Public Sector Enterprises which were revised by a notification no. 18(8)/2005-GM dt. 14th May 2010. The

guidelines were evolved through a consultation process where the stakeholders have participated. These Guidelines keep in view the provisions in the relevant laws, rules and instructions.

The guidelines on Corporate Governance for listed and unlisted CPSEs are being dealt in the succeeding chapters under the following headings.

- Board of Directors
- Audit Committee
- Remuneration Committee
- Subsidiary Companies
- Disclosures
- Report, Compliance and Schedule of Implementation

Applicability

For the purpose of the guidelines the public sector enterprises have been categorized in two groups; (a) listed entities and (b) Non-listed entities.

CPSEs listed on Stock Exchanges

All listed CPSEs are required to follow the SEBI Guidelines on Corporate Governance. In addition, they shall follow those provisions of these Guidelines which do not exist in the SEBI Guidelines and also do not contradict any of the provisions of the SEBI Guidelines.

Non-listed CPSEs

Each CPSE should strive to institutionalize good Corporate Governance practices broadly in conformity with the SEBI Guidelines. The guidelines provide that the provisions shall also be applicable to all the unlisted CPSE's on mandatory basis.

Answer 2(a)(iii)

Corporate Communication Officers (CCOs)

“Corporate Communications is all about managing perceptions and ensuring effective and timely dissemination of information, positive corporate image, smooth and affirmative relationship with all stakeholders”.

A corporate communication officer, in any organization shall be responsible for the coordination and implementation of public relations programs designed to project a favorable impression for a specific product, service or brand.

Corporate communication officers will closely monitor all factors that may have an effect on those they serve. After examining political, market, economic and social trends, the officer will recommend a course of action that could include writing and publishing press releases, creating websites, organizing events, sponsoring charity events or even donating to a specific cause to promote the company or organization while giving back to the community. Responsibilities may include:

- Effective communications with employees, customers, industry, media, investors and plant/ office communities.

- Reviewing information prior to public disclosure for materiality. Where it is considered that information is potentially material it must be referred to the committee or the Board for approval.
- All the external queries shall be transferred to him or his department.
- Provide the stakeholders with consistent, timely and accurate information consistent with the legal requirements.

Answer 2(a)(iv)

National Foundation for Corporate Governance

With the goal of promoting better corporate governance practices in India, the Ministry of Corporate Affairs, Government of India, has set up National Foundation for Corporate Governance (NFCG) in partnership with Confederation of Indian Industry (CII), Institute of Company Secretaries of India (ICSI) and Institute of Chartered Accountants of India (ICAI). In the year 2010, stakeholders in NFCG have been expanded with the inclusion of ICWAI and the National Stock Exchange.

Mission of NFCG

- To foster a culture for promoting good governance, voluntary compliance and facilitate effective participation of different stakeholders;
- To create a framework of best practices, structure, processes and ethics;
- To make significant difference to Indian Corporate Sector by raising the standard of corporate governance in India towards achieving stability and growth.

NFCG endeavors to build capabilities in the area of research in corporate governance and to disseminate quality and timely information to concerned stakeholders. It works to foster partnerships with national as well as international organizations.

Answer 2(b)

The statement that ‘Firms are not entirely free to decide on how they shall handle their risks’ is correct. In every country there are governmental and official regulations governing health and safety at work like fire precautions, hygiene, environmental pollution, welfare of employees, handling of dangerous substances and many other matters relating to properties, personal injuries and other risks. The Central Government and State Governments have enacted compulsory insurance regulations for vehicles and individuals. And in addition a firm may be obliged to insure certain risks under provisions of leases, construction and other contracts. Failure to comply with both safety and compulsory insurance regulations may constitute a criminal offence and may lead to the closure of a plant or other establishments. Thus, if a firm wishes to carry on certain activities it must comply with the relevant official risk handling regulations. There will remain, however, broad areas where it can exercise its own discretion to control physical or financial loss.

On its own, a firm can handle risk broadly in four ways:

Risk Avoidance

It is a rare possibility to avoid a risk completely. A riskless situation is rare. Generally risk avoidance is only feasible at the planning stage of an operation.

Risk Reduction

In many ways physical risk reduction (or loss prevention, as it is often called) is the best way of dealing with any risk situation and usually, it is possible to take steps to reduce the probability of loss. Again, the ideal time to think of risk reduction measures is at the planning stage of any new project when considerable improvement can be achieved at little or no extra cost.

Risk Retention

It is also known as risk assumption or risk absorption. It is the most common risk management technique. This technique is used to take care of losses ranging from minor to major break-down of operation.

Risk Transfer

This refers to legal assignment of cost of certain potential losses to another. The insurance of 'risks' is to occupy an important place, as it deals with those risks that could be transferred to an organization that specialises in accepting them, at a price. Usually, there are 3 major means of loss transfer viz.,

- By Tort
- By contract other than insurance
- By contract of insurance.

The main method of risk transfer is insurance. Thus, insurance substitutes certainty for uncertainty.

Legal Provisions on Risk Management under the Listing Agreement

In terms of Clause 49 of the Listing Agreement

- the company shall lay down procedures to inform Board members about the risk assessment and minimization procedures. These procedures shall be periodically reviewed to ensure that executive management controls risk through means of a properly defined framework.
- Management Discussion & Analysis should include discussion on
 1. Risks and concerns.
 2. Internal control systems and their adequacy.

Question 3

- (a) *“Within the broader concept of corporate social responsibility (CSR), the concept of triple bottom line (TBL) is gaining recognition.” Discuss the need to apply the concept of TBL.* (5 marks)
- (b) *Describe briefly the need and advantages of committee management. Name the committees which are to be constituted for good corporate governance.* (5 marks)
- (c) *Prepare a Board note on ‘internal control’ highlighting the elements of sound internal control system for a company.* (5 marks)

Answer 3(a)

Within the broader concept of corporate social responsibility, the concept of Triple Bottom Line (TBL), is gaining significance and becoming popular amongst corporate. "People, Planet and Profit" is used to succinctly describe the triple bottom lines. "**People**" (Human Capital) pertains to fair and beneficial business practices toward labor and the community and region in which a corporation conducts its business. "**Planet**" (Natural Capital) refers to sustainable environmental practices. It is the lasting economic impact the organization has on its economic environment. A TBL company endeavors to benefit the natural order as much as possible or at the least do no harm and curtails environmental impact. "**Profit**" is the bottom line shared by all commerce.

The need to apply the concept of TBL includes:

- (a) Increased consumer sensitivity to corporate social behaviour
- (b) Growing demands for transparency from shareholders/stakeholders
- (c) Increased environmental regulation
- (d) Legal costs of compliances and defaults
- (e) Concerns over global warming
- (f) Increased social awareness
- (g) Awareness about and willingness for respecting human rights
- (h) Media's attention to social issues
- (i) Growing corporate participation in social upliftment

While profitability is a pure economic bottomline, social and environmental bottomlines are semi or non-economic in nature so far as revenue generation is concerned but it has certainly a positive impact on long term value that an enterprise commands.

Answer 3(b)**Need and Advantage of Committee Management**

Committees are a sub-set of the board, deriving their authority from the powers delegated to them by the board. The committees are usually formed as a means of improving board effectiveness and efficiency in areas where more focussed, specialized and technically oriented discussions are required. These committees prepare the groundwork for decision-making and report at the subsequent board meeting.

In the present day, the regulatory requirement is such that the composition of the board comprising executive directors and non-executive independent directors is relatively large in number. In such a situation it becomes at times practically difficult to convene board meetings which suit the convenience and other commitments of each director. By having smaller committees this aspect also gets addressed effectively.

Committees allows the board to:

- Handle a greater number of issues with greater efficiency by having experts focus on specific areas.

- Develop subject specific expertise on areas such as compliance management, risk management, financial reporting.
- Enhance the objectivity and independence of the board’s judgment.

Greater specialization and intricacies of modern boardwork is one of the reasons for increased use of board committees. The reasons include:

- Responsibilities are shared.
- More members become involved.
- Specialized skills of members can be used to best advantage.
- Inexperienced members gain confidence while serving on the committee.
- Matters may be examined in more detail by a committee

The committees which are to be constituted for good corporate governance are:

- Audit Committee (mandatory under Clause 49 of listing agreement and section 292A of Companies Act, 1956)
- Shareholders Grievance Committee (mandatory under Clause 49 of listing agreement)
- Remuneration Committee
- Nomination Committee
- Corporate Governance Committee
- Corporate Compliance Committee

Answer 3(c)

Board of Directors

ABC Limited.

Sub : Note on internal control

A system of internal control is a proactive approach that balances the risk and control in the Company which helps in exploiting business opportunities fully. The following are the elements of a sound internal control system:

1. An internal control system encompasses the policies, processes, tasks, behaviour and other aspects of a company that taken together :
 - facilitates its effective and efficient operation by enabling it to respond appropriately to significant business, operational, financial, compliance and other risks to achieve the Company's objectives. This includes the safeguarding of assets from inappropriate use or from loss and fraud and ensuring that liabilities are identified and managed;
 - helps to ensure the quality of internal and external reporting. This requires the maintenance of proper records and processes that generate a flow of

timely, relevant and reliable information from within and outside the organisation;

- helps ensure compliance with applicable laws and regulations, and also internal policies with respect to conducting business.
2. The system of internal control should:
- be embedded in the operations of the company and form part of its culture;
 - be capable of responding quickly to evolving risk to the business arising from factors within the company and to changes in the business environment;
 - includes procedures for reporting immediately to appropriate levels of management any significant control failings or weaknesses that are identified together with details of corrective action being undertaken. Thus, it helps an entity achieve its goals and avoid pitfalls.

Sd/-

Company Secretary

Question 4

- (a) *Organisation for Economic Co-operation and Development (OECD) defines corporate governance as — “a system by which business corporations are directed and controlled.” In the light of this statement, enumerate the principles of corporate governance as evolved by OECD. (6 marks)*
- (b) *Discuss briefly any three of the following :*
- (i) *Evidence of corporate governance from Arthashastra*
 - (ii) *Related party transactions*
 - (iii) *Sarbanes-Oxley Act, 2002*
 - (iv) *Chief Executive Officer (CEO). (3 marks each)*

Answer 4(a)

OECD has defined corporate governance to mean “a system by which business corporations are directed and controlled”.

Thus corporate governance structure specifies the distribution of rights and responsibilities among different participants in the company such as board, management, shareholders and other stakeholders, and spells out the rules and procedures for corporate decision making. By doing this, it provides the structure through which the company's objectives are set alongwith the means of attaining these objectives as well as for monitoring performance.

As the globalisation expanded to make the world more interdependent, the need for internationally accepted forms of corporate governance become more apparent and found expression in private sector, public sector and the Government thinking. The focal point of official efforts has been the OECD Principles of Corporate Governance, endorsed by OECD Ministers in May 1999 and thereafter revised in 2004.

The following principles are covered with the respective areas by OECD:

- (i) They call on government to have in place an effective institutional and legal framework to support good corporate governance practices by ensuring the basis for an effective corporate governance framework which is to be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities to provide transparent and efficient markets.
- (ii) They call for a corporate governance framework that protects and facilitates the exercise of shareholders right and key ownership function.
- (iii) They also strongly support the equal treatment of all shareholders including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.
- (iv) They recognise the importance of the role of stakeholders in corporate governance and encourage active cooperation between corporations and stakeholders in creating wealth jobs.
- (v) They look at the importance of timely, accurate and transparent disclosure mechanisms.
- (vi) They deal with board, structure, responsibilities and procedures.

Answer 4(b)(i)

Evidence of corporate governance from Arthashastra

Kautilya's Arthashastra maintains that for good governance, all administrators, including the king were considered servants of the people. Good governance and stability were completely linked. If rulers are responsive, accountable, removable, recallable, there is stability. If not there is instability. These tenets hold good even today.

- | | |
|---|--|
| Kautilya's fourfold duty of a king | – The substitution of the state with the corporation, the king with the CEO or the board of a corporation, and the subjects with the shareholders, bring out the quintessence of corporate governance, because central to the concept of corporate governance is the belief that public good should be ahead of private good and that the corporation's resources cannot be used for personal benefit. |
| <i>Raksha</i> | – literally means protection, in the corporate scenario it can be equated with the risk management aspect. |
| <i>Vridhhi</i> | – literally means growth, in the present day context can be equated to stakeholder value enhancement |
| <i>Palana</i> | – literally means maintenance/compliance, in the present day context it can be equated to compliance of the law in letter and spirit. |
| <i>Yogakshema</i> | – literally means well being and in Kautilya's Arthashastra it is used in context of a social security system. In the present day context it can be equated to corporate social responsibility. |

Arthashastra talks self-discipline for a king and the six enemies which a king should overcome – lust, anger, greed, conceit, arrogance and foolhardiness. In the present day context, this addresses the ethics aspect of businesses and the personal ethics of the corporate leaders.

Answer 4(b)(ii)

Related Party Transactions

Related party transaction refers to Business deal or arrangement between two parties who are joined by a special relationship prior to the deal. For example, a business transaction between a major shareholder and the corporation, such as a contract for the shareholder's company to perform renovations to the corporation's offices, would be deemed a related-party transaction

Section 297 prohibits a director of the company or his relative, a firm in which such a director or relative is a partner, any other partner in such a firm, or a private company of which the director is a director or member to enter into any contract with the company for –

- (a) for the sale, purchase or supply of any goods, materials or services; or
- (b) for underwriting the subscription of any shares in or debentures of, the company.

Such a transaction shall be with the consent of the Board of directors accorded by a resolution passed at a meeting of the Board either before the contract is entered into or within three months of the date of which the contract is entered into.

Where the company has a paid-up share capital of not less than Rs. 1 crore, no such contract shall be entered into except with the previous approval of the Central Government.

The provisions of Section 297 do not affect –

- (a) purchase of goods and materials from the company or the sale thereof to the company for cash at prevailing market prices; or
- (b) any contract for sale, purchase or supply of any goods, materials and services, in which the company or such related party regularly trades or does business if such contract does not relate to goods and materials the value of which or services the cost of which, exceeds 5,000 rupees in the aggregate in any year; or
- (c) in the case of banking or insurance company any transaction in the ordinary course of business of such company with any director, etc.

Section 299 imposes a specific duty on every director to disclose his interest to the full Board. Every director of a company must disclose the nature of his concern or interest in any transaction of the company at a meeting of the Board of Directors.

Answer 4(b)(iii)

Sarbanes-Oxley Act, 2002

The SOX Act was signed into law by the US President on 30th July, 2002. The Sarbanes Oxley Act is also known as the 'Public Company Accounting Reform and Investor Protection Act of 2002'. This legislation brought with it fundamental changes in

virtually every area of corporate governance and particularly in auditor independence, conflicts of interest, corporate responsibility, enhanced financial disclosures, and severe penalties, both fines and imprisonment for wilful default by managers and auditors.

Answer 4(b)(iv)

Chief Executive Officer (CEO)

The Board appoints the CEO based on the criterion of his capability and competence to manage the company effectively. His main responsibilities include developing and implementing high-level strategies, making major corporate decisions, managing the overall operations and resources of a company, and acting as the main point of communication between the board of directors and the corporate operations. He is involved with every aspect of the company's performance. The CEO is supported and advised by a skilled board and CEO is ultimately accountable to the board for his actions. The most important skill of a CEO is to think strategically. His key role is leading the long term strategy and its implementation, it further includes:

- Developing implementation plan of action to meet the competition and keeping in mind the long term existence of the company
- Adequate control systems
- Monitoring the operating and financial outcomes against the set plan
- Remedial action
- Keeping the Board informed

PART B

(Answer ANY TWO questions from this part.)

Question 5

- (a) *“Companies displaying a clear commitment to ethical conduct consistently outperform companies that do not display ethical conduct.” Discuss this statement highlighting the advantages of business ethics. (6 marks)*
- (b) *Discuss briefly any three of the following :*
- (i) *Ethics audit*
 - (ii) *Activity analysis*
 - (iii) *Ethics in human resources*
 - (iv) *Enlightened egoism. (3 marks each)*

Answer 5(a)

Companies displaying a clear commitment to ethical conduct consistently outperform companies that do not display ethical conduct. The statement is correct.

Advantages of Business Ethics may be highlighted as:

1. Attracting and retaining talent

People aspire to join organisations that have high ethical values. Companies are able to attract the best talent. An ethical company that is dedicated to

taking care of is employees will be rewarded with employees being equally dedicated in taking care of the organisation. The ethical climate matters to the employees. Ethical organisations create an environment that is trust worthy making employees willing to rely, take decisions and act on the decisions and actions of the co-employees. In such a work environment, employees can expect to be treated with respect and consideration for their colleagues and superiors. It cultivates strong team work and productivity and support employee growth.

2. Investor Loyalty

Investors are concerned about ethics, social responsibility and reputation of the company in which they invest. Investors are becoming more and more aware that an ethical climate provides a foundation for efficiency productivity and profits. Relationship with any stakeholder, including investors, based on dependability, trust and commitment results in sustained loyalty.

3. Customer satisfaction

Customer satisfaction is a vital factor in successful business strategy. Repeat purchases/orders and enduring relationship of mutual respect is essential for the success of the company. The name of a company should evoke trust and respect among customers for enduring success. This is achieved by a company that adopts ethical practices. When a company because of its belief in high ethics is perceived as such, any crisis or mishaps along the way is tolerated by the customers as a minor aberration. Such companies are also guided by their ethics to survive a critical situation. Preferred values are identified ensuring that organizational behaviours are aligned with those values. An organisation with a strong ethical environment placed its customers interests as foremost. Ethical conduct towards customers builds a strong competitive position. It promotes a strong public image.

4. Regulators

Regulators eye companies functioning ethically as responsible citizens

Answer 5(b)(i)

Ethics Audit

The reasons for examining the state of a company's ethics are many and various. They include external societal pressures, risk management, stakeholder obligations and identifying a baseline to measure further improvement.

The following are the some of the suggested steps in ethics audit:

1. The first step in conducting an audit is securing the commitment of the firm's top management.
2. The second step is establishing a committee or team to oversee the audit process.
3. The third step is establishing the scope of the audit.

4. The fourth step should include a review of the firm's mission values, goals, and policies.
5. The fifth step is identifying the tools or methods that can be employed to measure the firm's progress and then collecting and analyzing the relevant information.
6. The sixth step is having the results of the data analysis verified by an independent party.
7. The final step in the audit process is reporting the audit findings to the board of directors and top executives and, if approved, to external stakeholders

Answer 5(b)(ii)

Activity Analysis

The ethical dimension of an activity can be determined with the help of the following grid which is self explanatory:

| ACTIVITY ANALYSIS (ETHICAL) | |
|--|--------------------------|
| Parasite | Win-win situation |
| Helping self | Helping self |
| Injuring others | Helping others |
| Martyr | Total loss |
| Helping others | Injuring self |
| Injuring self | Injuring others |

The first block in the grid-help self and injuring others is obviously unethical. The second block that is helping others and injuring self may appear to be ethical, however, it is not ethical. The third grid wherein one helps self and also helps others is the most ideal and ethical situation. The win-win situation. The last grid is a situation that should be avoided at all costs and is highly unethical.

Answer 5(b)(iii)

Ethics in Human Resources

Human resource management (HRM) plays a decisive role in introducing and implementing ethics. Ethics should be a pivotal issue for HR specialists. The ethics of HRM covers those ethical issues arising around the employer- employee relationship, such as the rights and duties owed between employer and employee. The issues of ethics faced by HRM include:

- Discrimination issues i.e. discrimination on the basis of age, gender, race, religion, disabilities, weight etc.
- Sexual harassment
- Affirmative action

- Issues surrounding the representation of employees and the democratization of the workplace, trade unionization.
- Issues affecting the privacy of the employee: workplace surveillance, drug testing.
- Issues affecting the privacy of the employer : whistle blowing
- Issues relating to the fairness of the employment contract and the balance of power between employer and employee
- Occupational safety and health

Answer 5(b)(iv)

Enlightened egoism

This model takes into account harms, benefit and rights. Therefore under the model an action is morally correct if it increases benefit for the individual in a way that does not intentionally hurt others, and if these benefits are believed to counterbalance any unintentional harms that ensue. For example, a company provides scholarships for education to needy students with a condition that the beneficiary is required to compulsorily work for the company for a period of 5 years. Although, the company's providing the scholarship benefits to the needy students, but ultimately it is in the company's self interest.

Question 6

- (a) *You are the Company Secretary of Great Fortunes Ltd. Prepare a Board note on the role of Board of directors in ethical decision-making. (5 marks)*
- (b) *“Stakeholder analysis is the identification of a project's/activity's key stakeholders, an assessment of their interests and the ways in which these interests affect project's riskiness and viability.” Elaborate the statement. (5 marks)*
- (c) *Elaborate the factors that indicate the success of an ethics programme. (5 marks)*

Answer 6(a)

Board of Directors Great Fortunes Ltd.

Sub: Note on Role of Board of Directors in ethical decision- making

The board of directors hold the ultimate responsibility for their firm's success or failure, as well as for ethics of their actions. The ethical tone of an organization is set at the top, the actions and attitudes of the board greatly influence the ethical climate of an organization. The directors on a company's board assume legal responsibility for the firm's resources and decisions. Board members have a fiduciary duty, i.e. a position of trust and confidence. Due to globalization, the role of the media, technology revolutionizing the nature and speed of communication, directors are feeling greater demands for accountability and transparency. This calls for ethical decision making and providing an ethical decision making framework.

The perspective and independent judgement of independent directors can be helpful in determining a company's approach towards ethical issues and stakeholder interests.

Independent directors are in a position to challenge current practices and also contribute knowledge and experience of good practices.

A Report by the Conference Board Commission on Public Trust and Private Enterprise suggested the following areas of oversight by a Board:

- Designation of a Board committee to oversee ethics issues;
- Designation of an officer to oversee ethics and compliance with the code of ethics;
- Inclusion of ethics-related criteria in employees' annual performance reviews and in the evaluation and compensation of management;
- Representation by senior management that all known ethics breaches have been reported, investigated, and resolved; and
- Disclosure of practices and processes the company has adopted to promote ethical behavior.

Sd/-

Company Secretary

Answer 6(b)

Stakeholder analysis is the identification of a project's/activity's key stakeholders, an assessment of their interests, and the ways in which these interests affect project riskiness and viability. It is linked to both institutional appraisal and social analysis: drawing on the information deriving from these approaches, but also contributing to the combining of such data in a single framework. Stakeholder analysis contributes to project design/activity design through the logical framework, and by helping to identify appropriate forms of stakeholder participation.

Doing a stakeholder analysis can:

- draw out the interests of stakeholders in relation to the problems which the project is seeking to address (at the identification stage) or the purpose of the project (once it has started).
- identify conflicts of interests between stakeholders,
- help to identify relations between stakeholders which can be built upon, and may enable establish synergies
- help to assess the appropriate type of participation by different stakeholders.

Answer 6(c)

The following factors indicate the success of an ethics programme:

- (i) *Leadership* : that executives and supervisors care about ethics and values as much as they do about the bottom line.
- (ii) *Consistency between words and actions* : that top management 'practices what it preaches'. This is more important than formal mechanisms such as hotlines for people to report wrong doing.

- (iii) *Fairness* : that is operates fairly. To most employees, the most important ethical issue is how the organisation treats them and their co-workers.
- (iv) *Openness* : that people talk openly about ethics and values, and that ethics and values are integrated into business decision making.
- (v) *Just rewards* : that ethical behaviour is rewarded. This has greater influence on the effectiveness of an ethics programme that the perception that unethical behaviour is punished.
- (vi) *Value driven* : that an ethics and compliance programme is values driven. This had the most positive effect on ethics and compliance programme and resulted in:
 - Lower observed unethical conduct
 - Stronger employee commitment
 - A stronger belief that it is acceptable to deliver bad news to management.

Question 7

- (a) *“An organisation’s structure is a significant factor to the study of business ethics.”*
Comment. (5 marks)
- (b) *Discuss briefly the Caux Round Table (CRT) and its principles of business.*
(5 marks)
- (c) *Explain the concept of ‘whistle blower’.* (5 marks)

Answer 7(a)

An organization’s structure is important to the study of business ethics. In a Centralized organization, decision-making authority is concentrated in the hands of top-level managers, and little authority is delegated to lower levels. Responsibility, both internal and external, rests with top management. This structure is especially suited for organizations that make high-risk decisions and whose lower-level managers are not highly skilled in decision making. It is also suitable for organizations in which production processes are routine and efficiency is of primary importance.

These organizations are usually extremely bureaucratic, and the division of labour is typically very well defined. Each worker knows his or her job and what is specifically expected, and each has a clear understanding of how to carry out assigned tasks. Centralized organizations stress formal rules, policies, and procedures, backed up with elaborate control systems. Their codes of ethics may specify the techniques to be used for decision making.

Because of their top-down approach and the distance between employee and decision maker, centralized organizational structures can lead to unethical acts. If the centralized organization is very bureaucratic, some employees may behave according to “the letter of the law” rather than the spirit.

In a decentralized organization, decision-making authority is delegated as far down the chain of command as possible. Such organizations have relatively few formal rules, and coordination and control are usually informal and personal. They focus instead on increasing the flow of information. As a result, one of the main strengths of decentralized

organizations is their adaptability and early recognition of external change. With greater flexibility, managers can react quickly to changes in their ethical environment. Weakness of decentralized organizations is the difficulty they have in responding quickly to changes in policy and procedures established by top management. In addition, independent profit centers within a decentralized organization may deviate from organizational objectives.

Answer 7(b)

The Caux Round Table (CRT) is based on the belief that the world business community should play an important role in improving economic and social conditions. As a statement of its aspirations, it developed a document that aims to express a world standard against which business behavior can be measured.

The Caux Round Table was founded in 1986 by Frederick Phillips, former President of Philips Electronics and Olivier Giscard d'Estaing, former Vice-Chairman of INSEAD, as a means of reducing escalating trade tensions.

The CRT Principles for Business were formally launched in 1994, and presented at the United Nations World Summit on Social Development in 1995. The CRT Principles for Business articulate a comprehensive set of ethical norms for businesses operating internationally or across multiple cultures. The CRT Principles for Business emerged from a series of dialogues catalyzed by the Caux Round Table during the late 1980's and early 1990's. The Principles are comprehensive statement of responsible business practice formulated by business leaders for business leaders.

Business behavior can affect relationships among nations and the prosperity and wellbeing of us all. Business is often the first contact between nations and, by the way in which it causes social and economic changes, has a significant impact on the level of fear or confidence felt by people worldwide. The emphasis is on seeking to establish what is right rather than who is right.

Principle 1. The Responsibilities of Businesses:

Beyond Shareholders toward Stakeholders

The value of a business to society is the wealth and employment it creates and the marketable products and services it provides to consumers at a reasonable price commensurate with quality. To create such value, a business must maintain its own economic health and viability, but survival is not a sufficient goal.

Businesses have a role to play in improving the lives of all their customers, employees, and shareholders by sharing with them the wealth they have created. Suppliers and competitors as well should expect businesses to honor their obligations in a spirit of honesty and fairness. As responsible citizens of the local, national, regional and global communities in which they operate, businesses share a part in shaping the future of those communities.

Answer 7(c)

A whistle blower is a person who publicly complains concealed misconduct on the part of an organization or body of people, usually from within that same organisation. This misconduct may be classified in many ways; for example, a violation of a law, rule, regulation and/or a direct threat to public interest, such as fraud, health/safety violations,

and corruption. Whistleblowers frequently are likely to face retaliation - sometimes at the hands of the organisation or group which they have accused unless a system is in place that would ensure confidentiality is maintained. In addition, people are more likely to take action with respect to unacceptable behavior, within an organization, if there are complaint systems that ensure confidentiality and indemnity. It is in this context whistleblowers are often protected under law from employer retaliation. In India, clause 49 of the Listing Agreement provides for Whistle Blower Policy as a non-mandatory provision.

PART C

Question 8

Attempt any four of the following :

- (i) *“It is not possible to adopt a policy of not having any chemical or any other hazardous industries merely because they pose hazards or risks to the community.” Discuss this statement in the light of Supreme Court decisions.*
(5 marks)
- (ii) *“The areas of improvement listed in the ‘Preamble’ of the International Labour Organisation (ILO) in 1919 remain relevant even today.” Discuss and state these areas.*
(5 marks)
- (iii) *Discuss the quantitative methods used to assess the sustainability.* (5 marks)
- (iv) *Narrate briefly the relationship between corporate sustainability and corporate social responsibility.*
(5 marks)
- (v) *“The reporting organisation should identify its stakeholders and explain in its sustainability reporting how it has responded to their reasonable expectations and interests.” Elucidate this statement by considering stakeholders’ inclusiveness.*
(5 marks)

Answer 8(i)

The given statement is based on the judgement of the Supreme Court of India pronounced in the case of *M.C. Mehta v. Union of India*, AIR 1987 SC 1086 commonly called oleum gas leak case. The Supreme Court in this case struck the realistic note by giving its opinion to the effect that there was a need to strike a balance between progress & development and hazard or risk to the community. The court said that :-

When science and technology are increasingly employed in producing goods and services calculated to improve the quality of life, there is certain element of hazard or risk inherent in the very use of science of technology and it is not possible to totally eliminate such hazard or risk altogether. The Court said that it is not possible to adopt a policy of not having any chemical or other hazardous industries merely because they pose hazard or risk to the community. If such a policy were adopted, it would mean the end of all progress and development. Such industries, even if hazardous have to be set up since they are essential for the economic development and advancement of well being of the people. We can only hope to reduce the element of hazard or risk to the community by taking all necessary steps for locating such industries in a manner which would pose least risk or danger to the community and maximizing safety requirements in such industries.

The judgement is based on maintaining balance between development of economy and maintaining quality of life.

Answer 8(ii)

The areas of improvement listed in the Preamble of the International Labour Organization (ILO) in 1999 remain relevant even today, for example:

- Regulation of the hours of work including the establishment of a maximum working day and week;
- Regulation of labour supply, prevention of unemployment and provision of an adequate living wage;
- Protection of the worker against sickness, disease and injury arising out of employment;
- Protection of children, young persons and women;
- Provision for old age and injury, protection of the interests of workers when employed in countries other than their own;
- Recognition of the principle of equal remuneration for work of equal value;
- Recognition of the principle of freedom of association;
- Organization of vocational and technical education, and other measures.

Answer 8(iii)

Some of the quantitative methods used to assess sustainability are:

Life Cycle Assessment : Life Cycle Assessment tracks the environmental impacts of a product from its raw materials through disposal at the end of the useful life. LCA is an important tool for developing an environmental self-portrait and for finding ways to minimize harm. A good LCA can shed light on ways to reduce the resources consumed and lower costs all along the value chain. A life cycle assessment looks at this complete circle and measures environmental impact at every phase.

Ecological Footprint : The ecological footprint is a measure of human demand on the Earth's ecosystems. It compares human demand with planet Earth's ecological capacity to regenerate it. It represents the amount of biologically productive land and sea area needed to regenerate the resources a human population consumes and to absorb and render harmless the corresponding waste, given prevailing technology and resource management practice.

Environmental Performance Index : Environmental Performance Index (EPI) is a method of quantifying and numerically benchmarking the environmental performance of a country's policies. The Index was developed from the Pilot Environmental Performance Index, first published in 2002, and designed to supplement the environmental targets set forth in the U N Millennium Development Goals.

Answer 8(iv)

Although scholars and practitioners often interpret Corporate Sustainability and

Corporate Social Responsibility as being nearly synonymous, pointing to similarities and the common domain. The two concepts have different backgrounds and different theoretical paths. According to management science, the notion of corporate sustainability can be defined first as the capacity of a firm to create value through the product and services it produces and to continue operating over the years.

The evolutionary part of the concept of Corporate Social Responsibility is different from that of Corporate Sustainability. The first recognized contribution in the literature dates back to Bowen, who stressed the responsibilities of businesses and wrote that social responsibility refers to the obligations of businessmen to pursue those policies, to make those decisions, or to follow those lines of action which are desirable in terms of the objectives and values of our society.

Although Corporate Sustainability and Corporate Social Responsibility have different roots and have developed along diverse theoretical paths, they ultimately converged. This strong complementarity is evident in some recent definitions of Corporate Social Responsibility provided by international organizations like the Prince of Wales International Business Leaders Forum : Corporate Social Responsibility means open and transparent business practices that are based on ethical values and respect for employees, communities and the environment. It is designed to deliver sustainable value to society at large, as well as to shareholders.

Sustainable business success and shareholder value cannot be achieved solely through maximising short-term profits, but instead through market-oriented yet responsible behaviour.

The concept of sustainable development has been transposed from the macro to the corporate dimension. According to management theory, the attempt to include sustainability issues in the managerial framework can be divided into two separate issues: Corporate Sustainability and Corporate Social Responsibility.

Answer 8(v)

The reporting organization should identify its stakeholders and explain in its sustainability report how it has responded to their reasonable expectations and interests.

Stakeholders are defined as entities or individuals that can reasonably be expected to be significantly affected by the organization's activities, products, and/or services; and whose actions can reasonably be expected to affect the ability of the organization to successfully implement its strategies and achieve its objectives. This included entities or individuals whose rights under law or international conventions provide them with legitimate claims *vis-à-vis* the organization.

Stakeholders can include those who are invested in the organization (e.g., employees, shareholders, suppliers) as well as those who are external to the organization (e.g., communities).

Since the stakeholders for an organization are scattered and there may be variation in their expectation and interest, stakeholder engagement processes can serve as tools for understanding the reasonable expectations and interests of stakeholders. Organizations typically initiate different types of stakeholder engagement as part of their regular activities, which can provide useful inputs for decisions on reporting.

The GRI guidance requires organization to document the stakeholder engagement processes. This will make the sustainability report assurable.

When stakeholder engagement processes are used for reporting purposes, they should be based on systematic or generally accepted approaches, methodologies, or principles. The overall approach should be sufficiently effective to ensure that stakeholders' information needs are properly understood. Failure to identify and engage with stakeholders is likely to result in reports that are not suitable, and therefore not fully credible, to all stakeholders.
